

Tax Implications of Selling a Business

Small business owners may envision turning their firm, practice, or storefront into a sizable payout. If you have a client who is looking to sell their business, they may be counting on the money from that sale to fund the next stage in their life, whether it's retirement or a second career. Because this sale is a big next step in their financial future, it's important that they approach the transaction with a tax-minded focus.

Feedback

The sale of a business, especially when involving a lump sum cash payment, can be a significant taxable event. But there are ways your clients can address their future capital gains and other tax obligations by spreading tax liability over time. Here's a look at how [structured installment sales](#) can help them accomplish their goals.

How Capital Gains Tax Is Calculated for a Business Sale

Most businesses consist of many assets with varying classifications. Every asset needs to be valued when a business owner decides it's time to sell. The valuations must be recorded, as they will need to be accounted for during the transaction.

Each asset is also classified into categories including:

- Capital assets
- Depreciable [property](#) that was used in the business
- Property held for sale to customers (such as inventory or stock in trade)

The gain or loss of each asset will be figured individually in part based on the classification type for tax purposes. For example, when a capital asset is sold, it either results in a capital gain or a capital loss. But when inventory is sold, the sale results in ordinary income or loss.

Your client's tax liability after selling a business will depend on the type of assets sold and the form of sale. If they receive the business sale proceeds in one lump sum, they might face n



In general, business owners can expect the capital gains tax rate from a business sale to range between 0% and 20% of the profit. If your client's income exceeds certain levels, the NIIT would add 3.8% in tax as well.*

*Source: [IRS Topic no. 409, Capital gains and losses](#)

Can Your Clients Use a Structured Installment Sale When Selling a Business?

Certain business sale transactions can be executed as a structured installment sale, rather than a lump sum sale. When using this method, all parties agree to installment payments for a stated number of years as a condition of the sale. The periodic payments are then made by the business owner or the insurer.

A structured installment sale may offer beneficial tax treatment, in that the taxes are paid as the installment payments are received rather than being paid entirely in the year of disposition. This allows sellers to defer their capital gains taxes and other tax obligations over a longer period.

Read a small business case example of a structured installment sale

[Learn More >](#)

Tax Considerations of an Installment Sale

There are certain tax rules, as outlined by Sections 453 and 453B of the Internal Revenue Code, that apply specifically to installment sales.

Generally, business owners can only use an installment sale for capital assets that have been held for more than a year. If a business has inventory to sell, those assets do not qualify for installment sale treatment. Taxes must be paid on these types of business assets in the same year the business is sold, even if payments are received in later years.

Sellers are also unable to use the installment method to report gains from the sale of stocks and securities traded on an established securities market. The seller must report any portion

If the business and its assets are being sold at a loss, the installment method rules do not apply.

The Benefits of a Structured Installment Sale

A structured installment sale offers sellers the distinct advantage of incorporating an insurance company into the equation.

Insurance companies are highly regulated and have strict reserve requirements to prevent insolvency. They also typically have strong financial strength ratings from leading credit rating agencies, which demonstrates their ability to meet future financial obligations.

With a structured installment sale, the buyer assigns the payments to the insurer's assignment company.³ The assignment company, in turn, agrees to take on the obligation and will use the lump sum provided by the buyer to purchase an annuity contract matching the specified periodic payment obligation. The insurance company will then issue the annuity to the assignment company and distribute future payments to the seller according to the schedule originally determined in the purchase and sale agreement. This way, the seller has the assurance of receiving future payments (which can serve as income for retirement) from a highly-rated insurance company.¹

Examples of Using a Structured Installment in a Business Sale



To see how a structured installment sale can benefit business owners, let's look at an example:

Jose is a 55-year-old dentist and business owner in California who, for many years, owned a major dental practice. He's decided to sell his practice to fund the next phase in his life, which is retirement.

The dental practice is in good shape but needs a refreshed marketing strategy and capital improvements to bring the next generation of customers. Selling the dental practice now will help Jose avoid an outlay of capital and help reduce his responsibilities in retirement.

After putting his practice on the market, he accepts an offer of \$2,500,000. The dental practice's adjusted basis is \$1,000,000 and the selling expenses associated with the transaction are \$50,000 resulting in a gain of \$1,450,000. The dental practice's property is not subject to a mortgage.

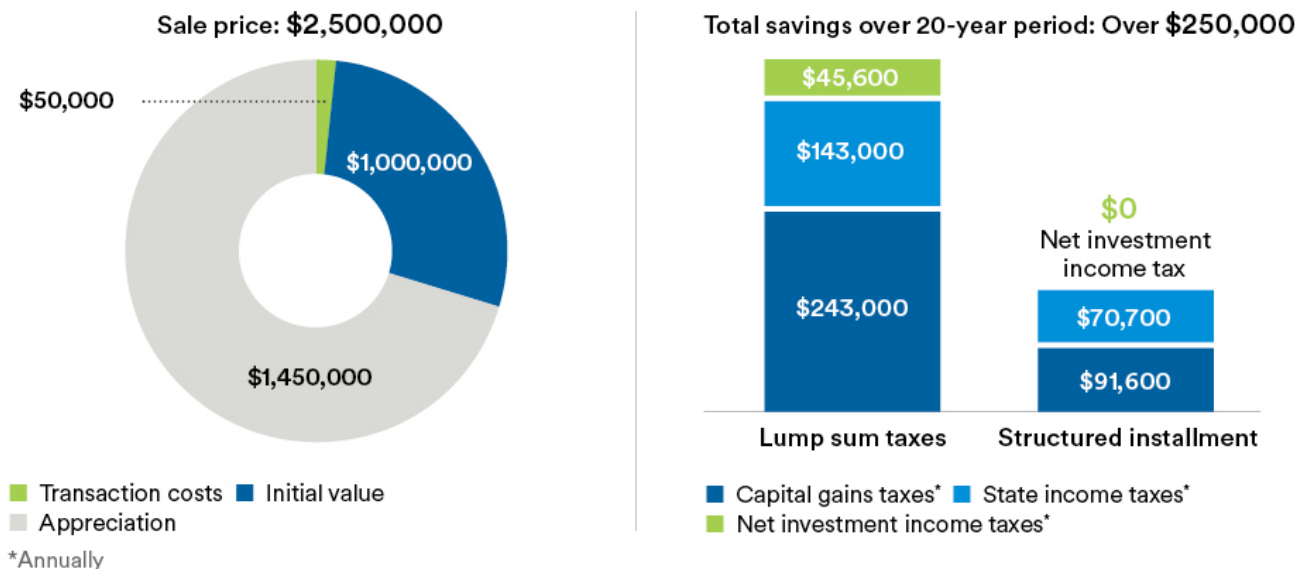
During the sales process, Jose consulted with his legal and tax advisors who advised that he should receive the proceeds in a structured installment sale. This was the best option for Jose because he didn't need the full sale proceeds immediately, and this structure would defer and reduce associated capital gain, NIIT, and state income taxes. In cooperation with the buyer, he structures \$2,500,000 of the sale proceeds to be payable as follows: \$191,755 payable in equal amounts for 20 years per the Purchase and Sale Agreement.

How a Structured Installment Sale Can Make Your Offer More Attractive

Using the example shared above, here's how Jose's tax obligation would differ by accepting installment payments over a single sum.

Dental Practice Sold via Structured Installment Sale

Illustrative example; in California, assuming no mortgage



If Jose had received the proceeds in full at the time of the sale, he would have to pay close to \$239,493 in federal capital gain taxes (at a marginal 20% federal capital gains rate), as well as about another \$45,600 due to the 3.8% NIIT. Additionally, since Jose is a resident of California which has graduated tax rates depending on income level, he would be subject to higher rates resulting in over \$141,000 of associated state income taxes.

Since Jose has chosen an offer that uses a structured installment sale, he will pay approximately \$5,819 of federal capital gains taxes annually over the 20 years (taking advantage of the 0% and 15% capital gains tax rates).

In addition, by spreading the gain over a period of years, he will avoid net investment income taxes altogether. His associated state income taxes would be about \$6,061 annually. This results in capital gains, NIIT, and state income tax savings of over \$188,000.*2

His savings is due to the tax rules applicable to installment sales which generally provide that each installment payment, which comprises a return of basis, capital gain and interest (with the interest taxed as ordinary income), will be taxable over time when paid to the seller. As a result, Jose was able to manage his annual taxable income and leverage lower tax brackets.

opportunity to pocket more profit and defer and reduce tax obligations can make an offer much more attractive to the seller.

*Rates are subject to change as of July 1, 2025.

Finding the Right Insurer

Working with your client and their tax and legal advisors to determine whether a structured installment sale is in your client's best interest is an important first step, but choosing the right insurance company to entrust is critical. This sale is instrumental in funding the seller's retirement or other future financial goals, and they want to be confident that they'll receive future payments.

To do this, try to help them find [a company that has a proven track record](#) of making long-term annuity payouts — and is able to withstand market volatility and economic turmoil.

You can also ask for the insurance company's credit ratings or look for them on the company website. Credit ratings are strong indicators of an insurance company's financial stability. There are four major insurance company rating agencies: A.M. Best, Moody's, Standard & Poor's, and Fitch. Because each agency has its own rating scale, the same insurance company could receive different ratings from the various agencies. Make sure to visit the rating companies' websites to ensure you understand their rating scales.

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¹For current ratings information and a more complete analysis of the financial strength of Metropolitan Tower Life Insurance Company, please go to www.metlife.com and click on “About Us” and then click on “Company Ratings”.

²How was Jose’s capital gain calculated? The capital gain taxes were computed by first determining the amount of gross profit (none of which is subject to depreciation recapture rules): Selling price of \$2,500,000 less adjusted basis (including expenses of the sale) of \$1,050,000 equals a gross profit of \$1,450,000. The gross profit factor is 58% (\$1,450,000 gross profit divided by \$2,500,000 contract price). During the 20 year period starting in the year of the sale, Jose will receive \$191,755 annually, assuming 0% rate of return. In applying the gross profit factor of 58%, Jose must report \$72,500 of capital gain income each year. Annually, this results in about \$5,819 of federal capital gains taxes, \$0 net investment income tax and about \$6,061 of associated state income tax. Tax computations assume Jose’s filing status is married filing joint and the standard deduction of \$30,000 was applied; other than \$75,000 of annual qualified dividend income due to Jose’s non-installment sale investments, other income was factored into this example. Estimated taxes shown do not account for taxes imposed on Jose’s qualified dividend income due to non-installment sale investments nor the interest component of the installment sale. The 15% and 0% capital gains tax rates assume Jose’s annual taxable income during the entire installment period does not exceed the applicable income ceiling to take advantage of these preferential capital gains rates. It is further assumed that the 2025 federal and 2024 state income tax rates apply for the life of the arrangement. Rates are subject to change. This example is hypothetical in nature and actual results will vary. For further information about the federal tax treatment of installment sales, see IRS publication 537 at www.irs.gov.

³The Buyer’s assignment of the periodic payment obligation is intended to be interpreted such that any Periodic Payments assigned to Assignee qualify for installment sale treatment under Internal Revenue Code Section 453. To better preserve this tax result, the Buyer remains indebted to the Seller for future Periodic Payments, however, Seller agrees to first look to the Assignee and to not seek payments from the Buyer unless and until the Assignee is in default of its Periodic Payments obligations.

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