

Interest only sale model

How it works

The buyer makes a down payment, then using an interest only note, pays the the seller interest for a specified period of time. At the end of the period, the buyer makes a balloon payment to the seller. Life insurance is often purchased to insure both the buyer and seller to protect the sale in the event of an untimely death.

Year (A)	Installment note			Cost to buyer		Net to seller			
	Beginning-of-year note value (B)	Interest & principal payment (C)	End-of-year note value (D)	Pre-tax annual cost (E)	After-tax annual cost (F)	Annual proceeds (G)	Personal income taxes (H)	Capital gains taxes (I)	Net proceeds to seller (J)
0	0	0	0	250,000	333,333	250,000	0	45,000	205,000
1	750,000	37,500	750,000	37,500	50,000	37,500	13,125	0	24,375
2	750,000	37,500	750,000	37,500	50,000	37,500	13,125	0	24,375
3	750,000	37,500	750,000	37,500	50,000	37,500	13,125	0	24,375
4	750,000	37,500	750,000	37,500	50,000	37,500	13,125	0	24,375
5	750,000	37,500	750,000	37,500	50,000	37,500	13,125	0	24,375
6	750,000	37,500	750,000	37,500	50,000	37,500	13,125	0	24,375
7	750,000	37,500	750,000	37,500	50,000	37,500	13,125	0	24,375
8	750,000	37,500	750,000	37,500	50,000	37,500	13,125	0	24,375
9	750,000	37,500	750,000	37,500	50,000	37,500	13,125	0	24,375
10	750,000	787,500	0	787,500	1,050,000	787,500	13,125	135,000	639,375

Assumptions

Business value	\$1,000,000	Seller's income tax rate	35%
Ownership interest to be sold	100%	Seller's capital gains rate	20%
Value of ownership interest	\$1,000,000	Seller's basis	\$100,000
Less minority discounts	0%	Buyer's income tax rate	25%
Sales price	\$1,000,000	Note term (years)	10
Down payment	\$250,000	Note interest rate	5%
Note value	\$750,000		

Column explanations

- A) Time period is annual.
- B) Beginning of year note value (amount still owed to seller)
- C) Annual interest; principal is paid as a balloon payment in final year
- D) End of year note value (after payment of interest and principal)
- E) In year 0 equals the down payment; in years 1+, equals the interest & principal payment (column C)
- F) Pre-tax annual cost (column E) divided by (1 - buyer's income tax rate)
- G) In year 0 equals the down payment; in years 1+, equals the interest & principal payment (column C)
- H) Annual interest multiplied by seller's income tax rate
- I) Annual amount of principal that is subject to capital gain multiplied by seller's capital gains rate
- J) Equals annual proceeds (column G) - personal income taxes (column H) - capital gains taxes (column I)

Illustrated values aren't guaranteed and are based on assumptions that are subject to change at any time.

Returns are hypothetical. Actual results may be more or less favorable.

You should contact your attorney, accountant or tax advisor for the specific implications of this transaction.

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