Installment Reporting for Income Tax Purposes

by Randall W. Roth and John T. Kearns

Randall W. Roth, Denver, is in the private practice of law as a shareholder-employee of Randall W. Roth, P.C. He is also an Assistant Professor of Accounting at Metropolitan State College. John T. Kearns, Denver, is in the private practice of law as a shareholder-employee of John T. Kearns, P.C.

Section 453 of the Internal Revenue Code grants taxpayers the election to report the gain from the sale or other disposition of certain property on the installment method for income tax purposes regardless of their regular method of accounting.[1] By making this election, a taxpayer can spread the amount of gain over the number of tax years in which payments are received, thereby deferring the payment of taxes and avoiding an unusually high marginal tax bracket for the year of sale. Appreciation of the potential advantage of this method of reporting gain requires an understanding of the alternatives.

DEFERRED PAYMENT SALE UNDER TAXPAYER'S REGULAR METHOD OF ACCOUNTING

If § 453 is not available or if it is available but is not elected, the gain from a sale or exchange of property will generally be recognized for tax purposes in the year of sale.[2] This results even though the seller may receive little or no cash in that year. The amount of the gain in the year of sale will depend upon the taxpayer's regular method of accounting.

Cash basis taxpayer

Upon the sale or exchange of property, a cash basis taxpayer must include in the amount realized from the sale or exchange the cash received as well as the fair market value (hereinafter referred to as "FMV") of any other property received.[3] The taxpayer's recognized gain for the year of sale is the difference between the amount realized and his basis in the property sold or exchanged.[4] The character of this gain (capital or ordinary) will depend upon the nature of the property sold or exchanged, as well as the taxpayer's holding period for that property.[5] If the payments to be received by the taxpayer have a face value in excess of the FMV which was included in the amount realized, this excess will be treated as ordinary income and a portion of such excess must be reported in each year in which a deferred payment is received.

To illustrate the income tax results of a deferred payment sale by a cash basis taxpayer, assume the following facts.

S sells a tract of land in 1976 to B for a total sales price of $100,000. B makes a $20,000 down payment and gives S an $80,000, 6 percent promissory note, payable $10,000 of principal per year over the next 8 years. Because of the low rate of interest and the term of the

note, the note has a FMV of only $60,000. S had paid $10,000 for the land in 1970 and has held it strictly for investment purposes.

Being a cash basis taxpayer, S would include the amount of cash, $20,000, and the FMV of other property received, $60,000, in his amount realized; less his $10,000 basis, S will report a recognized gain of $70,000 in 1976. Since the property sold was a capital asset and S had a holding period in excess of six months, this $70,000 will be reported as a long-term capital gain. In 1977 when S receives his first $10,000 deferred payment, he will have to report $2,500 as ordinary income while the remaining $7,500 will constitute a return of capital and be tax-free.

To understand why $2,500 of this payment has to be reported and why it is reported as ordinary income, keep in mind that S expects to receive $80,000 of principal payments from B over the eight-year period following the year of sale. Irrespective of that fact, he was required to include only $60,000, the note's FMV, in his amount realized for purposes of computing the gain on the sale. The excess of the note's face value over its FMV, which was not included in S's amount realized, will presumably be received by S over the eight-year period. Since gross income includes all "gains from dealings in property" this $20,000 must be taken into income by S as it is received.[6] This income generally does not qualify for capital gains treatment as it results from collection of a note rather than a sale or exchange.[7] Even though there are no assurances that the full face value of B's note will be collected, S cannot delay recognition of the ordinary income amounts until he has realized a complete return of capital. Instead, only a percentage of each payment can be considered as a return of capital.[8] That percentage is determined by dividing the face value of the note into its FMV at the date of sale. In the above example, $60,000/$80,000 or ¾ of each payment represents a return of capital; the remaining ¼ has to be reported as ordinary income. In addition, any interest received by S will be reported as ordinary income for the year of receipt.[9]

In the above example, it was assumed that B's note had an ascertainable FMV. In rare situations, it may be impossible to value B's obligation with any reasonable degree of certainty. This may be particularly true if the amount of B's obligation is based upon factors unknown at the time of sale, such as future profits. When such a situation exists, the seller is allowed to exclude the obligations from his amount realized. The payments received by the seller are treated as a return of capital up to the amount of his basis in the property sold. Once his basis has been completely recovered, all additional payments are taxed when received.[10] The character of this income is determined by the circumstances of the original sale. In the above example, S would, under this cost recovery approach, spread his taxable gain over the nine-year period (the $10,000 basis having been recovered in the year of sale) and, except for interest, all income would be reported as long-term capital gain.

Of course, the cost recovery method does not apply to S in the above example since B's note was subject to valuation. Furthermore, it is only in rare and extraordinary cases that the buyer's obligation will be considered to have no FMV.[11] The fact that the buyer's obligation may have a FMV considerably below its face amount does not qualify the seller to utilize the cost recovery approach.[12] Non-negotiability of the buyer's obligation may affect the amount of its FMV, but it generally does not permit the use of the cost recovery method.[13]

Accrual basis taxpayer

An accrual basis taxpayer must include income when "all events have occurred to establish the right to the income and the amount thereof can be determined with reasonable accuracy."[14] Furthermore, there must be at least a reasonable expectation that the amount will eventually be received.[15] Since it is the right to receive, rather than actual receipt, that determines inclusion into income, an accrual basis taxpayer must take the entire selling price into the amount realized, even if the FMV of the buyer's obligation is substantially below its face value. To illustrate, in the above example S would have an amount realized of $100,000, cash received of $20,000 plus the $80,000 face value of B's obligation; less his $10,000 basis, S's gain would be $90,000. It would all be reported as long term capital gain in 1976, the year of sale. Interest would be reported as ordinary income when it was earned.

Although its applicability is uncertain, the regulations under § 453 seem to give an option to the accrual basis taxpayer who sells real property on a deferred payment basis.[16] It purports to allow such a seller to include only the FMV of the buyer's obligation, rather than face amount, in the amount realized from the sale. Basically, this enables the accrual basis taxpayer in that narrow situation to report his gain in the same way as it would have to be reported by a cash basis taxpayer.

Problems without installment reporting

As discussed above, whether the seller is normally on the cash basis or the accrual basis, a deferred payment sale will almost always create two substantial problems. Both problems stem from the fact that the greatest portion of the gain will have to be recognized in the year of the sale. First, by lumping all or most of the gain into one taxable year, the seller may find himself in an unusually high marginal tax bracket. Second, the resulting tax on the recognized gain will be due relatively soon after the actual sale even though the down payment received by the seller might be substantially less than the taxes which are due.

The seller may be able to negotiate or otherwise transfer the buyer's obligation in order to raise more cash. Even if the obligation is transferable, however, it may not be desirable for the seller to do this for any one of a number of reasons. For example, if the obligation is secured by the property itself, he may wish to retain the obligation to preserve his right to regain the property in the event of a subsequent default. Also, the obligation may be transferable only at a substantial discount even though the accrual basis

taxpayer had to include its full face value in computing his gain on the sale.

APPLICATION OF SECTION 453

Assuming that § 453 is available to S in the example above, a much different treatment results. S still has a realized gain of $90,000 ($100,000 selling price minus $10,000 basis), but his recognized gain in the year of sale and future years is limited to a percentage of the payments received in each of those years. The percentage is computed in this example by dividing the $90,000 gain by the $100,000 selling price.

Since $20,000 is received by S in 1976, he will report a long-term capital gain for that year of $18,000 ($20,000 × 90 percent). In 1977, when S receives the first $10,000 payment, he will report a long-term capital gain of $9,000 ($10,000 × 90%). Of course, any interest received from B will be reported separately, in accordance with S's regular method of accounting, as ordinary income.

Keeping in mind the general advantage of electing installment reporting, the remainder of this article reviews the requirements of § 453, who can elect its provisions, when the election must be made, how the transaction must be structured, how the statute operates, and the tax results of a disposition of the buyer's obligation.

PERSONS ELIGIBLE TO ELECT INSTALLMENT REPORTING

Section 453 limits the availability of installment reporting to (1) dealers in personal property, (2) persons who engage in casual sales of personal property for a price exceeding $1,000, and (3) persons who sell real property.[17] The latter two groups must satisfy a further requirement that payments deemed received in the year of sale cannot exceed 30 percent of the sales price.[18] Although this article concentrates on the latter two groups, a general outline concerning dealers in personal property follows.

Dealers in personal property

A dealer is one who regularly sells or otherwise disposes of personal property which is regarded as his inventory. He can qualify for § 453 if he regularly sells on the installment plan or under a revolving credit plan. Basically, the amount of gain which must be recognized in any year is that proportion of the payments received in that year which the total gain realized on qualified sales bears to the total contract price of such sales. No requirement exists as to the amount of each sale or the amount of the initial payments received.[19]

Sales on an installment plan or a revolving credit plan must contemplate payment in at least two installments. Furthermore, sales on an installment plan must actually result in at least two separate payments. When some sales are made on an installment plan and others on open account, an election can be made as to the former but the latter will not qualify for § 453 treatment.[20]

The election can be made in the first year in which sales under an installment plan or revolving credit plan are made, without obtaining the approval of the Internal Revenue Service (hereinafter referred to as "IRS").[21] The election must be made on a timely filed income tax return for the taxable year of the election.[22] Upon default by the purchaser, the dealer may deduct, as a bad debt, the adjusted basis of the unpaid obligations. However, if the property is repossessed, a disposition of the obligation is considered to have occurred and the dealer will recognize gain or loss to the extent of the difference between the FMV of the repossessed property and the adjusted basis of the obligation.[23] In this situation, the FMV becomes the

dealer's new basis in the repossessed property. The dealer on the installment basis can discontinue the election at any time without prior approval of the IRS.[24]

Sales of personal and real property

The casual sale of personal property and dispositions of real property will be discussed together since the rules relating to these two categories are quite similar, except for the $1,000 minimum sales price for the casual sales of personalty.

Section 453 is available to persons falling into either of these categories only so long as payments received in the year of sale do not exceed 30 percent of the selling price.[25] Furthermore, although no payments are required to be received in the year of sale in order to qualify for installment reporting, the IRS has taken the position that at least two separate payments, in at least two separate years, must be made in order to qualify.[26] Since the position of the IRS has been upheld,[27] in structuring transactions intended to qualify for installment reporting it is imperative that there be a down payment in the year of sale or payment in some other year prior to a "balloon" payment in the final year. Whether a token down payment in an eariy year coupled with a balloon payment in the final year will pass IRS scrutiny remains an undecided question. However, this literal compliance with the position of the IRS may prove to be a simple solution to this practical problem.

PAYMENTS RECEIVED IN THE YEAR OF SALE

In structuring a transaction to qualify for installment reporting, normally the major concern is that payments in the year of sale do not exceed 30 percent of the selling price. If the payments exceed the 30 percent figure by even one dollar, § 453 does not apply.[28] Undoubtedly, the possibility of this unhappy result explains the conservative approach which calls for a 29 percent down payment, even though 30 percent is permitted.

Several easily overlooked factors can cause an unintentional failure to limit the payments received in the year of sale to the 30 percent maximum. Amounts paid to the seller in years preceding the year of sale, such as earnest money or option payments, which are credited against the purchase price in the year of sale, are considered to be payments in the year of sale.[29] Furthermore, payments received in the year of sale include payments, other than the down payment, which are made by the purchaser during the seller's taxable year in which the sale occurs.[30] Consequently,

a prepayment of an installment which was not due until the first day of the seller's taxable year following the year of the sale would be added to the down payment for purposes of applying the 30 percent test.[31]

To avoid both of these problems, the contract of sale should limit the down payment to that amount which, when added to monies already received, equals no more than 30 percent of selling price. Furthermore, prepayments in the year of sale should be expressly prohibited to the extent they would cause total payments already received before and during the year of sale to exceed the 30 percent ceiling.

Assumption of mortgage

A further problem can result when the property to be sold is encumbered by a mortgage or any other security interest. Generally, the buyer can assume the debt or take the property subject to the outstanding mortgage without the amount of the mortgage being added to the payments deemed to have been received by the seller in the year of sale.[32] However, an important exception to this general rule can result in the loss of installment reporting to the unwary seller. If the amount of the mortgage indebtedness exceeds the seller's adjusted basis in the property, the excess is treated as a payment in the year of sale.[33] For example, assume that property with an adjusted basis of $10,000 is sold for $100,000. The buyer assumes an existing $11,000 mortgage and makes a $30,000 (30 percent of selling price) down payment. Section 453 will not be available because when the $1,000 excess of the mortgage over basis is added to the $10,000 down payment, a violation of the 30 percent ceiling results.

Wrap-around mortgages

Obviously, the problem in the above example could have been circumvented merely by reducing the down payment by the $1,000 excess. But what if the mortgage had been $50,000 instead of $11,000? Now the excess itself exceeds the 30 percent ceiling. A viable technique for qualifying such a situation for installment reporting requires that the property be sold for its unencumbered value and that the seller remain liable and continue to make payments on the mortgage. Even though the existing mortgage constitutes a superior lien on the property, the Tax Court has reasoned that the buyer neither assumed the mortgage nor acquired the property subject to it since the purchase price was not reduced by the amount of the mortgage.[34] Under the general rule, the obligation of the buyer to the seller is not considered to be a payment in the year of sale.[35] This obligation is generally structured as a second mortgage on the property and is often referred to as a wrap-around mortgage.

In order to illustrate the advantageous use of a wrap-around mortgage, consider the following situation:

S has a $50,000 basis in a piece of real property which is subject to a $150,000 mortgage. He wishes to sell it to B for $300,000. S wants the transaction to qualify for installment reporting and he wants to receive some cash initially.

If B assumes the mortgage, the excess of the mortgage over S's basis will be considered to be a payment received by S in the year of sale. Since this amount alone ($150,000 — $50,000 = $100,000) exceeds the 30 percent limitation (30 percent of $300,000 = $90,000), installment reporting will not be available. To remedy this, S could take back a $300,000 second mortgage (wrap-around mortgage) and agree to personally remain liable for and discharge the existing mortgage. Use of the wrap-around mortgage also permits a down payment of up to $90,000 (30 percent of $300,000 = $90,000). If this

were desired, S could receive up to that amount as a down payment and take back B's obligation for the remainder of the sales price, $210,000.

Pre-sale mortgages

In the opposite situation, that is, when the seller has a high basis and little or no outstanding mortgage indebtedness, it may be possible to structure the sale so as to yield cash of more than 30 percent of the sales price to the seller in the year of sale and still qualify for installment reporting. This is accomplished by having the seller mortgage the property just prior to the sale. The proceeds of this loan would not be included in the payments in the year of sale for purposes of the 30 percent test provided the seller had a substantial business reason for mortgaging the property. The definition of what constitutes a substantial business reason is as difficult in this situation as in any other area of the tax law. The IRS would, however, probably claim the lack of a business purpose if the only reason is to generate more cash in the year of sale than could otherwise be received and still qualify under § 453.[36] In one case, the fact that the buyers did not have sufficient resources to obtain mortgages on their own was deemed reason enough for the seller to mortgage the property just prior to sale.[37] Arguably, the same result would follow if the seller were able to obtain a more favorable interest rate for a mortgage than the buyer.

Assumption of unsecured liabilities

As previously discussed, the buyer's assumption of a mortgage on the real property sold is not considered as a payment received in the year of sale, provided that the debt does not exceed the seller's basis. Case law has extended this approach to include the assumption of unsecured liabilities having no specific relationship to the assets purchased which were paid by the buyer in the year of sale.[38] The IRS has accepted this treatment in the case of a casual sale of personal property. It specifically limited its approval, however, to the situation where these liabilities were incurred in the ordinary course of business and not for the purpose of avoiding the 30 percent test.[39] Furthermore, the IRS has indicated that it will continue to treat liabilities which are directed to be paid out of the original purchase price as payment in the year of sale.[40] Because of these added uncertainties, in the situation where these liabilities are relatively

small, consideration should be given to having the seller pay them.

Imputed interest

The applicability of § 483 can also result in the disqualification of an installment sale for failure to meet the 30 percent test. Section 483 may apply to all payments made after 1963 on the sale or exchange of property.[41] This section contains a number of specific rules and exceptions, but basically it states that interest of 7 percent will be imputed to any obligation that does not itself provide for interest of at least 6 percent.[42] Section 483 was primarily enacted in retaliation to the situation where a seller would convert ordinary income into capital gains by simply increasing the selling price by the same amount that was lost by not charging any interest. If the seller was in a higher tax bracket than the buyer, overall tax savings were realized even though the buyer lost the interest deduction.

Unfortunately, the enactment of this statute also created a major problem for the unwary seller who assumes that the contracted selling price equates to the selling price for purposes of the 30 percent test for installment sales purposes. For example, with a selling price of $100,000 and a down payment of $29,000, the seller would normally feel secure that he has qualified for installment reporting. However, if the buyer's obligation in this case was noninterest bearing, then § 483 requires that interest be imputed. If the remaining $71,000 was due just over one year from the date of the sale, interest of $4,721 would be imputed.[43] The selling price would therefore be reduced by that amount to $95,279, and since 30 percent of this recomputed selling price is approximately $42 shy of the down payment, the 30 percent test is not met and the sale does not qualify under § 453.[44]

In the planning stage, this problem can be surmounted in either of two ways. The down payment can be reduced so as to be less than 30 percent of the "adjusted selling price," that is, selling price less imputed interest. In the alternative, interest of at least 6 percent can be provided in order to make § 483 inapplicable. What about the taxpayer, however, who learns about § 483 after his sale transaction has been closed? Is there any action which can be taken? Although only unproven courses of action may be available, there is probably nothing to lose in attempting to utilize them.

The seller should consider either a recision of the entire deal or a modification of its terms. If the seller is in a high tax bracket, he may prefer no sale to a sale that results in recognition of his entire gain in the year of sale. There is some indirect authority for the proposition that a sale can be rescinded and the parties returned to their original position.[45] However, the IRS could be expected to interpret the recision as either a repurchase or a repossession by the seller. (The results of these characterizations are discussed below under "Dispositions.") The correct interpretation would seem to depend upon the intent of the parties in unwinding the transaction. If the transaction was based upon a mistake of fact or law as of the day of sale, rather than a later change of mind, a valid argument could be made for recision. On the other hand, this argument would be weaker as the time span between the sale and the recision increases.

Unfortunately, a recision requires the agreement of both parties, which makes it an impractical alternative in most situations. A second approach would be to have the seller return the money received in the year of sale which exceeded 30 percent of the adjusted sales price. This money can then be repaid to the seller at the beginning of his next

taxable year.[46] Actually, this procedure, because it is based more in equity than law, has only limited justification and should be used as a last resort. Its value is further strained as a result of a recent finding by the Tax Court that a retroactive amendment to the sales contract in order to reduce the selling price and add interest did not suffice in an attempt to avoid the application of § 483.[47]

Constructive receipt

Suppose a buyer offers to pay cash for the property. If the seller rejects this offer and then negotiates a sale based upon a payment schedule which will qualify the sale for installment reporting, § 453 is applicable.[48] If the seller were to accept the original offer, however, and then later determine that he did not want to receive more than 30 percent of the selling price in the year of sale, the IRS might possibly argue that the seller could have received more than 30 percent in the year of sale and that he therefore was in constructive receipt of an amount which disqualified him for installment reporting. This is generally true even if the seller demanded that the buyer establish an escrow for the remaining 70 percent so that the funds would be beyond the seller's reach during the year of sale.[49]

If, on the other hand, the buyer had requested that such an escrow be utilized as a substitution of security, then the arrangement should qualify for § 453 treatment.[50] More than a mere request from the buyer will be required; the structure of the escrow arrangement is vital. If the arrangement actually resembles a vehicle providing security for the eventual payment of the buyer's obligation, rather than an actual payment, the seller should qualify for installment reporting. One important consideration in accomplishing the desired result is to entitle the buyer, rather than the seller, to the interest earned on the escrowed amount.[51] Another consideration dictates that the buyer remain liable on his obligation so that the seller looks to the escrow as security rather than payment. Unfortunately, the IRS has ruled that such an escrow arrangement prevents installment reporting where the seller was not in fact relying on the installment obligation of the buyer, but upon the escrow.[52] Although the reasoning of the IRS in this matter is questionable, most taxpayers will want to avoid the potential problem. Therefore, additional steps will generally be necessary to emphasize the function of the escrow arrangement as security rather than as payment. Several possibilities exist.

First, the agreement could possibly be structured so that the escrow could, at any time, be replaced by equally adequate security or the furnishing of a bond. Second, payments from the escrow could be made subject to continuing fulfillment of the seller's covenant not to compete, or some similar condition, if applicable. Caution must be exercised in this latter approach, however, as amounts due from a buyer which are allocable to the seller's covenant not to compete are not considered part of the selling price of the business, and therefore may reduce the amount of payments that can be received in the year of sale.[53]

The buyer's obligation

In applying the 30 percent test, payments in the year of sale generally do not include evidences of indebtedness of the buyer.[54] This is true even if the buyer's obligation is negotiable. At one time, § 453 did not distinguish between the various types of evidences of indebtedness of the purchaser which could be utilized in installment sale transactions. Now, however, the buyer's debt instrument cannot be a bond or other evidence of indebtedness which is payable on demand or which is readily tradable on an

established securities market. Such an instrument also cannot be with coupons attached or in registered form. These limitations create no problems in the typical situation.

Obligations of a third party

The buyer's obligation should not constitute a payment to the seller, even when it is guaranteed by a third party, and possibly even when it is secured by a pledge of property by the third party.[55] However, if the seller is given a note or other evidence of indebtedness of a third party as part payment under the sale, the FMV of this item will be included in the payments in the year of sale for purposes of the 30 percent test. This is the case whether or not the buyer is liable as an endorser or guarantor of the note.[56]

If the buyer's transfer of the third party note to the seller would cause a failure to meet the 30 percent test, the seller should request that the buyer issue his own note instead. If practicality dictates, the buyer can arrange to have the note endorsed by the third party and/or secured by the third party's note which the buyer now holds.

Liability of seller to buyer

A further complication arises in the situation where the seller is indebted to the buyer at the time of the sale. Clearly, if the buyer, in part payment of the selling price, cancels all or part of the seller's debt to the buyer, the amount so cancelled will be considered a payment received by the seller in the year of sale.[57] Even if no portion of the seller's debt is cancelled, a potential problem still exists. If each party's obligation to make payment is conditioned upon the receipt of payment from the other, it is possible that the IRS will offset the liabilities and treat the double cancellation as mutual payments.[58]

This cancellation would not be warranted if the debts were separately enforceable or if the debt of either party could be accelerated independently of the other. The buyer's obligation, however, cannot be subject to acceleration before the year after the year of sale or it will be included as a payment received in the year of sale. Perhaps the answer which would work in most cases is to have the seller pay off his debt to the buyer prior to the sale, even if this necessitates borrowing against the property which is about to be sold (see discussion above on pre-sale mortgages). Where feasible, a simpler solution would be to either request that the buyer assign the seller's debt to a related party, or to sell the property in question to a subsidiary or other related party of the buyer.

Like-kind exchanges

The installment method can be used for reporting taxable gain on exchanges of like-kind property with "boot" involved.[59] However, this combination will, in most cases, prove to be impractical since all of the cash and property received, including the like-kind property, must be included in the payments received in the year of sale. Any down payment plus the value of the property received will almost always exceed the 30 percent limitation.[60]

Sale and redemption of stock

Occasionally, a shareholder in a closely held corporation may want to sell his stock to someone who either wants stock in a corporation with fewer assets or lacks the resources to purchase all of the stock. In such a situation, the shareholder may consider a "bootstrap" arrangement whereby he simultaneously sells part of this stock to the purchasing party and has the remainder of his stock redeemed by the corporation. Ideally, the redemption will qualify as a complete termination of his stock interest, and thereby result in capital gains treat-

ment.[61] Such a transaction can qualify for installment reporting only if the amounts received in the year of sale from both the sale and the redemption do not exceed 30 percent of the combined sales price and redemption price.[62]

Multiple asset dispositions

When a taxpayer sells a going business, the transaction is regarded as a disposition of the various assets constituting the business.[63] The same treatment results from the sale of other types of multiple assets under a single sales contract.[64] If sold under an installment arrangement which meets the requirements of § 453, installment reporting would be available regarding all of the assets sold, with the exception of inventory and property sold at a loss for which § 453 cannot be utilized. Since the IRS has ruled that the initial payments under a multiple asset sale will be presumed to have been received for each asset on a pro rata basis in proportion to its relative FMV, a down payment in excess of 30 percent of the total selling price would cause a violation of the 30 percent requirement for each and every asset, thereby causing § 453 to be completely unavailable.[65]

This presumption, however, does not apply if the parties, at the time of the sale, agree to the contrary. The parties can agree to a special allocation of the down payment and/or the selling price and thereby qualify the sale of all or part of the qualifying property for installment reporting.[66] For example, a 40 percent down payment could be allocated to inventory and property sold at a loss; the buyer's obligation, which represents the remaining 60 percent of total selling price, could then be allocated to the purchase of qualifying property. This special allocation is not foolproof and cannot be made after the fact, so careful tax planning is necessary to insure that the seller and buyer agree upon such an allocation at the time of the sale.[67]

A recent case stressed the need to establish a reason other than the desire to utilize installment reporting for the allocation.[68]

While the fragmenting of a sale of a group of assets in order to permit installment reporting on some of them has proven effective in several cases, combining sales of several assets into a single sale in order to qualify for installment reporting on an overall basis is not so easy. In one case, the taxpayer belatedly attempted to treat sales of a partnership and stock in a corporation as one single business unit in order to meet the 30 percent test. The partnership and the stock were sold at the same time, but separate sales agreements were provided. The court found that the taxpayers had conducted the businesses separately and viewed their sale as separate transactions. Consequently, these assets could not be brought together merely to serve the seller's tax objectives.[69]

Fragmenting the sale of a single asset

Sometimes a taxpayer will want to qualify a sale for § 453 treatment, but for some reason needs more than 30 percent of the selling price as a down payment. It is conceivable that the sale can be structured in such a way as to make § 453 at least partially applicable. In one case, the taxpayer sold a tract of land for $262,800, of which $118,020 was paid immediately in cash, the balance being represented by the buyer's notes which were secured by a purchase money mortgage on a portion of the land. Taking into consideration testimony that suggested a logical division of the land into two parcels, the Tax Court treated this as a sale of one tract for $98,350 cash and a sale of the other tract (the land subject to the mortgage) for only $19,670 cash and notes of $114,780 (the

total face value of the buyer's notes).[70]

Thus, in situations where the asset sold has multiple purposes or lends itself to being viewed as the aggregation of separate parts, this planning technique may enable a sizable down payment without the total unavailability of § 453. The taxpayer should be cautioned as to the uncertainty of this approach as it is based upon a case with rather unusual facts. Proper adherence to form, however, may make this a viable approach in a situation which would otherwise offer no hope for installment reporting.

SALES BETWEEN RELATED TAXPAYERS

Sometimes the taxpayer desires the benefits of § 453 but does not really wish to part with the property in question, or perhaps he wants the immediate availability of more cash than would be allowed under the 30 percent limitation of § 453. To accomplish the first objective, he may want to "sell" the property to his spouse or children on an installment basis. He receives the tax benefits of § 453 but has kept the property within the family. If the need for cash outweighs the desire to keep the property within the family, the transferee family member can "resell" the property to an outsider and require much more than a 30 percent down payment. It makes no difference whether this second sale qualifies for § 453 as it will result in little or no gain since the second seller will have a cost basis equal to the selling price of the first sale.[71] This arrangement is so attractive that it comes as no surprise that the IRS has ruled that an installment sale to a spouse, child or controlled corporation, coupled with a prearranged sale to an outsider in the same year, will not qualify for § 453. The rationale for one of the rulings in this area was that the "installment sale" lacked reality and served no purpose other than to reduce income taxes.[72] The other ruling viewed the transferee spouse as merely acting as the original owner spouse's agent in effecting the sale of the property to the outsider.[73]

It should be noted, however, that the applicability of these rulings depends upon a finding of a prearranged plan to resell the property. In a recent case,[74] an installment sale was made between spouses. The buying spouse, the husband, resold the property within the same year. The husband used the proceeds to satisfy a personal obligation. The IRS did not contend that a prearranged plan existed and the court found nothing wrong with the transactions. Hence the original owner, the wife, continued to report her gain on the installment basis even though her husband had resold the property for cash. Since they filed a joint return for the year of the transactions, both spouses benefited from the availability of installment reporting of the gain from the sale of the property from the wife to her husband. For planning purposes, four factors in this case deserve emphasis. The second sale was not prearranged, the spouses were separate, healthy economic entities, the proceeds of the second sale by the husband did not directly benefit his wife, and the installment sale was made at FMV.

What is or is not prearranged gets one into the metaphysical, nevertheless, for practical purposes it probably dictates a Court Holding/Cumberland approach.[75] That is, care should be taken that negotiations with the outside buyer are not conducted by the original owner spouse and should not begin prior to the installment sale between spouses. As for the financially independent element, care should be taken to ensure that neither spouse can be viewed as being subordinate to the other in their financial affairs. In some situations, this may be

accomplished only through the use of a trust arrangement.

By having the taxpayer deal with a trustee, especially an independent trustee, the appearance of arm's-length dealing is preserved. In fact, utilization of a trust also served in one case to successfully combat the application of the "prearrangement" theory detailed in the revenue rulings discussed earlier.[76]

In that case, the taxpayer sold stock in a closely held corporation to an irrevocable trust on the installment basis after the corporation had adopted a § 337 one-year plan of liquidation. Although this prearranged liquidation was the tax equivalent of a prearranged resale, the court allowed the taxpayer to utilize § 453 because the sellers had parted with all control over the proceeds from the second sale (the liquidation) and derived no economic benefit from the liquidation.

MECHANICS OF INSTALLMENT REPORTING

Section 453 allows the taxpayer to spread the gain realized from the installment sale over the taxable years in which payments are received. In order to compute the taxable gain in any particular year, a formula must be determined at the time of the sale. This formula only makes sense after a complete understanding of the terminology is acquired.

Selling price

The selling price is the total amount involved in the sale. It includes cash, the FMV of any other property received by the seller, and the face amount of any notes or other evidences of indebtedness of the buyer. If there is an existing mortgage on the property, it is also included as a portion of the selling price, as long as it is either assumed by the buyer or the property is sold subject to the mortgage. Since § 453 is available only if the payments received by the seller in the year of sale do not exceed 30 percent of selling price, knowledge of the exact amount of the selling price is essential. As discussed earlier in this article, the amount of the selling price is not always obvious.

Generally, the total selling price must be ascertainable at the time of sale in order for the seller to qualify for installment reporting.[77] However, the IRS recently ruled that a nonascertainable sales price in a casual sale of personal property did not prevent use of installment reporting by the seller as long as the sales price became ascertainable before the end of the seller's taxable year.[78] The same rule would logically extend to the sale of real property.

Gain realized

The gain realized is calculated by subtracting the selling expenses and the seller's adjusted basis in the property sold from the selling price. Gross profit is a term often used in lieu of gain realized.

Contract price

The contract price is the total amount to be received by the seller from the buyer. In a sense, it is the seller's equity in the property at the time of sale. For example, if S sells to B property which is subject to a $50,000 mortgage for a selling price of $200,000, in exchange for a $20,000 down payment and B's obligation with a face value of $130,000, the contract price is $150,000. (This assumes that S's basis in the property exceeded the mortgage.)

An exception to the general rule occurs when the amount of the mortgage on the property exceeds S's basis, in which case that excess is treated as part of the contract price. If S's basis in the above example was only $40,000, the contract price would be increased by the $10,000 excess of mortgage over basis,

resulting in a contract price of $160,000.

The contract price is also increased by the amount of certain liabilities of the seller which are paid by the buyer. If the liabilities arose directly out of the sale itself (i.e., brokerage fees, legal and accounting costs), as opposed to liabilities which had been incurred by the seller in the ordinary course of business, the amount assumed or paid by the buyer will increase both the payments received in the year of sale and the contract price.[79]

Payments received in the year of sale

Knowledge of the exact amount of the payments received in the year of sale by the seller is essential in order to ensure compliance with the 30 percent test. As discussed earlier in this article, payments in the year of sale include more than just the down payment; such payments can also include earnest and option money received in years before the year of sale, any payments actually or constructively received during the year of sale, and certain evidences of indebtedness of the buyer (e.g., marketable bonds, demand notes).

Gross profit percentage

The gain which is recognized and therefore taxable in any year is determined by multiplying the amount of payments received in that year by the gross profit percentage. This percentage results from the division of the contract price into the gross profit.

For example, S sells property, with a basis of $100,000 and subject to a $50,000 mortgage, to B for a selling price of $200,000. B makes a down payment of $60,000 and gives his interest-bearing note, payable $10,000 per year for nine years beginning in the year after the year of sale. If S elects to have his gain taxed under § 453, his gross profit would be $100,000 ($200,000 selling price — $100,000 basis). The contract price is $150,000 ($200,000 selling price — $50,000 mortgage). The gross profit percentage would then be 66⅔ percent ($100,000 gross profit ÷ $150,000 contract price). Since a $60,000 payment (other than B's note) is received by S in the year of sale, 66⅔ percent of this amount, or $40,000, will be reportable for that year. In the second year when $10,000 plus interest is received, 66⅔ percent of $10,000, or $6,667, will be reportable for that year. If the property was a capital asset in S's hands and if his holding period at the time of the sale exceeded six months, all of this gain would be reported as a long-term capital gain, except to the extent of depreciation which would be subject to recapture.[80] If the sale resulted in the recapture of depreciation, the income portion of each installment payment is deemed to consist of recaptured depreciation until all such ordinary gain has been reported.[81] Interest collected on the notes would be taxed according to S's regular method of accounting and would be treated as ordinary income.

Selling expenses

As explained above, the excess of the amount of the existing mortgage over the seller's basis in the property is considered a payment in the year of sale for purposes of the 30 percent test. How selling expenses fit into this situation has been and continues to be an uncertain area.

The Ninth Circuit Court of Appeals has held that the seller's expenses of sale are an addition to his basis in determining the excess mortgage amount.[82] Unfortunately, the IRS has stated that it will not follow that decision.[83] Instead, it contends that basis is unaffected by selling expenses. The importance of this issue is illustrated by the following figures:

Selling price	$500,000
Basis of property	100,000

Selling expenses	25,000
Existing mortgage on property	175,000
Down payment	80,000

If case law is followed, the excess of mortgage over basis, $75,000, is reduced by the selling expenses of $25,000. Consequently, for purposes of the 30 percent test, the seller is considered to have received $130,000; that is, cash of $80,000 and the "excess mortgage" of $50,000. This amounts to 26 percent of selling price and hence qualifies the sale for § 453 treatment. However, if the IRS position were followed, the excess mortgage would be $75,000 (unreduced by selling expenses) and, together with the $80,000 cash received, would amount to $155,000, or 31 percent of the selling price. Section 453 would then be inapplicable. Since this is an all or nothing type of situation, a prudent taxpayer should steer clear of the argument.

TO ELECT THE INSTALLMENT METHOD

Since § 453 is optional, the taxpayer must make an election to obtain its benefits. Generally, the election must be made in the year of sale and must be made for each qualifying sale for which installment reporting is desired. An election to report under § 453 in one year for one or more sales has absolutely no effect on the taxpayer's ability or requirement to elect § 453 in other years or for other sales.

The election is made by the taxpayer "who sells or otherwise disposes of" the property.[84] Consequently, the election is made by the trustee of nongrantor trust.[85] Furthermore, a partnership, not the partners, makes the election.[86]

Unfortunately, neither the statute nor the regulations thereunder address the question of when the nondealer seller is required to make the election. Consequently, this void has been filled by numerous court decisions and an extensive, but somewhat inconclusive, revenue ruling.[87]

Basically, it appears that a retroactive election is sometimes allowed if made in "good faith" and prior to the running of the statute of limitations for the filing of the return for the year of sale.[88] The ruling also requires that no election inconsistent with the installment election had been made with respect to the sale. This clouds the issue since it is not clear as to what constitutes an "inconsistent election." The cases have not directly addressed this particular issue, but several of them have implied that an invalid election is to be considered as no election.[89]

This is important because the desire for a retroactive election usually arises in the situation where the seller had claimed that the buyer's obligation had no ascertainable FMV and, therefore, reported the gain from the sale under the cost recovery method (see discussion of cost recovery above, under "Cash Basis Taxpayer").[90] Upon being audited, he learned that almost everything is subject to an ascertainable FMV, even though sometimes at a substantial discount, and thus the seller desires to reduce his taxes due to the sale by making a retroactive election to report on the installment basis. If his original election to utilize the cost recovery method is found to be invalid, the seller can argue that he never made an "inconsistent election" and, therefore, should be entitled to make a good faith retroactive election of installment reporting.

Proper planning can provide a much stronger argument for a retroactive election. If a sale qualifies under § 453, but the cost recovery method is preferable, the taxpayer can provide for the possibility that the cost recovery method will be found inappropriate (a very real possibility) by making an alternative election to

report under § 453. The taxpayer did this in one instance and the IRS conceded that the election, as an alternative method of reporting, was proper.[91]

There is some question as to why this particular concession was made and some commentators feel that the IRS will continue to object to almost every retroactive election, even if it is listed as an alternative election in the year of sale.[92] From a planning point of view, this uncertainty makes no difference as the taxpayer in the proper situation has much to gain and little to lose in making the alternative election.

Revocation of the election

Once an election under § 453 has been made, it may not be revoked, whether by amending the return for the year of sale or otherwise.[93] Section 453 would not be desirable if losses from other sales exist which would offset the entire gain from the sale which is eligible for installment reporting. In such a situation, by electing § 453 in error, the tax benefits of the losses may be lost forever.

DISPOSITION OF INSTALLMENT OBLIGATIONS

If the installment obligation is satisfied at other than face value or sold or exchanged, gain or loss is recognized of the difference between the amount realized on the satisfaction, sale or exchange and the basis of the obligation.[94] The basis is the unrecovered cost element in the obligation; that is, the excess of the face value of the obligation over the amount of income which would be returnable if the obligation were fully satisfied.[95]

For example, if the buyer's $10,000 note is sold for $9,000, the recognized gain or loss would be the difference between the amount realized, $9,000, and the basis of the obligation. If the gross profit percentage was 80 percent, gain of 80 percent of $10,000, or $8,000, has yet to be taken income; the basis would be $2,000, the note's face value less the amount yet to be reported as income. Therefore, in this case, the seller would have a $7,000 gain ($9,000 amount realized — $2,000 basis) on the sale of the obligation. The character of this gain is determined by the nature of the gain on the sale of the underlying property.[96]

Pledge vs. sale

The question often arises whether the buyer's obligation was pledged for a loan or sold with a guarantee. The former is not a disposition, and therefore not a taxable event, whereas the latter does constitute a taxable disposition.[97]

The problem normally occurs because the installment seller, for some reason, needs or wants to raise additional funds. To do so, he generally enters into an agreement whereby he is advanced cash against the buyer's obligation, but he has to guarantee its payment. The economic effect is the same whether the transaction is called a sale with recourse or a secured loan. The courts have laid down a number of factors which can sway their determination. For example, the name given to the arrangement can make a difference.[98] More important is the structure of the arrangement. The installment seller should retain the obligation and continue to collect it for the benefit of the lender.[99] Where practical, some security, in addition to the obligation itself, should be given.[100] Formalities normally followed in a loan situation should be adhered to as much as possible. Finally, if possible, payments on the loan should not exactly coincide with the collection of the obligation.[101]

Substitution of obligor or security

In *Burrell Groves, Inc.*, the taxpayer sold property, received back the buyer's obligation and elected to report on the

installment basis.[102] The buyer later sold the property to a third party. The taxpayer surrendered the original obligation of the first buyer and received, in exchange, the obligation of the new buyer, bearing a different interest rate and different maturity dates. The court found this to be a taxable disposition under § 453.

Since that time, however, IRS rulings and court cases have permitted separately what the court in *Burrell Groves, Inc.* disallowed in the aggregate.[103] Revenue Rulings 55-5 and 74-157 permitted the substitution of security, Revenue Ruling 68-419 permitted the modification of the buyer's obligation, and the Tax Court permitted the substitution of obligors. If none of these changes by itself results in a taxable disposition, it is reasonable to conclude that the three changes together should not result in such a disposition. For planning purposes, however, prudence dictates that at least one of these aspects of the obligation be left unchanged. Furthermore, supporting documentation should be prepared to emphasize the intent to substitute security or modify the obligation, rather than to exchange one obligation for another. Although it is a fine line, it is one which may very well make the difference.

Repossession

The repossession of property sold by the seller following default by the buyer is a taxable disposition.[104] The rules for determining the resulting gain or loss depend upon whether the property repossessed is personalty or realty.

The gain or loss on the repossession of personal property is the difference between the FMV of the property when repossessed and the seller's basis in the installment obligation adjusted for costs incurred in the repossession.[105] Whether title was retained by the seller or transferred to the buyer makes no difference.[106] For example, seller sells a painting to B for $100,000; B gives seller $30,000 and his 6 percent note in the amount of $70,000, payable $10,000 per year over the next seven years. Assuming a basis in the painting of $50,000, S has a realized gain of $50,000 ($100,000 selling price — $50,000 basis). B defaults in year two, before making any payments on his note, so S repossesses the painting. At the time of repossession an objective third party appraises the painting as having a FMV of only $60,000.

Because of the repossession, S will have a recognized gain of $25,000 ($60,000 FMV — $35,000 basis in B's note). S's basis in B's note is computed by multiplying the outstanding balance, $70,000, by the gross profit percentage, 50 percent.

If the painting was valued at $30,000 as of the date of repossession, S would have a $5,000 recognized loss ($30,000 FMV — $35,000 basis in B's note).

The repossession of real property is subject to a different rule. Generally, a repossession of real property results in gain only to the extent that money and other property received by the seller exceeds the amount of the gain already recognized by him. The amount of the gain that is taxable, however, is limited to the gain on the original sale less repossession costs and gain previously reported as income.[107]

To illustrate this procedure, assume the facts in the example above, except that land, rather than a painting, is the subject of the sale and repossession. In this situation, S will have a recognized gain of $15,000 ($30,000 cash received — $15,000 gain already recognized). This is the result regardless of the then FMV of the real property.

Disposition of buyer's obligation other than by sale or exchange

If the buyer's obligation is disposed

of in any manner other than by satisfaction at other than its face value, or by sale or exchange, the gain or loss recognized will be the difference between the FMV of the obligation at the time of the disposition and the basis of the obligation.[108] For example, the transfer of installment obligations pursuant to a divorce decree is a taxable disposition.[109] However, an installment obligation transmitted by the death of the holder is not a tax disposition.[110] In this situation, the installment obligation is treated as income in respect of decedent and taxed to the estate or beneficiary in the same manner as the decedent would have been taxed had he lived to receive the payments.[111]

Gratuitous transfer of an installment obligation

A gift of an installment obligation constitutes a taxable disposition.[112] The IRS has ruled that the same result is reached where the donee of the gift is the debtor.[113]

Nevertheless, the holder of an installment obligation may benefit by making a gift of that obligation. If the gift is to a charitable organization, the donor gets a charitable deduction based on the FMV of the obligation.[114]

Also, an installment sale may prove to be the perfect vehicle for making annual gifts which qualify for the $3,000 gift tax exclusion.[115] By systematically cancelling the buyer's obligation to make principal and interest payments, the seller may avail himself of the annual gift tax exclusion. Moreover, some authority exists for the argument that a "cancellation" of the obligation, rather than delivery of the uncancelled obligation to the buyer, constitutes a "satisfaction at less than face value," thus, not being considered a taxable disposition to the seller.[116]

Transfer of an installment obligation to or from a trust

A gratuitous transfer of an installment obligation to a trust generally results in a taxable disposition.[117] Exceptions occur when the trust is a grantor trust or when only the right to collect the interest, rather than principal, is transferred to a short-term trust.[118] A distribution of installment obligations by a trust to its beneficiaries, whether during the term of the trust or at the termination of the trust, is a taxable disposition.[119] Presumably, the same rule would be applicable to a distribution of such obligations from an estate to its beneficiaries, provided that the obligations arose from the sale of property by the estate. Under such circumstances, it would be preferable to have the property distributed to the beneficiaries prior to the sale so that they may elect the installment method, if they so qualify.

Transfers not regarded as dispositions

In addition to installment obligations transmitted at death, several other transfers escape being taxed as dispositions.

A renegotiation of the sales price does not constitute a taxable disposition.[120] As the result of a renegotiation, the realized gain on the sale must be recomputed. The difference between the recomputed gain and the gain already reported in prior years must be reported ratably upon receipt of the remaining recomputed installments.[121]

The transfer of an installment obligation to a corporation will not constitute a taxable disposition so long as the transfer qualifies for nonrecognition under § 351 (relating to transfers to a controlled corporation) or § 361 (relating to certain reorganizations).[122] An exception occurs, however, when the transferee corporation is the obligor under the installment obligation.[123] Certain corporate liquidations can result in the transfer of an installment obligation not being

treated as a disposition.[124] However, in a § 337 one-year plan of liquidation the FMV of the buyer's obligation must be taken into account by the shareholders in computing their gain or loss on the liquidation distribution. Thus, it is important to remember that when a corporation is arranging for a sale of its assets after adopting a one-year plan of liquidation, its stockholders can derive no tax-deferral benefits from a sale on the installment basis, even though there may be business reasons for spreading the payments over a period of time.[125]

The transfer of an installment obligation to or from a partnership will generally not constitute a taxable disposition.[126]

If the installment obligations are transferred in a transaction which does not result in a gain or loss, the transferee assumes the transferor's basis in the obligations.[127]

NOTES

1. Unless otherwise indicated, all section references are to the Internal Revenue Code of 1954, as amended, and the regulations promulgated thereunder; Section 453 can not be utilized to report losses, Rev. Rul. 70-430, 1970-2 C.B. 51; Martin v. Comm'r, 61 F.2d 942 (2nd Cir. 1932).

2. Section 1002.

3. Section 1001(b).

4. Section 1001(a).

5. Sections 1221 and 1222.

6. Section 61(a)(3).

7. E. D. Rivers, Jr., 49 T.C. 663 (1968), Acq., 1968-2 C.B. 2; capital gain could result under § 1232 if B was a corporation and collection of the note qualified as a bond retirement.

8. *Id.*

9. Section 61.

10. Burnet v. Logan, 283 U.S. 404 (1931); § 453 is unavailable when the contract provides for an open-ended selling price. Gralapp v. U.S., 458 F.2d 1158 (10th Cir. 1972), *aff'g* 319 F. Supp. 265 (Kan. 1970); Steen v. U. S., 508 F.2d 268 (5th Cir. 1975), *aff'g* 61 T.C. 298 (1973).

11. Regs. § 1.1001-1(a); *see also* Regs. § 1.453-6(a)(2); Rev. Rul. 58-402, 1958-2 C.B. 15.

12. Warren Jones Co., 36 AFTR2d 75-5954 (9th Cir. 1975), *rev'g* 60 T.C. 663 (1973).

13. Warren Jones Co., 36 AFTR2d 75-5954 (9th Cir. 1975), *rev'g* 60 T.C. 663 (1973). *But see* Estate of Clarence W. Ennis, 23 T.C. 799 (1955), Nonacq., 1956-2 C.B. 10; Estate of Coid Hurlburt, 25 T.C. 1286 (1956), Nonacq., 1956-2 C.B. 10; Rev. Rul. 68-606, 1968-2 C.B. 42.

14. Regs. § 1.451-1(a).

15. H. Liebes & Co. v. Comr., 90 F.2d 932 (9th Cir. 1937).

16. Regs. § 1.453-6(a)(1); *but see* Rev. Rul. 68-606, 1968-2 C.B. 42.

17. Under § 7701(a)(1), the term "person" includes an individual, a trust, estate, partnership, association, company or corporation.

18. Section 453(b).

19. Regs. § 1.453-1(b).

20. Regs. § 1.453-1(a).

21. Regs. § 1.453-7(a).

22. Regs. § 1.453-8(a)(1).

23. Regs. § 1.453-1(d).

24. Section 453(c)(4).

25. Section 453(b)(2)(A)(ii).

26. Rev. Rul. 69-462, 1969-2 C.B. 107.

27. 10-42 Corporation, 55 T.C. 593 (1971) Nonacq., 1972-2 C.B. 4; Baltimore Baseball Club, Inc. v. U.S., 481 F.2d 1283 (Ct. Cls. 1973).

28. Section 453(b)(2)(A)(ii); Daniel Rosenthal, 32 T.C. 225 (1959).

29. Rev. Rul. 73-369, 1973-2 C.B. 155.

30. Regs. § 1.453-5(a).

31. Spielberger v. U.S., 58-1 USTC 9431, 1 AFTR2d 1435 (S.D. Calif. 1958).

32. Regs. § 1.453-4(c); Burnet v. S & L Building Corporation, 288 U.S. 406 (1933).

33. Regs. § 1.453-4(c); Burnet v. S & L Building Corporation, 288 U.S. 406 (1933); Waldrep v. Comm'r, 428 F.2d 1216 (5th Cir. 1970), *aff'g* 52 T.C. 640 (1969); Richards, T.C. Memo 1972-126; Ledford v. U.S., 492 F.2d 1186 (9th Cir. 1974), *aff'g* D.C. Calif., 5/18/72.

34. The Stonecrest Corp., 24 T.C. 659

(1955), Nonacq. 1956-1 C.B. 6; Estate of E. P. Lamberth, 31 T.C. 302 (1958), Nonacq. 1959-1 C.B. 6; United Pacific Insurance Corp., 39 T.C. 721 (1963); *but see* Waldrep v. Comm'r, 428 F.2d 1216 (5th Cir. 1970).

35. *But see* § 453(b)(3) for a description of some buyer obligations which will be considered as payment in the year of sale.

36. Rev. Rul. 73-555, 1973-2 C.B. 159; U.S. v. Marshall, 357 F.2d 294 (1966); Comm'r v. Irwin, 390 F.2d 91 (5th Cir., 1968).

37. Denco Lumber Co., 39 T.C. 8 (1962), acq. in result only, 1963-2 C.B. 4; *also see* Albert W. Turner, 33 TCM 1167 (1974).

38. U.S. v. Marshall, 357 F.2d 294 (1966); Comm'r v. Irwin, 390 F.2d 91 (5th Cir. 1968); Clodfelter v. Comm'r, 426 F.2d 1391 (9th Cir. 1970), *aff'g* 48 T.C. 694 (1967); Rev. Rul. 76-109, C.R.B. 1976-13, p. 10.

39. Rev. Rul. 73-555, 1973-2 C.B. 159.

40. Rev. Rul. 73-555, 1973-2 C.B. 159; Wagegro Corporation, 38 BTA 1225 (1933), Acq., 1939-1, Part I, C.B. 36.

41. Section 483, Shanahan v. U.S., 447 F.2d 1082 (10th Cir., 1971).

42. Regs. Section 1.483-1(c)(2)(B); for payments on account of a sale or exchange of property entered into before July 24, 1975, as well as a sale or exchange of property pursuant to a binding written contract entered into before such date, the interest rates utilized in § 483 are 4 percent / 5 percent instead of the current 6 percent / 7 percent rates.

43. Regs. § 1.483-1, Table VI.

44. Estate of Betty Berry, 43 T.C. 723 (1965), *aff'd* 372 F.2d 476 (6th Cir. 1967); Robinson, 434 F.2d 767 (8th Cir. 1971), *aff'g* 54 T.C. 772 (1970).

45. Spencer v. Granger, 102 F. Supp. 205 (W. D. Pa. 1952).

46. Lewis M. Ludlow, 36 T.C. 102 (1961), Acq. 1961-2 C.B. 5.

47. Dean W. Cox, 62 T.C. 247 (1974).

48. Rev. Rul. 73-396, 1973-2 C.B. 161.

49. Hendrix v. U.S., 73-2 USTC 9723, 32 AFTR2d 73-6089 (D.C. Ore., 1973); Everett Pozzi, 49 T.C. 119 (1967); Rev. Rul. 73-451, 1973-2 C.B. 158; Rev. Rul. 71-352, 1971-2 C.B. 221.

50. Rev. Rul. 68-246, 1968-1 C.B. 198; Gibbs & Hudson, Inc., 35 B.T.A. 205 (1936).

51. J. Earl Oden, 56 T.C. 569 (1971).

52. Rev. Rul. 73-451, 1973-2 C.B. 158.

53. Bolthrope v. Comm'r, 356 F.2d 28 (5th Cir. 1966).

54. Section 453(b)(3); Regs. § 1.453-3.

55. R. L. Brown Coal & Coke Co., 14 B.T.A. 609 (1928), Acq. IX-1 C.B. 8; *but see* "Caveat" 48 4th T.M. p. A-26.

56. Carl F. Holmes, 55 T.C. 53 (1970).

57. W. H. Batcheller, 19 B.T.A. 1050 (1939); Riss v. Comm'r, 368 F.2d 965 (105th Cir., 1966); U.S. v. Ingalls, 399 F.2d 143 (5th Cir. 1968); John H. Rickey, 54 T.C. 680 (1970), *aff'd* 502 F.2d 748 (9th Cir. 1974); Big "D" Development Corp. v. Comm'r, T.C. Memo. 1921-148, *aff'd* 453 F.2d 1365 (5th Cir. 1972).

58. Riss v. Comm'n, 368 F.2d 965 (10th Cir. 1966); U.S. v. Ingalls, 399 F.2d 143 (5th Cir. 1968); John H. Rickey, 54 T.C. 680 (1970), *aff'd* 502 F.2d 748 (9th Cir. 1974).

59. Rev. Rul. 65-155, 1965-1 C.B. 356.

60. Clinton H. Mitchell, 42 T.C. 953 (1964). *But see* Charles W. Yaeger, 18 T.C.M. 192 (1959); Richard H. Prichett, 63 T.C. 149 (1974), Acq. I.R.B. 1975-21, p. 5.

61. Section 302(b)(3); Zenz v. Quinlivan, 213 F.2d 914 (6th Cir. 1954).

62. Farha v. Comm'r, 483 F.2d 18 (10th Cir. 1973), *aff'g* 58 T.C. 526 (1972).

63. Williams v. McGowan, 152 F.2d 570 (2d Cir. 1945).

64. Rev. Rul. 76-110, I.R.B. 1976-13, p. 11.

65. Rev. Rul. 55-79, 1955-1 C.B. 370.

66. Rev. Rul. 68-13, 1968-1 C.B. 195; Rev. Rul. 75-323, I.R.B. 1975-31, p. 19; Monaghan, 40 T.C. 680 (1963); Lubken, 8 AFTR2d 5073 (D.C. Calif. 1961).

67. Bar-Deb Corporation v. U.S., 75-1 USTC 9453 (Ct. Cls. 1975); Richard H. Pritchett, 63 T.C. 149 (1974), Acq. I.R.B. 1975-21, p. 5; James A. Johnson, 49 T.C. 324 (1968).

68. Bar-Deb Corporation v. U.S., 75-1 USTC 9453 (Ct. Cls. 1975).

69. Farha v. Comm'r, 483 F.2d 18 (10th Cir. 1973), *aff'g* 58 T.C. 526 (1972).

70. Charles A. Collins, 48 T.C. 45 (1967), Acq., 1967-2 C.B. 2.

71. Section 1012.

72. Rev. Rul. 73-157, 1973-1 C.B. 213.

73. Rev. Rul. 73-536, 1973-2 C.B. 158.

74. Nye v. U.S., 36 AFTR2d 75-5150 (D.C.N.C., 1975).

75. Comm'r v. Court Holding Co., 324 U.S. 331 (1945); U.S. v. Cumberland Public Service Co., 338 U.S. 451 (1950); these famous cases dealt with the problem of determining which entity "arranged" the sale of a corporation's assets, the corporation itself or the shareholders who, upon receipt of the assets through a liquidating distribution of the corporation, immediately closed the sale.

76. Rushing v. Comm'r, 441 F.2d 593 (5th Cir. 1971), *aff'g* 52 T.C. 888.

77. Gralapp v. U.S., 458 F.2d 1158 (10th Cir. 1972); Steen v. N.S., 508 F.2d 268 (5th Cir. 1975), aff'g 61 T.C. 298 (1973).

78. Rev. Rul. 76-109, I.R.B. 1976-13, p. 10.

79. Rev. Rul. 76-109, I.R.B. 1976-13, p. 10.

80. Sections 1245 and 1250.

81. Regs. § 1.1245-6(d); Dunn Construction Co., Inc. v. U.S., 323 F. Supp. 440 (N.D. Ala. 1971); Regs. § 1.1250-1(c)(6).

82. Kirschenmann v. Comm'r, 488 F.2d 270 (9th Cir. 1973).

83. Rev. Rul. 74-384, 1974-2 C.B. 152.

84. Regs. § 1.453-8(b).

85. Marcello v. Comm'r, 414 F.2d 268 (5th Cir. 1969).

86. Section 703(b); Scherf, 20 T.C. 346 (1953).

87. Rev. Rul. 65-297, 1965-2 C.B. 152.

88. Mamula v. Comm'r, 346 F.2d 1016 (9th Cir. 1965); Estate of Broadhead, T.C.M. 1972-195; Rev. Rul. 74-421, 1974-2 C.B. 151; for nonallowance due to bad faith, *see* John Harper, 54 T.C. 1121 (1970) Acq., 1971-2 C.B. 2; Yellow Cab and Car Rental Co., T.C.M. 1974-79.

89. Mamula v. Comm'r, 346 F.2d 1016 (9th Cir. 1965); Estate of Broadhead, T.C.M. 1972-195.

90. Burnet v. Logan, 283 U.S. 404 (1931).

91. Warren Jones Company, 36 AFTR2d 75-5954 (9th Cir. 1975), *rev'g* 60 T.C. 663 (1973).

92. BNA, TMM 75-25, p. 7.

93. Pacific National Co. v. Welch, 304 U.S. 191 (1938); Ivan D. Pomeroy, 54 T.C. 1716 (1970); Youngblood v. U.S., 507 F.2d 1263 (5th Cir. 1975).

94. Section 453(d)(1)(A); Rev. Rul. 73-423, 1973-2 C.B. 161.

95. Section 453(d)(2); Regs. § 1.453-9.

96. Section 453(d)(1); Regs. § 1.453-9.

97. Pledge of the obligation as security for a loan is not taxable disposition. East Coast Equipment Co. v. Comm'r, 222 F.2d 676 (3rd Cir. 1955); United Surgical Steel Co., Inc., 54 T.C. 1215 (1970) Acq., 1971-2 C.B. 3; Town and County Food Co., Inc., 51 T.C. 1049 (1969); Acq. 1969-2 C.B. XXV; Yancy Bros. Co. v. U.S., 319 F. Supp. 441 (N.D. Ga. 1970). *But see* Dessauer Comm'r, 449 F.2d 562 (8th Cir. 1971), *rev'g* and *rem'g* 54 T.C. 327 (1970). Sale of the obligation with a guaranty is a taxable disposition. Estate of Broadhead, T.C. Memo 1972-195; John B. Mathers, 57 T.C. 666 (1972) Acq., 1973-1 C.B. 2.

98. Town and County Food Co., 51 T.C. 1049 (1969) Acq., 1969-2 C.B. XXV; United Surgical Steel Co., 54 T.C. 1215 (1970).

99. Town and County Food Co., 51 T.C. 1049 (1969) Acq. 1969-2 C.B. XXV; Rev. Rul. 65-185, 1965-2 C.B. 153; Joe D. Branham, 51 T.C. 175 (1968); Packard Cleveland Motor Co., 14 B.T.A. 118 (1928).

100. Town and County Food Co., 51 T.C. 1049 (1969) Acq. 1969-2 C.B. XXV.

101. United Surgical Steel Co., 54 T.C. 1215 (1970); Yancy Bros. Co. v. U.S., 70-2 USTC 9619 (N.D. Ga. 1970).

102. Burrell Groves Inc., 223 F.2d 526 (5th Cir. 1955), aff'g. 22 T.C. 1134 (1954).

103. Rev. Rul. 55-5, 1955-1 C.B. 331; Rev. Rul. 68-419, 1968-2 C.B. 196; Rev. Rul. 68-246, 1968-1 C.B. 198; Rev. Rul. 74-157, 1974-1 C.B. 115; Rev. Rul. 61-215, 1961-2 C.B. 110; John I. Cunningham, 44 T.C. 103 (1965) Acq., 1966-2 C.B. 4; Sam F. Soter, 27 T.C.M. 194 (1968); Wynne, 47 B.T.A. 731 (1942), Rev. Rul. 75-457, I.R.B. 1975-43, p. 8.

104. Baca Raton Co. v. Comm'r, 86 F.2d

9 (3rd Cir. 1936); Walker v. Thomas, 119 F.2d 58 (5th Cir. 1941); Morrison, 12 T.C. 1178 (1949); Spencer v. Granger, 102 F. Supp. 205 (W.D. Ga. 1952).

105. Regs. § 1.453-1(d).

106. Regs. § 1.453-1(d).

107. Section 1038.

108. Section 453(d)(1)(B).

109. Redmon v. U.S., 471 F.2d 687 (6th Cir. 1973), *aff'g* D.C. Ky., 3-15-72; Harry L. Swain, 417 F.2d 353 (6th Cir. 1959).

110. Section 453(d)(3).

111. Section 691(a)(4).

112. Marshall v. U.S., 26 F. Supp. 580 (S.D. Cal. 1939).

113. Rev. Rul. 55-157, 1955-1 C.B. 293.

114. Rev. Rul. 55-157, 1955-1 C.B. 293.

115. Section 2503(b).

116. Miller v. Usry, 160 F. Supp. 368 (W.D. La. 1958).

117. Marshall v. U.S., 26 F. Supp. 580 (S.D. Cal. 1939); A. W. Legg, *aff'g* 496 F.2d 1179 (9th Cir. 1974); 57 T.C. 164 (1971); Rev. Rul. 67-167, 1967-1 C.B. 107; Springer v. U.S. (D.C. Ala. 7/7/69).

118. Rev. Rul. 67-70, 1967-1 C.B. 106; Rev. Rul. 74-613, 1974-2 C.B. 153, *superceding* Rev. Rul. 73-584, 1972-2 C.B. 16.

119. Rev. Rul. 55-159, 1955-1 C.B. 391.

120. Rev. Rul. 55-429, 1955-2 C.B. 252; Sam F. Soter, 27 T.C.M. 194 (1968); Rev. Rul. 68-419, 1968-2 C.B. 196.

121. L. P. Jerpe, 45 B.T.A. 199 (1941) Acq. 1942-1 C.B. 9; Rev. Rul. 72-570, 1972-2 C.B. 241.

122. Regs. § 1.453-9(c)(2); § 351, and § 361.

123. Rev. Rul. 73-423, 1973-2 C.B. 161.

124. Section 453(d)(4)(A) and (B).

125. *See* Kearns, "Tax Tips," 4 The Colorado Lawyer 2290 (November 1975).

126. Regs. § 1.453-9(c)(2); Regs. § 1.721-1(a) and § 731.

127. Regs. § 1.453-9(c)(3).

How to make saving as easy as spending.

Getting rid of the good old American Green is about the easiest thing in the world.

Everywhere you turn there's somebody ready and willing to help you. So you keep making it, and you keep spending it.

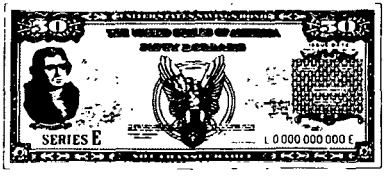
But, saving money is another matter.

That's why you should know about the Payroll Savings Plan. It makes saving about as easy as it's ever going to get. When you sign up for the Plan where you work, the amount you specify is set aside from each paycheck. That money is used to buy U.S. Savings Bonds.

The beautiful thing about the Payroll Savings Plan is that your money is saved for you before you, or anybody else, can get his hands on it.

And, now there's a bonus interest rate on all U.S. Savings Bonds—for E Bonds, 5½% when held to maturity of 5 years, 10 months (4% the first year). That extra ½%, payable as a bonus at maturity, applies to all Bonds issued since June 1, 1970 . . . with a comparable improvement for all older Bonds.

Join the Payroll Savings Plan where you work. Make saving as easy as spending.



Bonds are safe. If lost, stolen, or destroyed, we replace them. When needed, they can be cashed at your bank. Tax may be deferred until redemption. And always remember, Bonds are a proud way to save.

Take stock in America.

Now Bonds pay a bonus at maturity.