



Self Canceling Installment Note

A Self Canceling Installment Note (SCIN) is often used when transferring highly appreciating or income producing assets to subsequent generations.

The client sells the asset(s) to a trust or individual in exchange for an installment note payable over a specified period of time.

The seller will recognize gain over the term of years. The installment sale rules are very complex.

The assets sold will hopefully provide sufficient income to cover the debt service.

The note term must be less than the life expectancy of the seller and will contain a self-canceling cause in the event of seller's death.

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). The SCIN interest rate must contain a risk premium to compensate in the event of an early death.

If the risk premium is not sufficient, then the transaction will be treated as a part-sale, part-gift transfer.

The self-canceling feature can be used as an effective means of transferring property to individuals or trusts without estate or gift tax consequences.

How it works:

1. Client sells asset to buyer. The note bears a rate equal to the applicable federal rate based on the term of the note plus a risk premium.
2. Buyer receives the asset(s) and agrees to make installment payments to seller.
3. Seller receives payments and reports gain spread over the term of the note.
4. If seller dies before the final payment, the note is canceled.
5. If buyer dies before the final payment, the buyer's estate must continue making payments until note is satisfied.

Here is where a life insurance policy can cover the risk of non-payment.

Bottom line:

SCINs can be an effective mechanism in transferring assets to subsequent generations at little to no gift and/or estate tax costs.