Santa Clara Law
Santa Clara Law Digital Commons

Faculty Publications | Faculty Scholarship

1-1-1978

Installment Sales by Retailers: A Case for Repeal of Section 453(a) of the Internal Revenue Code

Patricia A. Cain
Santa Clara University School of Law, pcain@scu.edu

Follow this and additional works at: http://digitalcommons.law.scu.edu/facpubs

Recommended Citation
1978 Wis. L. Rev. 1

This Article is brought to you for free and open access by the Faculty Scholarship at Santa Clara Law Digital Commons. It has been accepted for inclusion in Faculty Publications by an authorized administrator of Santa Clara Law Digital Commons. For more information, please contact sculawlibrarian@gmail.com.

ARTICLE

INSTALLMENT SALES BY RETAILERS: A CASE FOR REPEAL OF SECTION 453(a) OF THE INTERNAL REVENUE CODE

PATRICIA A. CAIN*

I. INTRODUCTION

With the recent increase in interest rates, the time value of money has become a more noticeable factor in economic decisionmaking. Methods of tax deferral have received increasing attention, because deferring payment of a tax is one way to take advantage of the time value of money. Tax shelters provide a vehicle for tax deferral.[1] There are other obvious vehicles. The accrual basis contractor may elect to report his or her gain on the completed contract method,[2] thus deferring payment of taxes until a later year. The cash basis seller of real estate can structure a sale for promissory notes, the equivalent of cash, and elect to defer gain under Section 453(b).[3] The accrual basis merchant can make credit sales on an installment plan, thus deferring gain under Section 453(a).

Although tax shelters have recently been the subject of public attack,[4] other deferral methods have been relatively free from critical scrutiny. It is the purpose of this article to focus on the method available to merchants who sell on the installment plan, and to scrutinize its

---

* Assistant Professor of Law, University of Texas Law School. B.A., 1968, Vassar College; J.D., 1973, University of Georgia Law School.

1. Tax shelters include certain real estate investments that provide the taxpayer with excess deductions that "shelter" other taxable income. *See, e.g.*, Weinstein, *The Partnership as a Tax-Shelter Vehicle Since the Tax Reform Act of 1976*, 94 BANKING L.J. 440 (1977). Tax shelters typically provide benefits in addition to deferral. The conversion of ordinary income into capital gain is a prime example. *But see* Bittker, *Tax Shelters and Tax Capitalization or Does the Early Bird Get a Free Lunch?* 28 NAT'L TAX J. 416 (1975) (pointing out that often tax benefits created by shelters have been capitalized in the cost of the sheltered investment and thus do not always benefit the investor).

2. Treas. Reg. § 1.451-3(d) (1957), *as amended by* T.D. 7397, 1976-1 C.B. 115. Under this method, the contractor reports no gain on a given contract until the year in which the contract is fully completed, even though progress payments are received in earlier years as the contract is being performed.

3. I.R.C. § 453(b)(1). Gain is reported proportionately as the cash payments on the notes are received.

4. Many provisions of the Tax Reform Act of 1976, Pub. L. No. 94-455, 90 Stat. 1525, were aimed at the elimination of tax shelters. For a summary discussion of certain amendments specifically directed at tax shelters, see *Joint Committee Summary: Tax Reform Act of 1976*, 1976-3 C.B. 425, 426-39.

HeinOnline -- 1978 Wis. L. Rev. 1 1978

justification in light of the deferral benefit it offers. The scrutiny of Section 453(a) will be twofold. First, the provision will be analyzed with respect to its often articulated statutory purpose: furnishing relief to merchants who extend installment credit to their customers. Second, the provision will be analyzed in terms of three goals of tax policy which today are cited as the three major goals: equity, simplification, and economic growth.

For the first part of the analysis, it will be necessary to identify the intended relief. There are two possibilities: (1) relief from an *inequitable* burden; and (2) relief from an *inconvenient* burden. The appropriateness of each type of relief will be considered in light of the economic and business setting at the time of original enactment and at the present time. The analysis will show that neither type of relief is justified, and that by providing this relief to a single class of taxpayers, that is, retail merchants, Section 453(a) violates one of the major goals of tax policy, horizontal equity. This article will then consider whether Section 453(a) can be justified on the basis of either of the other two major goals, simplification and economic growth. It will contend that fostering economic growth is the only probable justification for Section 453(a). That justification will be analyzed in terms of the role the installment plan has played in encouraging consumption. Then, the effect of increased consumption on overall economic growth will be analyzed. It is argued that Section 453(a) is an ineffective means for encouraging consumption and economic growth. Because the provision cannot be justified on the other possible grounds, this article concludes by urging that it be repealed.

II. General History of Section 453(a)

Before analyzing this provision in terms of the relief it is thought to provide, a review of the history of the provision is in order. A general overview would be warranted in any case, as an introduction to the proposed analysis; but in this case special detail will be presented. The detail is necessary to provide a basis from which statutory purpose can be inferred, because, despite general agreement as to statutory purpose,[5] there is no direct evidence of legislative intent.

A. *Early History of the Development of the Installment Plan of Selling and the Consequent Adoption of the Installment Method of Reporting Gain*

Although merchants had developed the "installment plan" as a

5. According to the Internal Revenue Service, the rationale of § 453(a) was to "enable merchants to actually receive in cash the profit arising out of each installment before the tax was paid. In other words, the tax could be paid from the proceeds collected rather than be advanced by the taxpayer." Rev. Rul. 65-185, 1965-2 C.B. 153, 154.

HeinOnline -- 1978 Wis. L. Rev. 2 1978

selling method by 1916,[6] the federal tax consequences of selling on such a plan did not become important until a major increase in tax rates came into effect in 1918.[7] The "installment plan," as the term was used in that era, meant that the seller was willing to accept a small down payment (usually twenty-five percent of the sales price or less) and receive the balance in monthly payments over a period of several years.[8] This method of selling was created by merchants for economic, not tax, reasons. The plan first developed among mercantile houses dealing in "furniture, pianos, phonographs, household appliances and farm machinery."[9] Its purpose was to expand the market for such articles by making them available to the low-salaried employee who could not otherwise purchase them.[10]

Prior to the use of such plans, merchants sold for cash or on open account and reported income on the accrual basis.[11] Under general principles of accrual basis accounting, articulated by the Supreme Court in *Spring City Foundry Co. v. Commissioner*,[12] a merchant had to report an amount as income when his or her "right to receive [the] amount [became] fixed."[13] Deductions were accrued when the fact of liability

6. Doyle, *Taxation of Income Derived from Installment Sales*, 4 TAXES 53, 53 (1926) [hereinafter cited as Doyle].

7. *Id.* at 53-54. The following table illustrates the escalation of rates during this period:

Taxable Income	Tax Due in 1913	Tax Due in 1916/7	Tax Due in 1918
$10,000	$ 100	$ 200	$ 1,070
20,000	200	400	2,150
50,000	800	1,400	11,270

See 1 W. BARTON & C. BROWNING, BARTON'S FED. TAX LAWS CORRELATED 58-68 (2d ed. 1925).

8. *See* Blum's Inc., 7 B.T.A. 737, 740 (1927); *Revenue Revision 1927-28: Hearings before the House Committee on Ways & Means*, 69th-70th Cong., Interim Sess. 225 (1927) (statement of Nathan W. MacChesney).

9. Doyle, *supra* note 6, at 53.

10. *Id.*

11. The Revenue Act of 1913, ch. 16, §§ D, G(c), 38 Stat. 114, and the regulations promulgated thereunder required the accrual method to be used by all business taxpayers except farmers. *See* Schapiro, *Prepayments and Distortion of Income Under Cash Basis Tax Accounting*, 30 TAX. L. REV. 117, 129-30 n.35 (1975). The 1916 Act authorized both individual and corporate taxpayers to use the "actual receipts and disbursements" basis as well as the accrual basis. Revenue Act of 1916, ch. 463, §§ 8(g), 13(d), 39 Stat. 756. Regulations issued under the 1916 Act, however, required "mercantile corporations" to include as income for a given year "[a]ll sales made during the year whether compensated for by accounts receivable, bills receivable, cash or other property." Treas. Reg. 33, art. 92 (1918), 1918 CORPORATION TRUST COMPANY INCOME TAX SERVICE 416.

The 1918 Act basically restated the 1916 Act's accounting provisions. Revenue Act of 1918, ch. 18, § 212(b), 40 Stat. 1057. The regulations promulgated under the 1918 Act explicitly stated that "in any case in which it is necessary to use an inventory no accounting in regard to purchases and sales will correctly reflect income except an accrual method." Treas. Reg. 45, art. 23, T.D. 2873, 1 C.B. 58 (1919).

12. 292 U.S. 182 (1934).

13. *Id.* at 184.

HeinOnline -- 1978 Wis. L. Rev. 3 1978

became certain.[14] Deductions, however, were allowable only if there was specific statutory authorization. Partial uncollectibility, no matter how certain, was not authorized as a tax deduction for the 1920 merchant.[15] Furthermore, the Supreme Court's decision in *Spring City* was indicative of the pervasive understanding that accrual basis taxpayers must accrue obligations for future payment at their face value.[16]

Application of these accrual basis principles to early installment plan sellers created problems for them distinct from the problems faced by other accrual basis sellers. Accrual at face, for example, is an entirely different issue for sales on open account with payment due in 30 days than it is for sales involving long term extensions of credit.[17] The fact that the accrual at face could not be offset by a deduction for projected losses based on partial uncollectibility[18] created less of a hardship for the short term credit seller who could normally resolve the issue of final collectibility soon after the completion of the sale. Resolution of final collectibility on an installment sale, however, was subject to more lengthy delay simply because final payment was deferred for so long.

In other words, the accrual method created no meaningful hardship for the merchant who usually made cash or short term credit sales. The period between accrual and collection of an open account was short. When that period became extended to several years, however, as it was under the installment plan, the hardships became greater. The drain on cash reserves caused by early payment of taxes could curtail capital expansion, as well as threaten a floundering business.

Even though merchants quite often received negotiable promissory notes from their customers representing the installment sale debt, it was rare that these notes could be discounted at local banks in order to overcome temporary cash shortages caused by the early incidence of taxation.[19] One commentator of the period suggested that the risks of

14. *See, e.g.*, W.S. Buck Mercantile Co., 6 B.T.A. 285, 289 (1927) (installment seller's deduction for a reserve account covering worthless accounts and collection costs disallowed; deduction permitted only in the year that the loss is finally "ascertained"); Morrison-Ricker Mfg. Co., 2 B.T.A. 1008, 1011 (1925) (seller's deduction of sales value of goods that it anticipated would eventually be returned disallowed).

15. In 1920, the authorization for a bad debt deduction required that the debt be wholly worthless. Revenue Act of 1918, ch. 18, § 234(a)(5), 40 Stat. 1057. The use of bad debt reserves was not authorized until 1921. Revenue Act of 1921, ch. 136, § 214(a), 42 Stat. 227.

16. Accrual at face value is the accepted rule today. However an argument could have been made in 1918 that accrual at face should not have been the rule for installment sales accounts, which, unlike the 30-day open accounts involved in *Spring City*, were outstanding for a number of years. *See* Cain, *Taxation of Promises to Pay*, 8 GA. L. REV. 125, 146 (1973) [hereinafter cited as Cain]. The question of whether or not the accrual method should require accrual of installment sales accounts at face value has become less important since the authorization of bad debt reserves in 1921 because such a reserve may be used to account for projected losses. *See* note 15 *supra*.

17. *See* Cain, *supra* note 16.

18. A seller could neither utilize a bad debt reserve nor take a specific deduction for the projected loss. *See* note 15 *supra*.

19. *See* Doyle, *supra* note 6, at 53.

HeinOnline -- 1978 Wis. L. Rev. 4 1978

default on installment sales payments were so high "that it is quite impossible to say that the dealer realizes an immediate profit upon the execution of a contract of sale and the payment of the initial installment. . . ."[20]

It was within this framework of significant deferral of the receipt of cash and high risk of default, accentuated by steeply increased tax rates, that the Treasury Department in 1918 first officially recognized the installment method of reporting income for tax purposes.[21] The 1918 regulations allowed installment sellers to report as income "that proportion of each installment payment, which the gross profit to be realized when the contract is fully performed, bears to the gross contract price."[22] This regulation created the installment method as is presently prescribed by Section 453 of the Internal Revenue Code of 1954.

In 1925, however, the Board of Tax Appeals held this Treasury regulation invalid in *B.B. Todd, Inc.*[23] The Board regarded the installment method as a hybrid cash-accrual method. Deductions relating to the installment sales were allowed immediately as accrued, whereas income from the sales was deferred until cash payments were received.[24] Such a hybrid method did not clearly reflect income as required by statute.[25] Lacking statutory authorization, the installment method was therefore invalid.

The Senate Finance Committee responded by inserting Section 212(d) into the Revenue Act of 1926.[26] There is markedly little legislative history on this provision. The need for the provision was never discussed in the House. Apparently, the Senate had considered the advisability of relief for installment sellers as early as 1917, but was willing to rely on the then soon-to-be-promulgated Treasury regulations.[27] The insertion of Section 212(d) in the Revenue Act of 1926 appears to be a belated

20. *Id.*

21. Treas. Reg. 33, art. 120 (1918), 1918 CORPORATION TRUST COMPANY INCOME TAX SERVICE 422. Under this regulation, the installment method was available for reporting income from those installment sales in which title remained in the vendor until full payment was made. *Id.*

22. *Id.*

23. 1 B.T.A. 762 (1925).

24. For example, selling expenses would be deductible currently even though they might be directly connected with an installment sale on which income could be deferred. In addition, deductions such as those for interest, taxes, and depreciation are normally deductible currently. *See* Cox & Harris, *Installment Sales for "Dealers" in Personal Property: Review and Analysis* (pt. iv), 5 TAX ADVISER 132, 139 (1974).

25. Revenue Act of 1918, ch. 18, § 200, 40 Stat. 1057.

26. Revenue Act of 1926, ch. 27, § 212(d), 44 Stat. 9. Section 212(d) provided in part:

> Under regulations prescribed by the Commissioner with the approval of the Secretary, a person who regularly sells or otherwise disposes of personal property on the installment plan may return as income therefrom in any taxable year that proportion of the installment payments actually received in that year which the total profit realized or to be realized when the payment is completed, bears to the total contract price . . . .

27. *See* Doyle, *supra* note 6, at 54.

HeinOnline -- 1978 Wis. L. Rev. 5 1978

endorsement of the procedure for reporting installment income that had been devised by the Treasury, an endorsement necessitated by the *B.B. Todd* decision.[28]

In the absence of specific legislative history, one can infer legislative intent only from the known facts. It seems fair to conclude that the installment method of reporting gain was intended to give some type of relief to merchants who sold property on the installment plan, as that term was understood in the early 20th century. The main characteristics of an installment plan sale that differentiated it from other credit sales were a lengthier term of payment and high collection risks.[29] These two characteristics meant that merchants could not convert their sales into cash until well after the tax would normally be due.[30] Deferral of the tax payment was probably viewed as appropriate relief for the hardship created by this method of credit selling.

B. Subsequent History

In 1926, Congress determined that the installment method should be available as an alternative to certain merchants who would otherwise be forced to report gains on a strict accrual basis. Availability of the method, then as now, was tied to a single prerequisite: the merchant must be one who regularly sells on the installment plan.[31] Congress did not, however, define "installment plan." Because the availability of the installment method is largely dependent upon the meaning of this term,[32] the evolution of its meaning will be reviewed.

The term "installment plan" had a specialized meaning in 1918 which was derived from the business practices of the era. The regulations as passed pursuant to the 1918 Act, for example, cited four types of sales utilized by dealers in personal property: (1) cash sales, (2) personal credit sales, (3) installment plan sales, and (4) deferred payment sales.[33] The only specific distinction made for tax purposes was between installment plan sales and deferred payment sales, the latter being characterized as including a substantial down payment.[34] These regulations also pointed

28. According to the Board of Tax Appeals, the *B.B. Todd* decision was brought to the Senate's attention and was the primary reason for the introduction and subsequent enactment of § 212(d). *See* Blum's Inc., 7 B.T.A. 737, 755 (1927).

29. Doyle, *supra* note 6, at 53.

30. *Id.*

31. More specifically, § 453(a) is available to regular sellers of personal property on the installment plan. Section 453(b) governs all sales of real property as well as certain sales of personalty.

32. Availability of the installment method also depends upon the construction of "regularly sells." Courts have generally construed the phrase broadly. Cox & Harris, ***Installment Sales for "Dealers" in Personal Property: Review and Analysis*** (pt. 1), 4 TAX ADVISER 658, 662-63 (1973). *See* Louis Greenspon, 23 T.C. 138 (1954) ***modified on other grounds***, 229 F.2d 947 (8th Cir. 1956); Davenport Machine & Foundry Co., 18 T.C. 39 (1952).

33. Treas. Reg. 45, art. 42 (1919), ***as amended by*** T.D. 3082, 3 C.B. 107 (1920).

34. "Occasionally a . . . type of sale is met with, in which the buyer makes an initial

HeinOnline -- 1978 Wis. L. Rev. 6 1978

out that installment plan sales normally involved one of four different methods for protection against default.[35] Thus, in 1918, sales on the "installment plan" were characterized by a small down payment and the creation of some type of security interest in the property sold. Both of these characteristics reflect the fundamental nature of the transaction: a sale involving significant deferral of cash[36] and high risk of default.[37]

Although the seller's retention of a security interest[38] was a common feature of installment plan sales, presumably a merchant could choose to forego that protection and still be selling on the installment plan. This is so because the existence of a security interest was merely indicative of the risk element. Nonetheless, in the first major dispute over the meaning of "installment plan," the Commissioner took the position that the security interest was the pivotal characteristic.[39] The basis of his argument was that all early installment plans provided for a security interest.[40]

The court responded by stating:

> [Taxpayer's plan] may have dropped some of the features which had commonly been found in earlier installment plans, such as a retention of a security interest or the attribution of each payment to the purchase price of one specific item sold, because such features were impractical in a plan designed to cover not a single large sale but a series of transactions involving numerous smaller items. But it has retained the essential feature of an arrangement for the payment by the purchaser for the merchandise sold to him in a series of periodic payments of an agreed part or installment of the debt due.[41]

The court did not explain why it considered "a series of periodic payments" the *essential* feature, nor did it explain why identifying the

---

payment of such a substantial nature (for example, a payment of more than 25 percent) that the sale, though involving deferred payments, is not one on the installment plan." *Id.*

35. The four methods are as follows: (1) Seller retains title. (2) Purchaser receives title, and Seller retains lien. (3) Purchaser receives title and gives Seller a mortgage. (4) Seller conveys title to a trustee who will convey to Purchaser upon final payment. *Id.*

36. A small down payment was all that was required because purchasers did not have much discretionary wage income with which to purchase the semi-luxuries normally sold on the installment plan. For the same reason, these purchasers were able to make only small monthly payments and thus the payment period was typically stretched out over a number of years. *See* Doyle, *supra* note 6, at 53.

37. Significant deferral of cash, of course, is causally related to collection risks—as is the size of the down payment. An early analyst advocated adherence to three "safety principles" for avoiding default: (1) the down payment should be sufficient to give the purchaser a sense of ownership; (2) at no time should the unpaid balance be more than the resale value of the goods; and (3) payment should be completed before sufficient time has elapsed to permit the buyer to feel that his purchase is obsolete. Ayres, ***Installment Buying and Its Financing***, in AMERICAN ASSOC. OF PERSONAL FINANCE COS., YEAR BOOK OF PERSONAL FINANCE 95-103 (1931), *cited in* R. GARIS, PRINCIPLES OF MONEY AND CREDIT 354-55 (1933).

38. The present discussion applies as well to the creation of a security interest via the buyer's conveyance of a mortgage. *See* note 35 *supra*.

39. Consolidated Dry Goods Co. v. United States, 180 F. Supp. 878 (D. Mass. 1960).

40. *Id.* at 880.

41. *Id.* at 882.

HeinOnline -- 1978 Wis. L. Rev. 7 1978

essential feature of "installment plan" sales was necessary. The court also did not state whether the term "installment plan" had some specialized meaning drawn, for example, from the statutory purpose. Instead, it reasoned:

> It is true that the particular plan now used by [taxpayer] was probably unknown in 1926 when this statutory provision was first enacted. But it cannot be held that the meaning of these words as used in the 1926 Act and as repeated in successive statutes must be frozen to such an extent that they now refer only to the exact forms of installment plan known in 1926. The words must be interpreted to include such changes and developments in installment selling as fairly fall within the *generic* meaning of sales "on the installment plan."[42]

The generic meaning of "sales on the installment plan" was defined in this case to be "sales involving two or more payments."[43] This dictionary type approach, still followed by the courts today,[44] overlooks the relief aspects of the hypothesized statutory purpose.

Congress also appears to follow this dictionary approach. Although it has never dealt with the meaning of the term "installment plan" directly,[45] it has taken specific action which serves as indirect support for the "two or more payments" test. In 1964, Congress enacted a provision which mandated the availability of installment method reporting for merchants who sold on a revolving credit type plan.[46] Revolving credit plans were to qualify if they met the two payment test.[47] Because of technical difficulties in determining which revolving credit plan sales qualified under the statute, Congress repealed the statute 6 months after its enactment.[48] The repeal was accompanied by reinstatement of regula-

42. *Id.* (emphasis added).

43. *Id.* at 881. In addition to *Consolidated Dry Goods*, see W.T. Grant Co. v. Comm'r, 483 F.2d 1115 (2d Cir. 1973), in which a coupon book installment sales plan, which grouped together a number of purchases, was found not to qualify for installment reporting, even though two or more payments might occur, because there was no way to correlate the payments to individual sales of property. Although two payments might occur, each payment might fully cover the purchase of a single item. Thus, it was impossible to identify which individual sales constituted installment sales—*i.e.*, those paid for by two or more payments.

44. *See* note 43 *supra*. *See also* Baltimore Baseball Club, Inc. v. United States, 481 F.2d 1283 (Ct. Cl. 1973), and 10-42 Corp., 55 T.C. 593 (1971), both of which apply the two payments test to installment sellers electing under § 453(b).

45. *I.e.*, the term has never been defined by statute.

46. Revenue Act of 1964, Pub. L. No. 88-272, § 222(a), 78 Stat. 75, which provided:

> For purposes of subsection (a) [of section 453], the term "installment plan" includes a revolving credit type plan which provides that the purchaser of personal property at retail may pay for such property in a series of periodic payments of an agreed portion of the amounts due the seller under the plan, except that such term does not include any such plan with respect to a purchaser who uses his account primarily as an ordinary charge account.

47. *Id.* Prior to congressional action, Treasury regulations authorized installment treatment for certain revolving credit plan sales. *See* note 49 *infra*.

48. Act of Aug. 31, 1964, Pub. L. No. 88-539, § 3, 78 Stat. 746. Congressional debate on the repeal provision centered on which revolving credit plan charges should be treated as

HeinOnline -- 1978 Wis. L. Rev. 8 1978

tions specifying the types of revolving credit plan sales that would qualify.[49] Qualification was linked to a modified "two or more payments" test.[50]

Congress, then, appears to agree with the judicially created test.[51] The existence of periodic payments is the sole prerequisite for establishing an "installment plan" sale. The current Treasury regulations reflect this consensus by defining "sale on the installment plan" as:

> (1) A sale of personal property by the taxpayer under any plan for the sale or other disposition of personal property which plan, by its terms and conditions, contemplates that each sale under the plan will be paid for in two or more payments, or
>
> (2) A sale of personal property by the taxpayer under any plan for the sale or other disposition of personal property—
>
> (i) Which plan, by its terms and conditions, contemplates that such sale will be paid for in two or more payments, and
>
> (ii) Which sale is in fact paid for in two or more payments.[52]

Whatever this circuitous definition may or may not accomplish, its emphasis on two or more payments is unmistakable.

C. Conclusions as to Purpose Based on History

Although the early history of installment selling supports the view that the installment method was intended as a relief provision, it becomes

---

installment payments, not on whether the installment method should be generally available to merchants using revolving credit plans. 110 CONG. REC. 20033, 20033-34 (1964) (remarks of Senator Hartke).

49. Prior to passage of the Revenue Act of 1964, Treasury regulations had set forth a procedure for determining what proportion of revolving credit plan charges were to be treated as installment plan payments. Treas. Reg. § 1.453-2(d), T.D. 6682, 1963-2 C.B. 197. These regulations were implicitly repealed by the Revenue Act of 1964, Pub. L. No. 88-272, § 222(a), 78 Stat. 75, but were restored by the Act of Aug. 31, 1964, Pub. L. No. 88-539, § 3, 78 Stat. 746. *See* 110 CONG. REC. 20033, 20034 (1964) (remarks of Senator Hartke).

50. *See* Treas. Reg. § 1.453-2(d)(1)(1958), *as amended by* T.D. 6682, 1963-2 C.B. 197, and T.D. 6804, 1965-1 C.B. 215 (authorizing installment plan treatment for "sales under a revolving credit plan (1) which are *of the type* which the terms and conditions of the plan contemplate will be paid for in two or more installments and (2) which are charged to accounts on which subsequent payments indicate that *such sales* are being paid for in two or more installments") (emphasis added). *Cf.* Treas. Reg. § 1.453-2(b)(2)(1958), *as amended by* T.D. 6682, 1963-2 C.B. 197 (quoted in text accompanying note 52 *infra*).

Since a revolving credit plan may involve some periodic payment sales and some regular credit sales, sampling procedures must be followed by the merchant in order to establish what percentage of revolving credit sales will be deemed to result in two or more payments. This percentage may then be reported on the installment method. Treas. Reg. § 1.453-2(b)(2), (d) (1958), *as amended by* T.D. 6682, 1963-2 C.B. 197, and T.D. 6804, 1965-1 C.B. 215.

51. That is, the test stated in Consolidated Dry Goods Co. v. United States, 180 F. Supp. 878 (D. Mass. 1960). *See* text accompanying notes 39-43 *supra*.

52. Treas. Reg. § 1.453-2(b)(1958), *as amended by* T.D. 6682, 1963-2 C.B. 197. Subparagraph (1) of this regulation is meant to refer to "traditonal installment plan" sales, whereas subparagraph (2) refers to sales under "revolving credit plans." *Id.* Apparently sales of the former type qualify whether or not the two payment test is in fact met.

HeinOnline -- 1978 Wis. L. Rev. 9 1978

more difficult to understand the justification for that relief in light of the more recent development of the "two or more payments" test. Relief is deemed appropriate, according to the statute, when someone sells *on the installment plan*. There were certain characteristics of the early *installment plan* which suggested relief was appropriate, such as lengthy deferral of the receipt of cash and risk of collection. Today, however, relief becomes available provided regular sales are made in which two or more payments are made by the purchaser. The two payments may occur within 2 days or within 2 years.[53] Furthermore, relief is available even in cases in which payment may be practically ensured.[54] Therefore, it appears that the term "installment sale" has not been construed consistent with the apparent purpose of the statute.

Nonetheless, commentators[55] and even the Internal Revenue Service[56] continue to characterize Section 453(a) as a relief provision. No one, however, has attempted to explain exactly what type of relief it is thought to provide, or asked whether relief, from whatever the burden may be, is in fact appropriate.[57] The next section of this article will address these issues.

III. ANALYSIS OF SECTION 453(a) AS A RELIEF PROVISION

"The installment provisions were intended primarily to relieve persons engaged in selling furniture or other chattels on the installment plan from paying an income tax on the entire transaction at the outset when, because of the failure of the purchasers to meet all their payments, nothing like the expected profit might ever be realized."[58]

This statement is representative of attempts by commentators and courts to identify the legislative purpose behind the enactment of the installment method provisions.[59] The problem with this statement is that although its author identifies "relief" as the primary purpose, it does not

53. If the 2 days occur in different tax years, then partial deferral of gain is possible.

54. For example, many retailers today utilize elaborate credit check procedures and sell on credit only to those customers who have a strong credit standing.

55. "A retail taxpayer reporting income on the accrual basis finds that he is paying income tax on the profit from credit sales before the customer remits the cash . . . ." Wiese, *Techniques of Installment Sales and Revolving Credit: Methods of Election; Bulk Sales of Receivables and Notes*, 23 N.Y.U. INST. FED. TAX. 905, 905 (1965) [hereinafter cited as Wiese]. *See also* Mero, *The Installment Basis for Dealers in Personal Property*, 25 TAXES 223 (1947).

56. According to the Internal Revenue Service, the rationale of § 453(a) was to "enable merchants to actually receive in cash the profit arising out of each installment before the tax was paid." Rev. Rul. 65-185, 1965-2 C.B. 153, 154.

57. Some commentators, however, have noted generally that the installment method and its justification should be reviewed. *See* Surrey & Hellmuth, *The Tax Expenditure Budget—Response to Professor Bittker*, 22 NAT'L TAX J. 528, 533 (1969).

58. Mero, *The Installment Basis for Dealers in Personal Property*, 25 TAXES 223, 223 (1947).

59. *See* W.T. Grant v. Comm'r, 483 F.2d 1115 (2d Cir. 1973); Pendergast v. Comm'r, 22 B.T.A. 1259, 1262 (1931).

HeinOnline -- 1978 Wis. L. Rev. 10 1978

directly indicate from what the relief must be provided. It is true that the installment method furnishes relief from immediate payment of taxes, but this relief is only the *means* chosen by Congress. Choice of this particular *means* says nothing about the *end* purpose that Congress had in mind. Apparently Congress believed that installment plan sellers were suffering from some hardship which necessitated relief from immediate payment of taxes. The question is what that hardship is.

The perceived hardship must have resulted from the application of accrual basis accounting principles to installment plan sellers. There are two distinct possible hardships: (1) accounting for gain at the time of sale created an unfair burden on installment plan sellers in relation to the tax burden of other sellers, and (2) requiring payment of the tax in the absence of cash receipts created an inconvenience to the installment seller.

In order to discuss these two possibilities it will be necessary to refer to classical notions of tax policy. There is evidence from early legislative debates on the income tax that in choosing income as the appropriate tax base, Congress implicitly approved of two classical principles of taxation: fairness and convenience of payment.[60]

A. Creation of an Unfair Burden

Adam Smith's first principle of taxation states:

> The subjects of every state ought to contribute to the support of the government, as nearly as possible in proportion to their respective abilities: That is, in proportion to the revenue which they respectively enjoy under the protection of the state. In the observation or neglect of this maxim consists what is called the equality or inequality of taxation.[61]

A tax should be fair, and this means that each individual should bear his or her fair share of the burden of the tax.[62] The quote from Smith suggests that "ability to pay" is a fair measure of what one's burden ought to be.[63] Thus, if the installment plan seller is less "able to pay" than other sellers, he or she should be accorded relief to prevent an unfair distribution of the burden.[64]

---

60. *See, e.g.*, 44 CONG. REC. 532-36 (1909) (remarks of Rep. Hull).

61. A. SMITH, AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS, bk. 5, ch. 2, at 361 (Great Books ed. 1952) [hereinafter cited as A. SMITH].

62. J.S. MILL, PRINCIPLES OF POLITICAL ECONOMY 484 (1904) [hereinafter cited as J.S. MILL].

63. In the most recent policy statement by the Treasury Department, questions regarding the definition of a fair measure are addressed in terms of the "ability-to-pay" approach and also in terms of a "standard-of-living" approach. U.S. DEP'T OF THE TREASURY, BLUEPRINTS FOR BASIC TAX REFORM 41 (1977). The Treasury report notes that our present system of taxation encompasses the "ability-to-pay" approach.

64. "Ability to pay," in this context, refers to a theoretical measure of ability, such as that reflected in R.M. Haig's definition of income as an increase in economic power, and not to a practical measure of ability which might be reflected in a taxpayer's temporary lack of cash. *See* Haig, *The Concept of Income*, in THE FEDERAL INCOME TAX (R. Haig, ed. 1921).

HeinOnline -- 1978 Wis. L. Rev. 11 1978

This raises the question of what, in keeping with our notion of fairness, the most appropriate measure of "ability to pay" is. In enacting the income tax in 1913, Congress answered this question by providing income as the most appropriate measure. That answer, however, leads only to the question of what income is.

In the often quoted words of a well-known economist, R.M. Haig, "[i]ncome is the money value of the net accretion to one's economic power between two points in time."[65] Another well-known economist, Henry Simons, has interpreted "net accretion" to mean the sum of an individual's consumption and accumulation. In more detail: "Personal income may be defined as the algebraic sum of (1) the market value of rights exercised in consumption, and (2) the change in the value of the store of property rights between the beginning and the end of the period in question."[66]

Today, those familiar with developments in tax policy refer to the above concepts as the Haig-Simons definition of income.[67] Proponents of a broader tax base use the Haig-Simons concept as a touchstone for their discussions.[68] Thus, in analyzing fairness in the sense of "ability to pay" it seems appropriate to make reference to the Haig-Simons concept.

The problem, then, is to determine the best way to measure the ability to pay of an installment plan seller relative to the ability to pay of other sellers. Specifically, we must measure their relative abilities to pay at a specific point in time, such as the time of sale.[69] A simple comparison could be made by asking what each seller gave up and what each received in return. A comparison of relative changes in fair market values—that is, fair market value of property received minus fair market value of property transferred—should serve as a comparison of relative abilities to pay, because it would identify the "net accretion" of each of the two types of sellers.[70]

Assume that the most important distinction between installment plan retailers and other retailers[71] was perceived, at least in 1918, as being the significant deferral of receipt of cash by the installment plan retailer. The question then becomes whether significant deferral of the receipt of cash makes one retailer less "able to pay" taxes than another retailer who has cash in hand. The following comparison should suggest an answer.

---

65. *Id.*

66. H. SIMONS, PERSONAL INCOME TAXATION 50 (1938).

67. *See, e.g.*, Bittker, *A "Comprehensive Tax Base" as a Goal of Income Tax Reform*, 80 HARV. L. REV. 925 (1967).

68. *Id.*

69. We could choose another point in time, such as the time for payment of tax. For purposes of comparison, however, the particular point in time is irrelevant; we need only use the same point in time for each seller.

70. This comparison is merely an application of the Haig-Simons concept to installment sellers.

71. *I.e.*, those who sell for cash or on open account.

HeinOnline -- 1978 Wis. L. Rev. 12 1978

A and B each sell a widget on December 31, 1976. The widget costs each seller $1,000. A sells for $2,000 cash. B sells for $2,000 cash to be paid on December 31, 1977. The conclusion is that, in 1976, A is more "able to pay" than B because the fair market value of $2,000 cash is significantly greater than the fair market value of $2,000 cash one year hence.[72] Therefore, A and B should be taxed differently.

Requiring each to accrue a gain of $1,000 in 1976, the year of sale, would place an unfair burden on B. This is so because B does not in reality have a $1,000 gain, but something less. What the "something less" is depends on a number of factors, the most significant of which is the current time value of money.[73]

If B is a good business person, she knows that $2,000 one year hence is worth something less than $2,000 cash. If she knows that her widget can be sold for $2,000 cash, as A's widget was, it makes no sense for her to sell it for something less. B is likely, therefore, to charge her purchaser an additional charge which reflects the current time value of money.[74] Whether this charge is in the form of stated interest or in the form of an inflated deferred sales price makes little difference.[75] In the end, she will receive something in excess of $2,000 cash to compensate her for foregoing the immediate receipt of cash. If the current time value of money were 20%, for example, B should charge her purchaser a total of $2,400 to be paid on December 31, 1977. If she did so her "ability to pay" measured in terms of fair market value on December 31, 1976 would be no different from A's "ability to pay." B's right to receive $2,400 one year hence is exactly equal in value to A's $2,000 in cash.[76]

Because it is fairly clear that early installment plan sellers were

72. Provided, of course, that the rate of interest for the one year time period is positive. *See* A. ALCHIAN & W. ALLEN, UNIVERSITY ECONOMICS 205-09 (2d ed. 1967). For example, if the going interest rate were 10% the current value of $2,200 due in one year would be $2,000 because $2,000 invested at 10% for one year would yield $2,200.

73. For a complete list of factors affecting the fair market value of a promise to pay cash in the future, see Cain, *Taxation of Promises to Pay*, 8 GA. L. REV. 125, 135-45 (1973). Typically, time value is reflected in and roughly equivalent to the interest rate that banks charge their borrowers.

74. This hypothetical assumes that other factors affecting the fair market value of a promise to pay cash in the future, such as the risk of default, have no effect. *See* Cain, *supra* note 73, for a list of these other factors.

75. The form of the charge may, however, make some differences for tax purposes, primarily on the buyer's side of the transaction. Prior to the enactment of § 163(b), which imputes interest at the rate of 6% on installment purchases if the interest is not separately stated, the installment plan purchaser would have had difficulty deducting an interest charge unless it was separately stated as such. *See* Marsh & Marsh, Inc., 5 B.T.A. 902 (1926); Carl Lang, 3 B.T.A. 417 (1926) (deferred purchase prices contain no interest element). Even now, § 163(b) limits the deduction to an imputed factor of only 6%. I.R.C. § 163(b).

On the seller's side of the transaction, interest, if not separately stated, will be imputed under § 483, but only in cases involving sales of capital gains property. I.R.C. § 483; Treas. Reg. § 1.483-2(b)(3)(1966).

76. If the time value of money is 20%, then the $2,400 must be discounted by 16 2/3% to calculate its present value, which yields $2,000. Alternatively, if $2,000 were invested for one year at 20%, at the end of the year the amount would increase to $2,400.

HeinOnline -- 1978 Wis. L. Rev. 13 1978

charging interest rates that at least accounted for the time value of money,[77] no unfair burden was created by taxing them at time of sale, absent any other considerations. The time value of money, however, was but one factor affecting the present value of the right to future cash.

The most important of the other factors was the high risk of default.[78] Because bad debt reserves were not available to the accrual basis seller in 1918, collection losses could be deducted for tax purposes only when the debt became uncollectible.[79] For sellers other than installment plan sellers uncollectibility was likely to be established, and therefore a deduction allowed, within a reasonable time after the sale.[80] The installment seller, on the other hand, might not be able to justify a deduction for uncollectibility until years after the sale.[81] In the early years of installment plan selling, accrual basis reporting might have required payment of taxes on some gains that were never in fact realized. Moreover, the availability of a deduction in a subsequent year was not sufficient to offset the true cost of paying taxes on the gain in the year of sale, because the deduction merely served to reduce taxable income in the year it was claimed. It did not allow the seller fully to recover excess taxes paid in a prior year or account for interest on the excess taxes.[82] Thus, one might

77. Yields from U.S. Government securities in the 1920's ranged from 2% to 6% and averaged around 4%. R. KESSEL, THE CYCLICAL BEHAVIOR OF THE TERM STRUCTURE OF INTEREST RATES 68-70 (1965). There are similar indications from the early cases that the actual time value of money during this period was in the neighborhood of 4-6%. *See* Daniel Bros., 7 B.T.A. 1086, 1087-88 (1927), *aff'd*, 28 F.2d 761 (5th Cir. 1928) (real estate contract allowed for prepayment discount at rate of 6%); Marsh & Marsh, Inc. 5 B.T.A. 902, 903 (1926) (real estate prepayment discount at rate of 4%).

At least one installment sales case, however, from this period suggests that the amount of the sales price ostensibly allocated to interest by installment sellers was much higher. In Anderson & Co., 6 B.T.A. 713 (1927), a taxpayer who had sold goods at cost plus 120% indicated that "40 per cent was added for overhead, 40 per cent as interest, 20 per cent to cover charges for collection and the remaining 20 per cent as profit." *Id.* at 716. The 40% interest figure yields an annual interest rate in excess of 10%.

Further, a report issued by the Federal Trade Commission in 1923 indicates that stores that sold household products on the installment plan showed mark-ups more than sufficient to cover the cost of deferred payment. FEDERAL TRADE COMMISSION, HOUSE FURNISHINGS INDUSTRIES: SUMMARY OF REPORT OF THE F.T.C. ON HOUSEHOLD FURNITURE 21 (1923) [hereinafter cited as FTC REPORT].

78. Doyle, *supra* note 6, at 53.

79. To be deductible, debts had to be fully uncollectible. *See* text accompanying notes 12-16 *supra*.

80. Sales of household goods made on a non-installment basis generally required payment within 90 days. FTC REPORT, *supra* note 77, at 25.

81. Since final payment might not be due until 3 years after the time of sale, it might be 3 years before a merchant could establish an individual account as uncollectible. For example, the purchaser might make payments for the first 2 1/2 years and then default. At that point the merchant would be entitled to a deduction; but in the meantime, having accrued a taxable gain at the time of sale, the merchant would have already paid taxes on the gain represented by the uncollected payments.

82. For example, even if the deduction in year four saved the merchant an amount in taxes in that year exactly equal to the amount paid as taxes in year one on the gain that was never fully collected, the merchant would nonetheless have lost the use of that amount of money during the 4-year period. If the merchant was in a higher tax bracket in the year of sale than in the year of deduction, he or she also would have lost the extra value of a deduction taken in a higher bracket.

HeinOnline -- 1978 Wis. L. Rev. 14 1978

argue that the installment method provided for some relief from this added cost.

The question then becomes whether the cost imposed by the long delay between the reporting of income and deducting of uncollectible debts creates an unfair burden which the tax laws should attempt to alleviate. Since the seller could pass this cost through to the purchaser in the form of a higher deferred selling price, it arguably is inappropriate for the Government to consider granting the seller relief through preferential tax treatment. If the higher selling price reflects a tax burden that is unfair, however, passing the burden on to the purchaser does not make it any fairer. For example, absent collectibility problems, taxing our installment seller on a $1,000 profit on December 31, 1976, is taxing the true measure of her ability to pay.[83] The payment by B's purchaser of an extra $400 reflects a "true cost"[84]—the time value of money. Taxing our installment seller on a $1,000 profit when problems as to collectibility not accounted for in the selling price or interest charge suggest that a somewhat smaller profit is her actual income, however, is unfair because it taxes more than her ability to pay. She may, of course, pass this cost through to her purchasers in the form of higher sales prices, but the mere fact that she is capable of shifting the incidence of the tax burden in this manner does not justify an otherwise inappropriate tax measure. In other words, the cost of the time value of money represents a "true cost" of something of value to the purchaser. The "tax cost" of subsequent uncollectibility, however, results from a tax system that fails to account for the risks of uncollectibility at the time of sale. This cost differs from the "true cost" of uncollectibility, which results from the seller's failure to recoup the cost of goods sold to a defaulting purchaser. Although it might be fair to pass the "true cost" on to purchasers, it is not fair to make purchasers bear the "tax cost."[85] Under this analysis, installment

83. The present value of $2,400 due in one year at 20% interest less $1,000 basis equals $1,000 gain.

84. A "true cost," as the term is used in this article, is a cost which is occasioned by the free operation of the market and not a cost which results from governmental intrusion in the market's operation. Costs which result from governmental intrusion are identified herein as "tax costs." Thus, "true costs" are the result of equal bargaining in a free market, whereas "tax costs" are directly linked to governmental action (the action being not just that of the government as another participant in the market, but action arising from an essential governmental function, such as the taxing function). Passing this $400 interest charge on to the purchaser is fair since it represents a true cost of providing credit to consumers. The availability of credit is presumably of value to those consumers who wish to purchase on credit, and it is fair for them to pay its costs. Of course, it might be argued that the cost is one that should be borne by all consumers (in the form of higher prices in general) since the availability of consumer credit benefits all consumers by increasing the supply of consumer goods and presumably lowering prices. This, however, relates to a pricing decision made by the merchant, and not to the distinction between "true" and "tax" costs.

85. One could claim that the "tax cost" of uncollectibility is in a sense part of the time value of money. But if economic neutrality is accepted as a goal of tax policy, then taxes should not affect the market's determination of the time value of money (except, of course, when taxes are intended to interrupt the free operation of the market in order to further

HeinOnline -- 1978 Wis. L. Rev. 15 1978

plan sellers in 1918 were suffering from a hardship caused by the interaction of two factors: the significant uncollectibility of accounts and the inability to take account of that fact for tax purposes at the time of sale. Although this was a hardship that could conceivably have plagued any credit seller in those times, the degree of hardship would have been noticeably less for the short term credit seller. First, collection problems for such sellers were less severe,[86] and second, whatever uncollectibility did exist could be accounted for relatively sooner for tax purposes.[87]

In view of the greater hardship facing installment plan sellers, the installment method may have been intended to relieve them from this hardship and thus from bearing an unfair share of the burden. This particular problem, however, could have been solved more directly— and in fact it was in 1921, when Congress authorized the use of bad debt reserves for tax accounting purposes.[88] A bad debt reserve allows a seller, in effect, to take a current deduction at the time of the credit sale for anticipated losses due to collection problems.[89] With the advent of the bad debt reserve, the installment plan seller's economic position relative to other sellers should have been equalized.

To demonstrate this fact, reconsider the prior example of A, the cash seller, and B, the installment plan seller. Assume that A sells his $1,000 widget for $2,000 cash and B sells her identical widget for $2,400 cash to be paid in one year. The time value of money is 20%. Assume further that both A and B pay taxes at the rate of 50%.[90] At the end of one year A's total cash will be $1,650, consisting of a $500 after-tax profit on the

some other goal of tax policy). See Sneed, *The Criteria of Federal Income Tax Policy*, 17 STAN. L. REV. 567, 568-90 (1965) [hereinafter cited as Sneed], for an explanation of the neutrality principle, which Sneed designates "Free Market Compatibility." Basically, the principle of neutrality means that taxes should not affect resource allocation as it is determined by the market.

86. *See* Doyle, *supra* note 6, at 53.

87. *See* note 80 *supra*.

88. Revenue Act of 1921, ch. 136, § 214(a), 42 Stat. 227.

89. With IRS approval, a taxpayer may set up a bad debt reserve in lieu of deducting specific debts that become worthless during the tax year. The taxpayer may take a deduction for any "reasonable addition" made to the reserve. I.R.C. § 166(c). The regulation generally applicable to bad debt deductions, Treas. Reg. § 1.166-1 (1959) *as amended by* T.D. 6996, 1969-1 C.B. 88, applies to taxpayers using the reserve method. For rules specially applicable to bad debt reserves, see Treas. Reg. § 1.166-4 (1959), *as amended by* T.D. 6728, 1964-1 C.B. 195, and T.D. 7444, 1977-2 I.R.B. 6.

90. If A and B are in different tax brackets, their incomes, after taxes, will obviously be different. Tax brackets differ based on the total amount of income one has, brackets being more progressive for individuals than for corporations. Thus if A's total income is greater than B's, he will pay taxes at a rate greater than B. This progressive aspect of our taxing system reflects the principle of vertical equity. *See generally* W. KLEIN, POLICY ANALYSIS OF THE FEDERAL INCOME TAX (1976) at Chapter 1 [hereinafter cited as W. KLEIN].

For purposes of demonstration, A and B have been placed in the same tax bracket. If they were in different brackets, their incomes and taxes would be different, but the difference would arise from the progressiveness of the tax structure, not the installment seller's inability to account for the risks of uncollectibility at the time of sale. Therefore it would have no bearing on the point which this example is meant to demonstrate—that A and B are equally able to pay even though A sells for cash and B sells on credit.

HeinOnline -- 1978 Wis. L. Rev. 16 1978

sale,[91] plus $1,000 return of basis, plus a $150 return on cash invested for the year.[92] Under the accrual method as it is now applied, B would report a gain of $1,000 at the time of sale and pay a tax of $500. Since she has received no cash, she would have to borrow the $500 at 20%. At the end of the year she would report the $400 interest charge on the sale as interest income from her extension of credit to the purchaser.[93] Thus, her cash position at the end of the one year period will be $2,400 received less $600 repayment of the loan[94] less $200 taxes paid on the $400 interest element. This yields a total of $1,600, which is less than the $1,650 cash in A's hands. There is, however, one final factor to be considered. B has paid $100 in interest, which, because it can be deducted from other income[95] and thereby reduce B's taxes, is worth $50.[96] If this $50 is added to her $1,600 in cash, the total is $1,650—the same amount of cash that A has at that point in time.

This example assumes that B collects in full. If B knows from experience that she will not collect in full, then she will charge something more than $2,400. Assume she typically experiences a rate of uncollectibility equal to 10% of her credit sales price. She will charge $2,640 to her purchaser and through use of the bad debt reserve she will take an immediate deduction of $240 so that it is as though the *true* credit sales price were $2,400.[97]

Thus, under current general accrual principles A's and B's increases in economic power at the end of the year are both $1,650. Under this analysis, there appears to be no justification for claiming that the statutory

---

91. $2,000 selling price less $1,000 basis equals $1,000 gross profit. The gross profit minus $500 in taxes yields $500 in after-tax profit.

92. The $1,000 return of basis plus $500 after-tax profit is available to be invested. At 20% (the assumed time value of money), the return would be $300 less $150 in taxes, for a net return of $150.

93. Interest is not reported by an accrual basis taxpayer until it has been earned, unless it is received in cash at an earlier date. I.R.C. § 451. Thus, even though charged to the purchaser at the time of sale, it is not earned until one year's passage of time.

94. $500 principal plus $100 interest equals $600.

95. I.R.C. § 163. Interest has always been deductible. *See* Revenue Act of 1913, ch. 16, G(b), 38 Stat. 114.

96. Since B is in the 50% bracket, the $100 deduction saves her $50 that would otherwise have to be paid to the government in cash. If B somehow has no other income against which to take this deduction, the resulting inequality arises from B's personal financial situation, not from the use of the accrual method. The tax code has served the interests of equity by providing the potential for equality through the interest deduction. In addition, B has the opportunity to carry the deduction over to a year in which she does have other income. *See* I.R.C. § 172.

97. In passing on this $240 cost of uncollectibility, B is, in effect, charging the purchaser for making credit available. The cost is a "true cost," because it is a feature of the installment credit market, and should be borne by the purchaser. *See* note 84 *supra*. On the other hand, if no bad debt deduction were allowed, and B were forced to report a gain of $1,240 (based on a sales price of $2,640 with $400 of that to be reported as interest income) rather than $1,000, then the added cost of paying a tax on the extra $240 of gain would be a "tax cost" and that is a cost that should not be borne by the purchaser (or the seller for that matter). *See* note 85 *supra*.

HeinOnline -- 1978 Wis. L. Rev. 17 1978

purpose of Section 453(a) is to provide relief for sellers who would otherwise be forced to bear an unfair share of the tax burden. If this type of relief was the intended statutory purpose, that intent was based on a misunderstanding, a fact that now must be recognized.

B. Creation of an Inconvenient Burden

In addition to the principle of equity, Adam Smith identifies "convenience of payment" as a major principle of taxation. "Every tax ought to be levied at the time, or in the manner, in which it is most likely to be convenient for the contributor to pay it."[98] "Convenience of payment" has become an accepted goal of tax policy.[99]

Since taxes must be paid in cash, the most convenient time for a taxpayer to pay taxes is when he or she has cash from the transaction giving rise to the tax. For an installment plan retailer the relevant transaction is the installment sale. The cash from the transaction, however, is not received until later, when the payments are made by the purchaser. As one commentator noted in discussing the need for Section 453(a), "[a] retail taxpayer reporting income on the accrual basis finds that he is paying income tax on the profit from credit sales before the customer remits the cash."[100]

Requiring a retailer to pay taxes on a gain before the gain has been converted into cash does create a burden, which is caused by the principles of the accrual method of tax accounting. But this burden is not necessarily inequitable. Requiring payment of taxes before the retailer has received cash from the purchaser simply means that the retailer must provide the cash from some other source. It may be inconvenient for the retailer to find another source, but it is not inequitable because, as we have seen, the burden on him or her is the same as the non-installment seller's tax burden.[101]

Section 453(a) serves to relieve installment plan retailers from the burden of finding another source for cash to make tax payments. It does so by deferring payment of taxes until the time at which cash is received from the purchaser. Thus, Section 453(a) furthers the goal of "convenience of payment."

"Convenience of payment," however, is not the most important goal of tax policy. A tax provision cannot be justified on the ground that it furthers this goal if it seriously conflicts with other goals of tax policy. Thus, in order to determine whether Section 453(a) is justified, further analysis is necessary. If the provision conflicts with other goals, then

98. A. SMITH, *supra* note 61, at 362.
99. J.S. MILL, *supra* note 62, at 483; Sneed, *supra* note 85, at 572.
100. Wiese, *supra* note 55, at 905.
101. Even if the cash must be borrowed, the extra cost of interest paid on the borrowed funds does not create an inequity. *See* text accompanying notes 90-96 *supra*.

HeinOnline -- 1978 Wis. L. Rev. 18 1978

even though it implements "convenience of payment," its justification will depend on the extent to which it conflicts with other goals. In other words, the costs of Section 453(a) may outweigh its benefits. If the question of costs versus benefits is a close one, then the desirability of Section 453(a) should be viewed in light of feasible alternatives designed to provide the same benefit, but at less overall cost. The present analysis must therefore consider two questions: (1) whether Section 453(a) conflicts with other goals of taxation; and (2) whether there are alternatives which could accomplish the same purpose at lower cost.

1. THE CONFLICT WITH OTHER GOALS

Adam Smith's four principles of taxation have been widely quoted and discussed by tax theorists.[102] They serve as a traditional foundation from which more recent writers have built their broader panoplies of principles.[103] Thus, it seems appropriate to analyze the goal of "convenience of payment," which is one of Smith's principles,[104] by first balancing it against Smith's other three principles or goals. These principles may be characterized as (1) equality of taxation;[105] (2) certainty;[106] and (3) efficient administration.[107] "Convenience of payment" as it is accomplished by Section 453(a) need not conflict with the goals of certainty and efficient administration ipso facto. If the installment method is clearly delineated, it does little, if any, violence to the goal of certainty.[108] Furthermore, it is capable of relatively economical and efficient administration.[109]

The major challenge comes from the goal of equality.[110] With direct

102. *See, e.g.*, J.S. MILL, *supra* note 62, at 483-95; W. KLEIN, *supra* note 90, at 103-38.

103. *See, e.g.*, H. GROVES, POSTWAR TAXATION AND ECONOMIC PROGRESS 373-74 (1946) [hereinafter cited as H. GROVES]; Sneed, *supra* note 85, at 567.

104. A. SMITH, *supra* note 61, at 362.

105. A. SMITH, *supra* note 61, at 361. *See* text accompanying notes 61-64 *supra*.

106. "The tax which every individual is bound to pay ought to be certain, and not arbitrary." A. SMITH, *supra* note 61, at 362.

107. "Every tax ought to be so contrived as both to take out and to keep out of the pockets of the people as little as possible over and above what it brings into the public treasury of the state." *Id.* Other commentators have added such goals as "redistribution of wealth," "preservation of incentives," "adequacy," and various other social and economic goals. H. GROVES, *supra* note 103, at 373-74; Sneed, *supra* note 85, at 569-97. These are not discussed herein because they are tangential to the issues at hand.

108. Unfortunately, the installment method, as it is currently interpreted by the IRS and the courts, has become so complex that the goal of certainty has been thwarted to some extent. For a full discussion of many of these hidden complexities, see Cox & Harris, *Installment Sales for "Dealers" in Personal Property: Review and Analysis* (pts. 1-4), 4 THE TAX ADVISER 658, 723 (1973), 5 THE TAX ADVISER 100, 132 (1974).

109. Just as the goal of certainty has been somewhat thwarted by current complexities underlying § 453(a)'s application, damage has also been done to the goal of economical and efficient administration. There is nothing inherent in the operation or application of the installment method, however, that requires it significantly to undermine either economy or efficiency.

110. Equality is identical to the goal of equity, which is discussed in the text accompanying notes 61-97.

HeinOnline -- 1978 Wis. L. Rev. 19 1978

reference to Smith, John Stuart Mill describes this goal as "equality of sacrifice."[111] In other words, each taxpayer should bear his or her fair share of the burden of the tax. "Fair share," at the very least, means that similarly situated taxpayers should bear a similar proportion of the tax burden. In more recent literature, this principle of taxation has come to be known as the principle of horizontal and vertical equity.[112]

In attempting to further the goal of convenience of payment, it is possible that sufficient harm may be done to the principle of equity that the desirability of Section 453(a) may become questionable. For example, the ultimate convenience would be to allow all taxpayers to wait until they have received cash before making them pay a tax. Providing for a strict cash receipts computation of income, however, would create serious conflicts with equity. Any taxpayer who could arrange to be paid in property rather than cash would escape taxation altogether. In order to serve both goals, compromises are necessary.[113] Section 453(a) represents a typical compromise between equity and convenience of payment. The question is which goal is best served or, conversely, which goal is most harmed.

The goal of horizontal equity is harmed, rather than served, by the operation of Section 453(a). As demonstrated in the prior section, installment plan sellers and other sellers, given comparable powers of business management, are equally able to pay their taxes. Horizontal equity requires equal treatment of those who are equally able to pay. Since Section 453(a) favors installment plan sellers over other sellers, it subverts the goal of horizontal equity. Consider the example of widget sellers A and B once more. As before, both A and B start out with $1,000 in cash which they invest in a widget. A sells for cash and B sells for cash in one year.[114] Everything else is equal and the time value of money is 20%. A sells for $2,000 cash and B for $2,400 cash due in one year. Both have a basis in the widget of $1,000. Both pay taxes at the rate of 50%, and taxes are immediately payable.

At the end of one year, A's total cash will be $1,650.[115] B's total

111. J.S. MILL, *supra* note 62, at 484.

112. Sneed, *supra* note 85, at 574-81.

113. The cash receipts and disbursements method of reporting income represents a partial compromise. Admittedly the method is not as accurate a measure of "ability to pay" as the accrual method and therefore may violate principles of equity to some degree. On the other hand, the availability of the method serves to further the goal of "convenience of payment" as well as other practical goals such as "simplicity of record keeping." The potential degree of harm done to the principle of equity has been reduced by other tax provisions. *See, e.g.*, Treas. Reg. § 1.451-2 (1957), *as amended by* T.D. 6723, 1946-1 C.B. 73, and T.D. 7154, 1972-1 C.B. 236 (doctrine of constructive receipt); I.R.C. § 1001(b) (fair market value of property received by a cash basis taxpayer is an "amount realized" for purposes of computing gain).

114. Under current definitions, B would not qualify as an installment plan seller unless she received at least two payments. For purposes of simplicity, however, this example hypothesizes only one payment to be made one year after the sale is completed. Deferral of payments, not number of payments, is the key element for the purposes of this article.

115. *See* text accompanying notes 91 and 92 *supra*.

HeinOnline -- 1978 Wis. L. Rev. 20 1978

cash will be $1,700.[116] Based on these facts, installment treatment (deferral of taxes until cash is received) clearly favors B because it creates a $50 benefit for her which would not otherwise exist.

The foregoing example supports the point made in the foregoing section—that A and B are equally able to pay and, therefore, the accrual method of reporting income does not unduly burden installment plan sellers. The installment method, on the other hand, creates an additional benefit for B and, therefore, violates the principle of horizontal equity. Since it conflicts with such an established principle of taxation, alternative methods of accomplishing the goal of convenience should be considered.

2. ALTERNATIVE METHODS FOR ATTAINING CONVENIENCE OF PAYMENT

If Congress had been made aware of the benefit created by the installment method, as promulgated in the 1918 Treasury regulations, it might have considered an alternative statutory remedy for the installment plan seller. One alternative would be to tax all sellers in the same manner, (that is according to accrual basis principles), and then defer payment of the tax for installment plan sellers who found themselves short of cash. In other words, the Government would simply become a lender. Taking our example involving A and B, if B is forced to borrow $500 to pay the tax in year one, she would be allowed to borrow from the Government. The Government would then charge the same 20% interest as our hypothetical lender charged, assuming that 20% is the true time value of money.[117] Government lending in this manner permits both goals—equity and convenience—to be served.[118]

There are certain problems with this alternative. It may be difficult to administer. Taxpayer calculations for reporting purposes may become more complicated. If the time value of money changes, the Government would have to decide whether or not to change the interest rate.[119] Such changes might frustrate attainment of the goal of certainty. Presumably, if the harm done to other goals of taxation is small, the alternative might be justified on the principle of equity alone. However, it is not clear how desirable this option is.

Another alternative would be to repeal Section 453(a) altogether in

116. A $1,400 profit ($2,400 minus $1,000) less $700 in tax paid at the end of the year plus $1,000 return of basis yields $1,700.

117. Given a 50% tax rate, the 20% interest charge yields an effective rate of 10% given the offsetting deduction for payment of interest. This is true in the case of both the private lender and the government lender since interest paid to the government is also deductible.

118. The notion of the Treasury as a lender is not altogether unfamiliar. Under certain conditions, payment of an estate tax that is otherwise due and payable may be deferred. Interest is charged on the unpaid portion. I.R.C. §§ 6161, 6166, 6166a.

119. The IRS recently made such an adjustment in the interest rate prescribed pursuant to § 483, which deals with imputed interest. *See* Treas. Reg. § 1.483-1(c)(2)(1966), *as amended by* T.D. 7154, 1972-1 C.B. 236, and T.D. 7394, 1976-1 C.B. 135.

HeinOnline -- 1978 Wis. L. Rev. 21 1978

the interest of equity. One should inquire, however, as to what effect that would have on the principle of convenience. In 1918, when installment plan selling was relatively new, merchants found themselves unable to borrow from outside sources merely on the strength of expected future collections from installment sales accounts.[120] This phenomenon, however, no longer exists. Since World War II, accounts receivable financing in general has increased,[121] and the assignment of consumer installment sales contracts to financial institutions in exchange for immediate cash has become a standard practice.[122] If the retail merchant can readily obtain cash with which to pay the tax, then the fact that he or she does not finally collect cash from a purchaser until some later time has no bearing on the issue of taxpayer convenience.[123] Moreover, the fact that he or she might suffer an added interest expense in order to obtain cash for tax payments does not, as has been demonstrated, conflict with principles of equity.[124]

Because Section 453(a) violates the principle of horizontal equity by creating a benefit for installment plan sellers, one can justify its continued existence on the ground that it furthers the goal of convenience of payment only if the benefits conferred upon the goal of convenience outweigh the harm done to the goal of equity. In 1918, when sellers were unable to borrow from financial institutions, perhaps the benefits outweighed the harm.[125] Today, however, financial institutions are willing to provide temporary cash to installment sellers. Thus, the benefits have lessened and Section 453(a)'s continued justification on the basis of "convenience of payment" has become questionable.

IV. Other Grounds for Justification of Section 453(a)

Traditionally, Section 453(a) has been identified as a relief measure. However, as the foregoing section of this article demonstrates, the relief provided is neither necessary nor appropriate. Rather than distributing the tax burden more equitably, Section 453(a) actually creates an inequity by giving preferential treatment to those taxpayers who both qualify for and elect to use the installment method.

Equity, however, is not the only goal of taxation. There are many provisions in the current tax structures which create inequities. The

120. Doyle, *supra* note 6, at 53.

121. C. Phelps, Accounts Receivable Financing as a Method of Securing Business Loans 11 (2d ed. 1962).

122. *See* P. McCracken, J. Mao, & C. Fricke, Consumer Installment Credit and Public Policy 7-10 (1965) [hereinafter cited as Consumer Installment Credit].

123. For a broader discussion of changes in the consumer credit industry, see text accompanying notes 140-143 *infra*.

124. *See* text accompanying notes 90-97 *supra*.

125. Other less harmful alternatives may nonetheless have been available, such as borrowing from the Treasury, as was discussed in the text accompanying notes 117-19 *supra*.

HeinOnline -- 1978 Wis. L. Rev. 22 1978

deduction for interest payments by homeowners, for example, creates an inequity which renters are quick to decry. Such provisions must seek justification in some other goal of tax policy.[126]

At present there are three main tax goals or objectives which President Carter and his administration have enumerated. These are equity, simplification, and economic growth.[127] Representative Al Ullman, the current Chairman of the House Ways and Means Committee, also emphasizes these goals.[128] Although simplification and economic growth were only recently identified as separate goals of tax policy, they have been implicitly recognized as important considerations for some time.[129]

The goal of simplification is clearly not a ground upon which Section 453(a) can be justified. Section 453(a) creates a method of accounting for income in addition to the accrual method, and is fraught with complexities that the accrual method lacks.[130]

The goal of economic growth, however, presents a more favorable possibility as a ground for justification. Economic growth, it could be argued, was aided in the early part of this century by the retailer who was willing to extend credit to installment plan purchasers.

> The record of expansion and development of the consumer installment lending industry, impressive as it may be when taken by itself, has its greatest significance in the wider context of its contribution to the growth and expansion of the economy generally. . . . The complex methods of mass production from which we have derived the important gains in productivity that have provided the foundation for advances in real incomes, were made possible only by the emergence of mass markets. Mass markets for such items as automobiles, whose large purchase price really constitutes an act of consumer investment, required that means of financing be readily available to consumers. . . . The industry of lending to consumers on the installment plan emerged to fill that need and thereby played a vital role in the country's economic development.[131]

---

126. For example, the interest deduction on home mortgages is justified on the grounds that it provides an indirect governmental subsidy to the building industry which is intended to aid the economic growth of the country as a whole. *See* [1968] TREAS. SEC'Y ANN. REP. ON FINANCES 327, 329-330.

127. Comments of Laurence N. Woodworth, Assistant Secretary of the Treasury for Tax Policy, at a recent Conference on Tax Policy and Economic Growth, co-sponsored by Representative Barber Conable and the National Journal, held in Washington, D.C. (Nov. 14-15, 1977).

128. Speech by Rep. Ullman at Conference on Tax Policy and Economic Growth, in Washington, D.C. (Nov. 14, 1977).

129. Simplicity, for example, is implicit in Adam Smith's goals of certainty and efficient administration.

130. For example, the sampling procedures in Reg. § 1.453-2(d) (1965), which must be followed to determine which revolving credit sales qualify for installment treatment, are an additional complexity of the installment method.

131. CONSUMER INSTALLMENT CREDIT, *supra* note 122, at 2-3.

HeinOnline -- 1978 Wis. L. Rev. 23 1978

Because the extension of installment plan credit was beneficial to overall economic growth, it arguably was appropriate to provide an indirect governmental subsidy in the form of a tax benefit to the persons supplying that credit. Section 453(a), in providing a benefit to installment plan retailers, accomplished this objective.

Although it may be possible, in retrospect, to characterize Section 453(a) as a tax subsidy aimed at improving economic growth, it is unrealistic to suppose that it was ever intended as such. There is nothing in the legislative history or the writings of early commentators and supporters of the provision to suggest that the installment method was perceived as a tax benefit linked to economic growth and production. Nevertheless, whether conscious or not, the immediate reaction of Congress in 1926 to the Board of Tax Appeals invalidation of the Treasury regulation permitting the installment method[132] may indicate a recognition of the important role installment plan retailers were playing in this country's economic development. Perhaps, then, it would be fair to characterize Section 453(a) as a subconscious enactment of an indirect subsidy aimed at economic growth. We must determine, however, if it can withstand scrutiny as a tax subsidy. In other words, the question is whether Section 453(a) may be justified today on the ground that it effectively furthers the goal of economic growth.

This question is difficult at the outset because it poses the underlying question of what type of activity will improve the country's economic growth, more spending or more saving. Although most economists are advocating more savings in order to cope with a perceived imminent capital shortage, some Keynesians still advocate spending.[133] This article will not deal with the underlying question. Instead, it will analyze Section 453(a) under each of the two alternative means suggested for improving economic growth.

A. *Economic Growth and Consumer Spending*

According to Keynesian economic theory, increased consumption leads to an increase in production.[134] The availability of installment plan credit effectively opened up new markets for producers.[135] The wage earner, who typically had very little money left out of each paycheck once the rent was paid and groceries purchased, could hardly afford to invest in such consumer durables as phonographs, washing machines and automobiles. With the advent of the installment plan, the wage earner was able to purchase such items, take immediate possession, and pay the price

132. *See* text accompanying notes 21-28 *supra*.

133. *See* TAX POLICY AND ECONOMIC GROWTH, A NATIONAL JOURNAL ISSUES BOOK (1977); Comments by participants at Nov. 14-15, 1977 conference, note 127 *supra*.

134. *See* J. KEYNES, THE GENERAL THEORY OF EMPLOYMENT, INTEREST AND MONEY 372-376 (1936).

135. *See* text accompanying note 131 *supra*.

HeinOnline -- 1978 Wis. L. Rev. 24 1978

out of future earnings, with a small portion coming out of each paycheck. This increase in consumption led to an increase in production. Increased production fostered greater economic growth, which in turn led to increased wages and employment. This resulted in more money for consumers to make additional purchases while still paying off prior installment sales obligations.

If this cycle were to continue without interruption, then each stage would lead to an expansion at the following stage, with the result that overall growth would continue.[136] The availability of consumer credit is an integral part of this hypothesized cycle, and presumably any increase in the availability of consumer credit will result in greater economic growth.[137] Thus, an argument could be made that any indirect subsidy to those who provide this necessary credit will help accomplish the final goal of increased economic growth, and therefore be justified as a tax provision.

This argument, however, must be scrutinized more closely by asking whether it is rational to provide this subsidy in the manner prescribed by Section 453(a). Whether Section 453(a) is an appropriate means depends on a number of factors. For example, it makes little sense to rely on the complexities of Section 453(a) if there is some other less complex way to provide the subsidy, provided this alternative is directed, as Section 453(a), at the activity intended to be benefited. Because the installment method is available only for gains derived from installment credit sales, Section 453(a) appears to be sufficiently narrow in the benefits it confers. There are, however, alternatives to Section 453(a) which can be equally as narrow and yet less complex. For example, retailers could be given a special deduction or credit linked to their installment plan sales.[138] Installment plan sales would still have to be identified, but all sales income would be reported on the accrual basis. This would avoid numerous problems caused by the installment method of accounting itself.[139]

136. This hypothetical cycle ignores for the moment other factors that might affect economic growth, such as investment in permanent capital.

137. Of course when the economic system of the United States is viewed as a closed system, it is somewhat unrealistic to consider an increase in consumer credit in the abstract, without, for example, considering its effect on the overall money supply. However, for purposes of the argument in the text, abstract considerations are sufficient.

138. If the indirect benefit in promoting economic growth produced by Section 453(a) were equivalent in value to 5% of all installment credit sales, then a direct credit against taxes equal to 5% of installment credit sales made within the taxable year would accomplish the same result. More specifically, Section 453(a) may stimulate economic growth by giving the installment seller a cash subsidy, compared to his or her financial position under the accrual method. *See* text accompanying notes 114-116 *supra*. A tax credit to the same extent gives the installment seller an equivalent cash subsidy, thereby stimulating growth to the same extent.

139. Problems as to whether or not a disposition of the installment obligation had occurred, thereby accelerating gain, would be avoided. There no longer would be the question of which expenses should be deducted currently and which allocated to cost of goods sold. The installment method also poses problems relating to corporate mergers and subchapter S corporations which would be avoided. *See generally* Cox & Harris, *Installment*

HeinOnline -- 1978 Wis. L. Rev. 25 1978

Another question is whether it makes sense to provide a governmental subsidy to just one type of taxpayer providing consumer installment credit. Although retailers may have been the main source of this type of credit in 1918, that is certainly not the case any more. Today consumer installment credit, and consumer credit in general, are big business. At the end of 1974, financial institutions held 63% of all outstanding "other consumer goods" paper.[140] Commercial banks currently provide most of the financing for consumer purchases of automobiles.[141] Credit for smaller consumer purchases is extended directly to the purchasers via bank credit cards.[142] In 1975, retailers, who used to be the major source of consumer credit, held only 11% of all outstanding consumer credit.[143]

Consumer credit has become a competitive moneymaking business itself, separate from the actual sale of goods. Since financial institutions have the resources to engage in this activity on a larger scale and at lower costs than the small retailer, they have largely taken over the consumer credit business. No tax subsidy was necessary to encourage financial institutions to enter the field of consumer credit.[144]

The subsidy provided by Section 453(a) is justified, if at all, because it is directed at a particular activity, extension of consumer installment credit. The economic growth argument, however, does not require that the credit be extended by retailers, because it may be adequately supplied by financial institutions, which, as was shown earlier, is the case today. It also does not require that the credit extended be installment credit.[145] It is therefore difficult to justify Section 453(a) as a desirable subsidy to consumer credit.[146] It may, in fact, produce undesirable results. For example, the takeover of the consumer credit industry by financial institutions occurred because financial institutions were able to provide such credit at less cost than the retailer. The continued subsidization of retailers via Section 453(a) is a subsidization of the less efficient lender which can only be justified if it serves to accomplish some other unrelated purpose. No such purpose seems plausible. Therefore, Section 453(a) remains unjustified.

Sales for "Dealers" in Personal Property: Review and Analysis (pt. iv), 5 TAX ADVISER 132, 139-140 (1974).

140. 62 FED. RES. BULL. A46 (1976). The term "other consumer goods" refers to consumer goods other than automobiles.

141. *Id.*

142. *See The Impact of Credit Cards on Small Business: Hearings Before the Subcommittee on Special Small Business Problems of the House of Representatives Select Committee on Small Business*, 91st Cong., 2d Sess. 351-444 (1970).

143. 62 FED. RES. BULL. A46 (1976).

144. Although banks have benefited from a number of tax breaks such as that provided by I.R.C. § 585 (which provides for bad debt reserves in excess of actual losses), none of them have been directly related to consumer credit.

145. This argument applies except to the extent that installment credit, if characterized by small periodic payments over a sufficiently long period of time, serves to provide credit on terms consumers find attractive and easy to manage.

146. If consumer credit is worthy of a subsidy, the Government would have more effect if it subsidized banks that extend consumer credit.

HeinOnline -- 1978 Wis. L. Rev. 26 1978

B. Economic Growth and Savings

> There is little disagreement among the existing studies that investment as a percentage of GNP will have to increase somewhat over the next decade if previous rates of productivity growth are to be maintained with employment and if the nation is to meet the special capital requirements in areas of energy and pollution abatement.[147]

If we once again characterize Section 453(a) as a tax subsidy directed at consumer credit and spending, we would have to conclude immediately that Section 453(a) poses a threat to savings and investment, and thus a threat to economic growth. In fact, it is difficult to reach any other conclusion.

As noted earlier, one currently popular school of economic thought teaches that taxpayers should be encouraged to invest rather than spend. Because a tax break to retailers for installment sales is likely to stimulate consumption rather than savings, Section 453(a), in creating such a benefit, frustrates the policy embodied in other tax provisions that encourage investment.[148] It can hardly be justified as furthering economic growth if attainment of that goal is seen as requiring more savings and investment.

V. CONCLUSION

This article has demonstrated that although Section 453(a) was probably intended as a relief measure, there is no justification for providing that relief today. Furthermore, since Section 453(a) violates the goals of equity and simplification, and because it cannot be justified as a sensible means for fostering economic growth, it should be repealed.

In the interest of fairness and of certainty, however, the repeal should be accomplished as follows: first, the effective date of repeal should be at least 3 years after the repeal is enacted; second, retailers should be allowed to elect to report a portion of their installment sales income which would otherwise be deferred, in any year during the 3-year period. This option would provide a transition period which could be phased in as the retailer-taxpayers choose. It should make no difference to the Commissioner how much an individual elects to report in a given year because election would only accelerate recognition of income to earlier than the end of the 3-year period. At the end of the 3 years, all retailers would be reporting on the accrual method, and all unreported installment sales income would have to be accrued.

---

147. Bosworth, *Capital Formation in Times of Economic Crisis*, in TAX POLICY AND ECONOMIC GROWTH, A NATIONAL JOURNAL ISSUES BOOK 14 (1977).

148. For example, there is the investment tax credit provided in I.R.C. §§ 38, 46-50.

HeinOnline -- 1978 Wis. L. Rev. 27 1978

HeinOnline -- 1978 Wis. L. Rev. 28 1978