

THE LAW OF INSTALLMENT SALES

Question

Which section of the tax code governs installment sales?

Is a collateralized installment sale an installment sale within the meaning of Section 453?

Answer

Section 453 of the Internal Revenue Code provides for the tax effects of installment sales.

Yes. Section 453(a)(1) says, "The term 'installment sale' means a disposition of property where at least 1 payment is to be received after the close of the taxable year in which the disposition occurs."

(Photos by David Ryan Photography)



Question

Answer

What is the installment method of reporting?

Section 453(c) says, “For purposes of this section, the term ‘installment method’ means a method under which the income recognized for any taxable year from a disposition is that proportion of the payments received in that year which the gross profit (realized or to be realized when payment is completed) bears to the total contract price.” In other words, the taxpayer is required to pay the tax proportionately as the principal payments are received.

Is installment reporting automatic?

Under Section 453(d), an installment sale is entitled to installment reporting, unless the taxpayer affirmatively elects not to have it be treated as an installment sale.

In a collateralized installment sale, when are the principal payments made?

The timing of principal payments is governed by the installment contract. The payments of principal may occur by amortization or at scheduled times during the term of the contract, or the principal may be paid entirely at the end, which may be as long as 30 years after the beginning. If the latter, all of the tax is deferred for that 30 years.

Is the tax due, if the installment buyer re-sells the property before the installment contract is paid?

Under Section 453(e), resale by the installment buyer has no effect on the installment seller, if the installment buyer is unrelated to the installment seller.

Is the seller entitled to installment reporting if the seller could have had a cash sale?

Yes, under Section 453(d), cited above. Installment reporting has been included in the Internal Revenue Code from its very beginning, and the availability or non-availability of a cash sale as an alternative has never been a condition or a factor.

Is installment reporting available, if the installment obligation is guaranteed in some way?

Yes, under Section 453(f)(3), which says, “**(3) Payment.**—Except as provided in paragraph (4) [readily tradable securities transferred from buyer to seller], the term ‘payment’ does not include the receipt of evidences of indebtedness of the person acquiring the property (whether or not payment of such indebtedness is guaranteed by another person).”

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