



# Agent and Advisor Guide to Advanced Markets Concepts



## IDIT

- An Installment Sale to an Intentionally Defective Trust (IDIT) is often used when transferring highly appreciating or income producing assets to subsequent generations. It is also effective in planning to terminate premium financing of life insurance, private financing of life insurance, and economic benefit arrangements.
- The client sells assets to an IDIT in exchange for an installment note payable over a specified period of time.
- The assets sold to the IDIT will hopefully provide sufficient income to cover the debt service. Any excess income can be added to trust principal or expended for other uses (i.e. paying premiums).
- The assets remaining in the trust can remain in the trust or go to the beneficiary after the note is repaid.
- The IDIT is structured as a “grantor trust”:
  - No capital gain is recognized by the seller upon transfer of the assets;
  - The IDIT assumes the seller's basis in the property sold;
  - The income or gain generated inside the IDIT is taxable to the client (lender) even though it is not distributed to the client (lender); and
  - The interest received on the note is neither taxable nor deductible.
- The IDIT must be “seeded” or otherwise made a viable borrower – adequate “seeding” may be between 10% and 20% of the value of property sold.
- The note must bear an adequate rate of interest based on the note's duration – based on the applicable federal rate (short-term, mid-term, or long-term).
- If the seller does not survive the term of the IDIT, the remaining balance on the note is included in his/her estate for ESTATE TAX purposes.
  - A life insurance policy may be good additional planning to cover the estate tax caused by inclusion.
- There are no gift tax concerns regarding the sale as long as the note bears an adequate rate of interest.
- There are gift tax concerns if the IDIT must be seeded by gifting funds. However, these can be made subject to the grantor's annual exclusions (\$13,000 for 2009) if property structured.
- The sale could be structured to cancel any outstanding balance of the note at the seller's death by using a Self-Canceling Installment Note (SCIN). The adequate rate of interest will be adjusted.

The preceding summary is intended to be a general discussion of the topic presented, and is based on our current understanding of applicable tax laws, regulations and rulings. In actual practice, the transaction discussed may be more complex and will require the attention and expertise of professional advisors. In no way should this summary be construed to constitute tax or legal advice. **For agent use only.**