

A Personal Experience with Installment Sales

When I was a brand-new, ready-to-be-licensed lawyer and also ready to purchase my first house, the owner of the house I chose preferred to “carry the paper”, to enjoy the benefits of an income stream from the property. He was concerned, though, about whether I would make the payments as promised.

As an indication of the times then, his way of assuring himself that I was a good risk was this: He asked only that the senior partner of the law firm which I was joining write a letter to the owner to say that I was reliable and had good prospects. I relayed the message to the senior partner, who said, “You write it, and I’ll sign it.”

I did, he did, the owner was satisfied, and I bought the house—and I really did make all of the payments! I didn’t really think of it as an installment sale, but that’s what it was.

What this story illustrates is that the installment sale which your parents and grandparents knew was often a transaction between two persons who knew and trusted each other, because of the clear risk that a seller might have to foreclose and repossess the property, if the buyer failed to pay in full.

With the widespread advent of trust deeds and varieties of kinds of third-party lending sources, installment sales faded into the



Stanley D. Crow
President, S.Crow
Collateral Corp.

background and ceased to be a significant part of the financing of purchases of either business or personal assets. Because sellers wanted to minimize foreclosure or repossession risk and because buyers wanted to be free from oversight by sellers, installment sales became a financial backwater.

My First Collateralized Installment Sale

In 1995 a rancher in Idaho contacted me for legal advice concerning an installment contract he had signed for the sale of some timber land. The rancher had expected and wanted a long-term income stream from the sale, but the buyer notified the rancher that the buyer had obtained other financing—the timber land was prime for resort development—and was about to pay the installment contract in full. The rancher asked whether there was any way to prevent the prepayment.

Upon examination of the contract I found no provision which prevented prepayment, so I asked the rancher for some time to think about what could be done.

The solution I devised was the forerunner of today’s collateralized installment sale. I arranged for another entity to assume the installment contract from the buyer. The rancher agreed to release the lien the rancher had retained on the land. The buyer paid the unpaid balance in full, but paid it to the entity which had assumed the installment contract. The cash proceeds were used to acquire mutual fund investments in the entity’s name and tax number, and the mutual-fund account made the installment payments to the rancher.

As a result, the rancher retained his desired income stream and installment reporting of the gain on sale, and the buyer obtained free and clear title and proceeded with development of the resort.

The Essence of a Collateralized Installment Sale

A collateralized installment sale is simply an installment sale in which the collateral or security for the unpaid purchase price is something other than the property or asset which is being sold.

Without their having been explicitly called “collateralized” installment sales, such sales have existed for a long time, maybe throughout history, as sellers and buyers have negotiated with each other over what collateral the buyers could provide, beyond or separate from the asset being sold.

It was that realization that helped me to see that an installment sale is simply a sale with time payments of the purchase price. What the security for the unpaid purchase price is, or even whether there is any security at all, has nothing to do with whether the sale is an installment sale. It was only common practice, and nothing inherent in an installment sale, which caused the asset being sold to be the *default*—but not the necessary—security for the unpaid purchase price.

Section 453 of the Tax Code

With that realization, I re-read the tax code. I was pleased to see that for tax purposes, as well, the meaning of an installment sale is, indeed, related only to whether payments are received over time.

Provision for Dealers, Such as S.Crow Collateral

Further, I found that Congress had understood that while individuals and businesses occasionally sell with installment contracts, dealers may regularly buy and sell with installment contracts, too—and Congress explicitly retained installment reporting (*i.e.*, tax deferral) for both occasional installment sales and for sales *to* dealers. Because S.Crow Collateral Corp. is a dealer, that includes installment sales to us.

Today's New Collateralized Installment Sales

Today, installment sales—especially collateralized installment sales—are re-making the financial marketplace once again. The reason why that is true is this: it turns out that collateralized installment sales are a fertile field for innovation, for ways to respond to changing conditions in financial and business markets.

While collateralized installment sales are in accord with Section 453 of the *Internal Revenue Code*—and for that reason we use “C453” as a short-hand name for these transactions—collateralized installment sales are about so much more than just taxes. For example, using C453's principles, we engage in transactions such as these:

- C453: For sale of appreciated assets, with tax deferral (as long as 30 years);
- C453-1031: For rescue of failing tax-deferred exchanges;
- C453-SL: For full recovery of troubled securitized commercial mortgage loans;
- C453-SS: For full recovery of troubled commercial mortgage loans in short sales;
- C453-PL: For full recovery of troubled commercial mortgage loans in a lender's portfolio;
- PC453: For 50-100 years of income on sale of high-value appreciated assets;
- C61: For anticipated ordinary-income lump sums, with tax deferral;
- C453-LS: For loan swaps linked to underlying restricted assets; and
- C453-__: For other circumstances, yet to arise.

What You May Achieve

What you may achieve in a C453 (in whatever form it takes) transaction with us can vary widely depending on the circumstances (consult your tax and legal advisers), but here are some possible benefits:

Sellers:

- Substantially increased investment return
- High level of security
- Freedom from asset management
- Investment flexibility and diversification
- Improved liquidity
- Easier issue resolution with buyers
- Protection from creditors
- Estate valuation discount and freeze
- Pay tax later, in depreciated dollars
- Pay tax later, and keep the principal intact

Lenders:

- Reduced risk:
 - Non-performing loan paid in full
 - Commensurate investment in government securities
 - Matching of investment and loan maturities
 - No property management
- New cash infusion:
 - Can be Tier 1 capital
 - Reverse loan-loss reserve
 - No net cost of funds
- Increased income
- Quickest path to break-even and profit
- Qualified transaction coordination and replication

Commercial Borrowers:

- Reduced debt-service cost
- Instant equity
- Potentially reduced property tax
- Positive cash flow and appreciation in value
- Easier agreement among multiple owners
- No debt-over-basis problem
- Potential for some extra cash out of the deal
- Good credit preserved or restored
- No costs of foreclosure, collection or deficiency

Buyers:

- Potential for some break on the purchase price
- Less deal resistance and easier issue resolution
- Potential to partner with existing borrowers
- New lender relationships
- Re-allocation of tax basis

The Story of the Collateralized Installment Sale

as told by
Stanley D. Crow

S.Crow Collateral Corp.

POST OFFICE BOX 972
BOISE, IDAHO 83701-0972
(208) 345-7561 or (866) 345-7561
E-MAIL: SCrowCollateral@aol.com
Web: www.SCrowCollateral.com