Internal Revenue Service Chief Counsel Advice 2019103109421213
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https://apps.irs.gov/app/picklist/list/writtenDeterminations.html

Issues Raised with the Structure of Some Promoters'
Monetized Installment Sales Transactions

On August 24, 2012, the Internal Revenue Service issued a Chief Counsel Memorandum (CCM) which approved a particular monetized installment sale transaction for purposes of tax deferral for installment reporting by the seller under *Internal Revenue Code* Section 453.

On May 7, 2021, the Internal Revenue Service issued a Chief Counsel Advice which identified six issues with the ways—ways that are not in accord with the CCM—in which certain promoters offer monetized installment sale transactions. Those six issues are reiterated *verbatim* below, and following each is an explanation how it is that the issue does not apply to a monetized installment sale in which S.Crow Collateral Corp. is the buyer. S.Crow Collateral Corp. does not offer or promote monetized installment sale transactions which do not accord with the CCM.

Issue #1: No genuine indebtedness. At least one promoter contends that the seller receives the proceeds of an unsecured nonrecourse loan from a lender, but a genuine nonrecourse loan must be secured by collateral. A "borrower" who is not personally liable and has not pledged collateral would have no reason to repay a purported "loan." *See Estate of Franklin v. CIR*, 544 F.2d 1045 (9th Cir. 1976). Therefore, the loan proceeds would be income.

How the S.Crow Collateral Corp. monetized installment sale differs from that:

1-1. The monetization loan from the lender with which S.Crow Collateral Corp. works is not non-recourse; it is limited recourse, and it's limited in only one respect: If S.Crow Collateral Corp. were to default on S.Crow Collateral Corp.'s installment obligation to the seller, to that extent and only to that extent and only while that default continues the lender may not compel the seller-borrower to pay more to the lender than S.Crow Collateral Corp. has paid to the seller.

1-2. Even in that event, the seller *does* put up some collateral, to the extent of one month's interest payment. (See 2-1 and 2-4 below.)

1-3. The seller-borrower remains liable on the monetization loan, and the lender is precluded by the loan documents from writing down or canceling the debt or any part of it.

1-4. That one limit per 1-1 above on the lender's recourse does not apply in the case of any other default by the seller-borrower, such as a material adverse change in the borrower's ability to perform, or non-payment of the annual escrow fee, or becoming insolvent, or using the loan proceeds for other than a business or investment purpose, or violating any law pertaining to the seller's business, and so on. In any of those events or others beyond those stated here, the seller-borrower is fully liable to the lender for the entire amount owing on the monetization loan, for which the lender has full-recourse rights against the seller-borrower.

1-5. Throughout the term of the monetization loan, the seller-borrower must disclose or note the obligation, as a liability of the seller-borrower, on the seller-borrower's financial statements.

1.6. An installment seller to S.Crow Collateral Corp. has every reason to repay the monetization loan, because if the seller fails to pay the lender after S.Crow Collateral Corp. pays the seller, the limitation on the lender's recourse goes away, and the seller becomes fully liable to the lender, which has full-recourse rights against the seller-borrower in this event as well. See 3-6 below.

Issue #2: Debt secured by escrow. In one arrangement, the promoter states that the lender can look only to the cash escrow for payment. It appears that, in effect, the cash escrow is security for the loan to taxpayer. If so, taxpayer economically benefits from the cash escrow and should be treated as receiving payment under the "economic benefit" doctrine for purposes of section 453. *Compare Reed v. CIR*, 723 F.2d 138 (1st Cir. 1983).

How the S.Crow Collateral Corp. monetized installment sale differs from that:

2-1. There is no escrow security for the monetization loan made by the lender with which S.Crow Collateral Corp. works, other than the *seller's* deposit, into an escrow owned by the *seller*, of the *seller's* money for one month's loan interest.

2-2. No other money is held in escrow at all, other than the seller's deposit of one-month's loan interest into an escrow owned by the seller, from the proceeds of that loan to the seller-borrower by the lender on the monetization loan.

2-3. That one-month's interest payment is initially deducted from the seller-borrower's loan proceeds and is placed into an escrow of the seller's from which the seller directs that the seller's loan payments be made. It is the seller-borrower's money, and it is put up by the seller-borrower, not anyone else.

2-4. To the extent of that one month's interest, the *seller* is putting up collateral for the monetization loan.

Issue #3: Debt secured by dealer note. Alternatively, the Monetization Loan to taxpayer is secured by the right to payment from the escrow under the installment note from the dealer. This would result in deemed payment under the pledging rule, under which loan proceeds are treated as payment of the dealer note. Section 453A(d).

How the S.Crow Collateral Corp. monetized installment sale differs from that:

3-1. In the case of a monetized installment sale transaction with S.Crow Collateral Corp., the seller agrees to a directed payment arrangement in which, each month, the money for the seller's interest payment to the lender is automatically taken from an escrow account which the seller owns that is separate and distinct from the installment escrow and to which S.Crow Collateral Corp. is not a party, and in regard to which S.Crow Collateral Corp. has no right, claim or involvement. That escrow is not the escrow which is established into which S.Crow Collateral Corp. makes its installment payments to the seller.

3-2. S.Crow Collateral Corp.'s installment agreement explicitly renders void, from the beginning, any attempt by the seller to borrow against or pledge or encumber the installment obligation in any way.

3-3. S.Crow Collateral Corp.'s installment agreement requires S.Crow Collateral Corp. not to recognize any attempt by the seller to borrow against or pledge or encumber the installment obligation.

3-4. The seller-borrower agrees with the monetization-loan lender that if S.Crow Collateral Corp. pays money into the installment escrow, the seller will pay an equal amount to the lender on the monetization loan.

3-5. In the case of a monetized installment sale transaction with S.Crow Collateral Corp., the monetization lender has no right to require payment from the installment escrow or from S.Crow Collateral Corp.

3-6. If S.Crow Collateral Corp. pays money into the installment escrow and the seller doesn't pay an equal amount of money to the monetization lender, the lender's recourse is not to the installment escrow money but directly to the seller, who then has full-recourse liability to the lender, not a security interest in the installment escrow. See 1-6 above.

Issue #4: Section 453(f). The intermediary does not appear to be the true buyer of the asset sold by taxpayer. Under section 453(f), only debt instruments from an "acquirer" can be excluded from the definition of payment and thus not constitute payment for purposes of section 453. Debt instruments issued by a party that is not the "acquirer" would be considered payment, requiring recognition of gain. See Rev. Rul. 77-414, 1977-2 C.B. 299; Rev. Rul. 73-157, 1973-1 C.B. 213; and Wrenn v. CIR, 67 T.C. 576 (1976) (intermediaries ignored in a back-to-back sale situation).

How the S.Crow Collateral Corp. monetized installment sale differs from that:

4-1 Unlike a situation in which an intermediary is only momentarily present in the transaction, S.Crow Collateral Corp. agrees, as a principal, to buy the asset and pledges its full faith and credit, with full-recourse liability to the seller, to pay the entire purchase price with interest thereon over thirty years.

4-2 S.Crow Collateral Corp. operates under Treasury Regulation 26 CFR § 15a.453-1(b)(3)(i), pursuant to which a "qualified intermediary" such as S.Crow Collateral Corp. is deemed to be the buyer from the seller and not an agent of the seller. As such a qualified intermediary, when S.Crow Collateral Corp. re-sells the asset and receives the resale proceeds, it does not do so as an agent of the seller and does not do so for the seller. S.Crow Collateral Corp., not the seller, receives, owns and puts the resale proceeds to work for its own purposes.

4-3 S.Crow Collateral Corp. is not a "related person" to the seller as that term is defined in Section 453(f), and therefore the required two-year holding period under Section 453(e) for a related party-installment buyer does not apply.

4-4 Unlike many, S.Crow Collateral Corp. is a dealer in capital assets, which means that it *buys* assets *to sell them* for its own account. Throughout the economy and the law, a dealer acts as a principal to buy and sell for its own account. A dealer buys for resale rather than for investment. For example, see 15 U.S. Code § 78c, subsection (a)(5)(A): "The term 'dealer' means any person engaged in the business of *buying* and *selling* securities . . ." (Emphases added.) As a dealer, when S.Crow

Collateral Corp. re-sells the asset and receives the resale proceeds, it does not do so as an agent of the seller and does not do so on behalf of the seller. S.Crow Collateral Corp., not the seller, receives, owns and puts the resale proceeds to work for its own purposes.

4-5 Unlike someone who is in and out of the deal in a moment, at the moment when the seller and S.Crow Collateral Corp. sign an installment agreement for the sale of the asset to S.Crow Collateral Corp., S.Crow Collateral Corp. *acquires* (if you'll pardon the expression) *equitable title* to the asset, without there having yet been any deed or other instrument of transfer other than the agreement of sale itself. For example, in the context of an acquisition of real property, it is true of any purchaser that the purchaser holds equitable title to the property from the date the purchase and sale agreement is executed, although legal title may not be transferred until the deed to the property is transferred from the seller to the purchaser or at the purchaser's direction. The rights of the holder of that *equitable title* are ownership rights that are enforceable in the courts of the relevant state.

4-6 Actually, the word "acquirer" nowhere appears in Section 453(f). The word used in Section 453(f) is "purchaser".

Issue #5: Cash Security. To the extent the installment note from the intermediary to the seller is secured by a cash escrow, taxpayer is treated as receiving payment irrespective of the pledging rule. Treas. Reg. section 15a.453-1(b)(3) ("Receipt of an evidence of indebtedness which is secured directly or indirectly by cash or a cash equivalent . . . will be treated as the receipt of payment.")

How the S.Crow Collateral Corp. monetized installment sale differs from that:

5-1 S.Crow Collateral Corp.'s installment obligation is not secured by anything, let alone a cash escrow. Not even one month's interest payment is held in escrow to secure any payment on the installment obligation.

5-2 No payment on the installment obligation occurs unless and until S.Crow Collateral Corp. affirmatively causes it to occur.

5-3 No subsequent or further payment on the installment obligation occurs unless and until S.Crow Collateral Corp. affirmatively causes that one to occur.

5-4 If a payment does not occur on the installment obligation, the seller's *only* recourse is to initiate a collection proceeding against S.Crow Collateral Corp.

Issue #6: NSAR 20123401F is distinguishable. The case addressed in the memorandum did not involve an intermediary. Further, loans to a disregarded entity wholly owned by seller were secured by the buyer's installment notes, but the pledging rule of section 453A(d) was not applicable. There is an exception to the pledging rule for sales of farm property, which applied in the case.

How the S.Crow Collateral Corp. monetized installment sale differs from that:

6-1 What is referenced by "NSAR 20123401F" is the 2012 CCM. (It's reproduced on S.Crow Collateral Corp.'s Website under the "Publications" tab.) It is correct to say that the CCM did not involve an intermediary, in the sense that the CCM never mentioned anything about an intermediary or whether one was present in the

transaction, or whether the presence or absence of an intermediary had anything to do with the tax treatment.

6-2 The CCM does not say that the installment buyer went into title or possession, nor does the memorandum say that the installment buyer retained title or possession for even a day. Indeed, the installment buyer was completely free to re-sell the property immediately if the buyer was not a related party to the seller. (See 4-3 above.)

6-3 Nothing in the memorandum hinged on whether or not the installment buyer went into title at all or retained title or possession.

6-4 It is correct that the anti-pledging rule of Section 453A(d) was not applicable in the CCM situation, because the property was agricultural property. (Section 453A(d) declares that if the installment seller pledges the installment obligation to the monetization lender as security, the loan proceeds will count as sale proceeds, unless the asset being sold is agricultural or personal-use property.) The anti-pledging rule is not applicable in S.Crow Collateral Corp.'s monetized installment sale transactions either, because the installment seller to S.Crow Collateral Corp. does not pledge the installment obligation (or of anything else). Indeed, in S.Crow Collateral Corp.'s monetized installment sale transactions, such a pledge is prohibited by the terms of the installment agreement. See 3-2 and 3-3 above.