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[JOINT COMMITTEE PRINT]

DESCRIPTION OF H.R. 6883

(AS PASSED THE HOUSE)

RELATING TO

REVISION OF INSTALLMENT SALE REPORTING RULES

SCHEDULED FOR A HEARING

BY THE

SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT GENERALLY

OF THE

COMMITTEE ON FINANCE

ON SEPTEMBER 10, 1980

PREPARED FOR THE USE OF THE

COMMITTEE ON FINANCE

BY THE STAFF OF THE

JOINT COMMITTEE ON TAXATION

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INTRODUCTION

The bill described in this pamphlet (H.R. 6883) has been scheduled for a hearing on September 10, 1980, by the Subcommittee on Taxation and Debt Management Generally of the Senate Committee on Finance. The bill relates to the tax rules for reporting gain under the installment method for sales of real property and personal property other than inventory. This bill was developed as a result of the suggestions and comments received in connection with other bills, H.R. 3899 and S. 1063, which were introduced last year.

A hearing was held by the Subcommittee on Select Revenue Measures of the Ways and Means Committee on the provisions of H.R. 3899 in July 1979. Senate hearings were also held on an identical bill, S. 1063, which had been introduced by Senators Long and Dole. At the hearings, most of the provisions of the bill were supported by the witnesses.

However, a number of modifications were suggested and a number of additional problems were raised for consideration. After the hearings, the staff was directed to develop a revised bill to simplify and improve this area of the tax law by taking into account the comments and testimony received. In developing the revised bill, the staff worked closely with the Treasury Department, the Tax Section of the American Bar Association, and the Federal Tax Division of the American Institute of Certified Public Accountants. In addition, comments and suggestions were received from a number of other professional organizations, including the New York City and State Bar Associations, and the Illinois and California Bar Associations. Also, representatives of small business, real estate, banking and farm groups made comments and suggestions.

The bill, H.R. 6883, was the subject of a hearing by the Subcommittee on Select Revenue Measures of the House Committee on Ways and Means on April 17, 1980. With amendments, that subcommittee approved the bill on April 24, 1980, and the Ways and Means Committee approved the bill on May 15, 1980. The House of Representatives passed the bill on June 17, 1980.

In connection with the hearing scheduled for H.R. 6883, the staff of the Joint Committee on Taxation has prepared for each provision a description of present law and the bill provision. The pamphlet also includes the estimated revenue effect of the bill.

I. SUMMARY

INSTALLMENT SALES REVISION ACT OF 1980

The bill (H.R. 6883) amends the rules for reporting gain under the installment method for sales of real property and casual sales of personal property.

The bill makes the following changes:

(*1*) ***Structural improvements.***—Under present law, a single provision (Code sec. 453) prescribes rules for installment method reporting for dealers in personal property, for sales of real property and nondealer personal property, and special disposition rules. Under the bill, the basic rules for nondealer transactions will be contained in one Code section (sec. 453), the rules for dealer transactions will be contained in another section (sec. 453A), and generally applicable installment obligation disposition rules will be contained in a third section (sec. 453B).

(*2*) ***Initial payment limitation.***—The bill eliminates the requirement that no more than 30 percent of the selling price be received in the taxable year of sale to qualify for installment sale reporting for gains from sales of realty and nondealer personal property.

(*3*) ***Two-payment rule.***—The bill eliminates the requirement that a deferred payment sale be for two or more payments. Thus, a sale will be eligible for installment reporting even if the purchase price is to be paid in a single lump sum amount in a year subsequent to the taxable year in which the sale is made.

(*4*) ***Selling price requirements.***—The bill eliminates the requirement that the selling price for casual sales of personal property must exceed $1,000 to qualify for installment sale reporting.

(*5*) ***Election.***—The bill eliminates the present law requirement that the installment method must be elected for reporting gains from sales of realty and nondealer personal property. Instead, the provision will automatically apply to a qualified sale unless the taxpayer elects not to have the provision apply with respect to a deferred payment sale.

(*6*) ***Related Party sales.***—The bill prescribes special rules for situations involving installment sales to certain related parties who also dispose of the property and for situations involving installment sales of depreciable property between a taxpayer and his spouse or certain 80-percent owned corporations or partnerships.

Sales other than sales of depreciable property between certain closely-related parties.—Under the bill, the amount realized upon a resale by the related party installment purchaser will trigger recognition of gain by the initial seller, based on his gross profit ratio, only to the extent the amount realized from the second disposition exceeds actual payments made under the installment sale. Thus, acceleration of recognition of the installment gain from the first sale will generally result only to the extent additional cash and other property flows into the related group as a result of a second disposition of the property.

The excess of any amount realized from resales over payments received on the first sale as of the end of a taxable year will be taken into account. If, under these rules, a resale results in the recognition of gain to the initial seller, subsequent payments actually received by that seller will be recovered tax-free until they equal the amount realized from the resale which resulted in the acceleration of recognition of gain.

In the case of property other than marketable stock and securities, the resale rule will apply only with respect to second dispositions occurring within 2 years of the initial installment sale. In the case of marketable stock and securities, the resale rule will apply without a time limit for resales occurring before the installment obligation is satisfied.

The bill also contains several exceptions to the application of these rules. Since gain from the sale of a corporation's treasury stock is nontaxable and therefore its basis in the stock is irrelevant, the related party rule will not apply to any sale or exchange of stock to the issuing corporation. In addition, there generally will be no acceleration of recognition of gain as a result of a second disposition which is an involuntary conversion of the property or which occurs after the death of the installment seller or purchaser. Finally, the resale rules will not apply in any case where it is established to the satisfaction of the Internal Revenue Service that none of the dispositions had as one of its principal purposes the avoidance of Federal income taxes.

For purposes of the related party rules, the bill adopts a definition of related parties which will include spouses, children, grandchildren, and parents but will exclude brothers and sisters. However, it is to be understood that the omission of a specific family relationship is not intended to preclude the Internal Revenue Service from asserting the proper tax treatment to transactions that are shams. A corporation will be considered to be related to another taxpayer if stock of another corporation which is or might be owned by it would be treated as owned by the taxpayer under the general corporate attribution rules. Generally, a related corporation will be one in which a person directly or indirectly owned 50 percent or more in value of the stock in the corporation. Also for this purpose, the principles of the general corporate stock ownership attribution rules will apply in determining the related party status of partnerships, trusts, and estates.

Sales of depreciable property between certain closely-related parties.—Under the bill, the accrual method of accounting in effect is required for deferred payment sales of depreciable property between certain closely-related parties. In general, this special rule applies to transactions which are fairly analogous to "self-dealing" and involve transfers of depreciable property to obtain income tax deferral benefits. For these transactions the deferred payments will be deemed to be received in the taxable year in which the sale occurs.

This special rule will apply only to deferred payment sales between a taxpayer and the taxpayer's spouse, the taxpayer and a trust treated as owned by the taxpayer or the taxpayer's spouse under present law, the taxpayer and a partnership or corporation which is 80-percent owned by the taxpayer and/or the taxpayer's spouse, and between partnerships and corporations which are 80-percent owned by the taxpayer and/or the taxpayer's spouse. To avoid possible application to transactions which may be undertaken other than for tax avoid-

ance purposes, an exception is provided with respect to a deferred payment sale between a taxpayer and his spouse if the sale is incident to a divorce or a separation.

(7) ***Like-kind exchanges.***—The bill provides that the receipt of like-kind property in connection with a disposition will not be taken into account in determining gain recognized for installment sale reporting purposes. Under the present Internal Revenue Service position, the receipt of like-kind property results in the recognition of installment gain before cash is received by the taxpayer because the value of such property is treated as a payment received. The bill reverses this rule.

(8) ***Installment obligations distributed in a corporate liquidation.***—In general, the bill provides nonrecognition of gain treatment for a shareholder who receives installment obligations as liquidating distributions from a corporation liquidating within 12 months of adoption of a plan of complete liquidation. In general, this rule will apply to obligations arising from sales by a corporation during the 12-month period. Obligations from the sale of inventory will qualify only if the inventory of that trade or business is sold in bulk. The gain realized by the shareholder on his stock will be recognized as payments are received on the installment obligation. Thus, in most significant aspects, the tax consequences to a shareholder will be essentially the same whether the corporation sells its assets and then distributes installment obligations in complete liquidation or the shareholder makes an installment sale of the stock.

Under the bill, nonrecognition treatment will not be available if the installment purchaser is either the shareholder-distributee's spouse, a trust treated as owned by the shareholder-distributee or his spouse, or a corporation or a partnership which is 80-percent owned by the shareholder-distributee and/or his spouse.

(9) ***Sales subject to a contingency.***—The bill permits installment method reporting for sales for a contingent selling price. Under present law, these sales are not eligible for installment reporting. In extending eligibility, the bill does not prescribe specific rules which would apply to every conceivable transaction. Rather, the bill provides that the specific rules will be prescribed under regulations.

However, it is intended that, for sales under which there is a stated maximum selling price, the regulations will permit basis recovery on the basis of a gross profit ratio determined by reference to the stated maximum selling price. In cases where the sales price is indefinite but payable over a fixed period of time, it is generally intended that the basis of the property sold would be recovered ratably over that fixed period. In cases where the selling price and payment period are both indefinite, it is intended that the regulations would permit ratable basis recovery over some reasonable period of time. Also, in appropriate cases, it is intended that basis recovery would be permitted under an income forecast type method.

(10) ***Cancellation of installment obligation.***—The bill makes it clear that the cancellation of an installment obligation is treated as a disposition of the obligation by the holder of the obligation.

(11) ***Bequest of obligation to obligor.***—The bill provides that the installment obligation disposition rules cannot be avoided by the bequest of an obligation to the obliger.

(*12*) ***Foreclosure of real property sold on installment method by deceased taxpayer.***—The bill provides that an executor or beneficiary who receives a secured installment obligation from a decedent will succeed the decedent for purposes of qualifying for nonrecognition treatment if the real property sold by the decedent is reacquired in cancellation of the obligation.

(*13*) ***Effective dates.***—In general, the bill is effective for sales, cancellations, bequests, and reacquisitions of real property, as the case may be, occurring after the date of enactment. However, the related party installment sale rules apply to installment sales after May 14, 1980. The provision relating to the distribution of installment obligations in connection with a 12-month corporate liquidation apply with respect to installment obligations distributed after March 31, 1980.

(*14*) ***Revenue effects.***—Due to the interaction between the provisions of this bill, revenue effects for each specific provision cannot be determined independently. It is estimated that on balance the provisions of this bill (except related party sales) will not have a significant revenue effect on budget receipts.

Due to the extensive litigation and controversy concerning the treatment of related party sales under present law, the revenue gain for the related party provision of the bill is indeterminant.

II. EXPLANATION OF THE BILL*

A. Installment Sales Generally (sec. 2 of the bill and sec. 453 of the Code)

Present law

Generally, under present law (Code sec. 453), income from a sale of property on the installment basis may be reported as the payments are received. If the installment method is elected for qualifying sales, the gain reported for any taxable year is the proportion of the installment payment received in that year which the gross profit, realized or to be realized when payment is completed, bears to the total contract price. In general, the contract price is the amount which will be paid to the seller.

The function of the installment method of reporting income is to permit the spreading of the income tax over the period during which payments of the sales price are received. Thus, the installment method alleviates possible liquidity problems which might arise from the bunching of gain in the year of sale when a portion of the selling price has not been actually received.

Explanation of provision

In general

Although the bill makes structural revisions of existing law and makes the specific changes described below, most of the basic concepts of existing law are continued. As under present law, the provisions relate to installment reporting of gains and do not affect the time for recognizing losses from the sale or exchange of property for deferred payments.

Except as otherwise provided for sales subject to a contingency or for sales to certain related persons, gain from an installment sale would continue to be recognized for any taxable year with respect to the payments received in that year in the same proportion as the gross profit from the sale bears to the total contract price. The payments taken into account as being received in a taxable year would not include the purchaser's obligation of future payment, whether dischargeable in money or other property (including foreign currency), unless that obligation is a bond or other evidence or indebtedness which is either payable on demand or has been issued by a corporation or government and is readily tradable.

Structural improvements

Under present law, a single provision (Code sec. 453) prescribes rules for installment method reporting for dealers in personal property, for sales of real property and nondealer personal property, and special disposition rules. Under the bill, the rules for nondealer transactions are contained in one Code section (sec. 453), the rules for

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*This explanation is from the Ways and Means Committee report on the bill, House Rept. No. 96–1042.

personal property dealer transactions are contained in another section (sec. 453A), and generally applicable installment obligation disposition rules are contained in a third section (sec. 453B).

In making these structural changes and certain language changes, no substantive changes are intended to be made by the bill with respect to the provisions relating to installment sales by dealers in personal property. The substantive changes under the bill relate only to sales of realty and casual sales of personal property.

For purposes of the bill, it is intended that gain from the sale of property which is not required to be inventoried by a farmer under his method of accounting will be eligible for installment method reporting as gain from a casual sale of personal property.

B. Initial Payment Limitation (sec. 2 of the bill and sec. 453(b)(2) of the Code)

Present law

Under present law, gain from the sale of realty or nondealer personal property may not be reported under the installment method if the payments received in the taxable year of sale exceed 30 percent of the selling price.

A number of problems have arisen in connection with the 30-percent initial payment requirement which was designed to limit installment sale reporting to transactions where hardships might result from current imposition of tax on uncollected amounts. Some have argued that it is an arbitrary limitation which has unduly complicated and interfered with normal business transactions. In addition, it has been argued that the limitation has operated as a trap for the unwary. If a taxpayer fails to secure competent advice and inadvertently exceeds the 30-percent limitation, however slightly, the entire gain must be recognized in the year of sale. The limitation has produced an inordinate amount of litigation and confusion.

In applying the 30-percent limitation, the problem areas generally involve interpretations of the terms "selling price" and "payment." Where the imputed interest provision applies (Code sec. 483), the limitation may not be satisfied if the selling price is reduced by the amount required to be treated as unstated interest (Treas. reg. § 1.453 (b)(2)). Thus, after reduction of the selling price for unstated interest, the payments received in the year of sale may exceed 30 percent of the selling price although the limitation appeared to be satisfied on the basis of the written sales agreement. A similar disqualification can arise when the installment obligation is a corporate obligation issued at a discount because the amount treated as original issue discount is not included as part of the selling price (Treas. reg. § 1.453–1(b)(3)).

Another problem arises under present law in connection with the sale of property which is subject to an existing mortgage which is assumed by the installment buyer. Generally, the amount of the mortgage is taken into account as part of the selling price but is not taken into account for purposes of determining the contract price or the amount of payments received by the seller. However, to the extent the mortgage exceeds the seller's basis in the property, the excess is considered as a payment received and correspondingly is included in the contract amount. (Treas. reg. § 1.453–4(c)). The problem arising from

this treatment does not involve its correctness but rather the inadvertent disqualification of the sale for installment method reporting for failing to take the amount of the mortgage in excess of basis into account for the 30-percent initial payment requirement. Where the taxpayers are cognizant of problems of this type, the 30-percent requirement has fostered ingenious "wraparound" mortgage arrangements to qualify for installment method reporting.[1]

Under the wraparound arrangement, the buyer does not assume the mortgage and agrees not to make direct payments to the mortgagee but agrees to make the payments to the seller who will continue to pay the mortgage debt. In one case, the wraparound technique was used by having the seller retain title to the property for a period of years so there would be no transfer of property "subject to" the existing mortgage.[2] If title passes in the year of sale, the Internal Revenue Service will treat the mortgage debt in excess of basis as a payment received in the year of the sale.[3] This issue is said to be another instance of the 30-percent initial payment rule fostering uncertainty and litigation.

Another problem area relates to the treatment of selling expenses when determining whether the mortgage assumed by the buyer exceeds the adjusted basis of the property sold. Under the regulations, commissions and selling expenses are taken into account as an offset to selling price for purposes of determining the gross profit from a sale by a nondealer (Treas. reg. § 1.453–1(b)), but do not reduce the amount of the payments, the total contract price, or the selling price (Treas. reg. § 1.453–4(c)). However, the Ninth Circuit has held that selling expenses are to be added to basis for this purpose.[4] The Internal Revenue Service has announced that it will not follow the Ninth Circuit's decision on the treatment of selling expenses.[5] Thus, this is another area where the 30-percent initial payment requirement may foster litigation and confusion.

Another problem area involves the case where the buyer pays some of the seller's obligations in the year of sale. The Service has ruled that, in the case of a casual sale of personal property, the assumption and payment of secured and general unsecured liabilities by the purchaser will not be considered as a payment to the seller for installment sale reporting qualification purposes if the seller establishes that the liabilities were incurred in the ordinary course of business and not for purposes of avoiding the 30-percent initial payment limitation.[6] The avoidance test under the ruling would involve a subjective determination of motive. Thus, this is another area where the initial payment rule may foster litigation and confusion.

Explanation of provision

The bill eliminates the 30-percent initial payment limitation for reporting gain on the installment method from the disposition of real property or nondealer personal property.

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[1] Wyndelts and Campbell "Installment Reporting Need Not Be Lost When Year-Of-Sale Payments Are More Than 30%," 20 *Taxation for Accountants* 328 (1978); Ginsburg, "Taxing the Sale for Future Payment," 30 *Tax Law Review* 469, 488 (1975).

[2] *Stonecrest*, 24 TC 659 (1955) *nonacq.* 1956–1 C.B. 6.

[3] Letter rulings 7814010 and 7814011.

[4] *Kirschenmann* v. *United States*, 488 F.2d 270 (9th Cir. 1973).

[5] Rev. Rul. 74–384, 1974–2 C.B. 152.

[6] Rev. Rul. 73–555, 1973–2 C.B. 159.

C. Two-Payment Rule (sec. 2 of the bill and sec. 453 of the Code)

Present law

Under present law, it is the position of the Internal Revenue Service that a taxpayer may not elect to report income from the sale of real property on the installment method if the total purchase price is payable in a lump sum in a taxable year subsequent to the year of sale.[7] The same issue may arise with respect to casual sales of personal property. The rationale for the ruling is that the installment concept generally calls for two or more payments of the purchase price in two or more taxable years and that a single payment sale cannot be considered to to be payable in installments. The courts have agreed with the Service's interpretation.[8]

It is argued that the two-payment rule is a trap for the unwary and results in different tax results for transactions that are substantially similar. For example, installment method reporting would be available for a taxpayer who sells for a modest down payment with the balance due in 5 years but would not be available for a taxpayer who receives no down payment with the entire balance due in 5 years. In these situations, the ability to pay income taxes from the sales proceeds is essentially the same. Thus, to the extent the rationale for installment method reporting is based on ability to pay concepts, both sales should qualify for installment reporting.

Explanation of provision

The bill eliminates the requirement that a sale must be for two or more payments to qualify for installment method reporting. Thus, under the bill, income from the sale of qualifying property for a purchase price payable in a lump sum in a taxable year subsequent to the year of sale may be reported in the year in which payment is received.

D. Selling Price Limitation for Casual Sales of Personal Property (sec. 2 of the bill and sec. 453(b)(1)(B) of the Code)

Present law

Under present law, a casual sale of personal property must be for a selling price in excess of $1,000 to qualify for installment reporting.

In certain situations, the selling price requirement may be difficult to apply because questions may arise as to whether there is a single sale of several items for more than $1,000, which satisfies the requirement, or a number of sales of individual items for $1,000 or less for each item.

Explanation of provision

The bill eliminates the selling price requirement to qualify for installment reporting.[9]

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[7] Rev. Rul. 69–462, 1969–2 C.B. 107, amplified by Rev. Rul. 71–595, 1971–2 C.B. 223.

[8] *Baltimore Baseball Co. Inc.*, v. *U.S.*, 481 F.2d 1283 (Ct. Cl. 1973); *10–42 Corp.*, 55 TC 593 (1971).

[9] If, for practical reasons, it is not feasible to report gain from sales for relatively small amounts, a taxpayer could elect not to report gain under the installment method and thereby eliminate compliance burdens. See the following discussion relating to installment sale elections under the bill.

E. Election of Installment Reporting (sec. 2 of the bill and new sec. 453(d) of the Code)

Present law

Under present law, an election may be made to report gain from an installment sale on a timely filed return, a delinquent return, or on an amended return for the year of sale not barred by the statute of limitations, if the facts indicate no position inconsistent with the installment election had been taken with respect to the sale (Rev. Rul. 65–297, 1965–2 C.B. 152). If a return is filed which includes in gross income the entire gain from an installment sale, an amended return or claim for refund cannot be used to elect installment sale reporting for the sale because the election to report the gain in full is treated as a binding election not to report on the installment method.[10]

Explanation of provision

The bill eliminates the present law requirement that the installment method must be elected for reporting gains from sales of realty and nondealer personal property. Instead, installment reporting would automatically apply to a qualified sale unless the taxpayer elects not to have the provision apply with respect to a deferred payment sale. Generally, the election not to have installment method reporting apply to a deferred payment sale must be made in the manner prescribed by regulations on or before the due date (including extensions of time for filing) for filing the income tax return for the year in which the sale occurs. It is anticipated that reporting the entire gain in gross income for the taxable year in which the sale occurs will operate as an election not to have installment sale reporting apply. It is anticipated that, under regulations, late elections will be permitted in rare circumstances when the Internal Revenue Service finds that reasonable cause for failing to make a timely election exists under the particular circumstances of each case.

Generally, an election made under this provision is to be irrevocable. However, an election may be revoked with the consent of the Internal Revenue Service. Generally, it is anticipated that consent would be given by the Internal Revenue Service in circumstances when a revocation does not have as one of its purposes the avoidance of income taxes. Also, it is anticipated that consent to revocation will generally be granted in cases involving a contingent selling price if the election is made prior to adoption of final regulations under the provisions of the bill relating to contingent selling price sales and the request for revocation is filed within a reasonable time after the regulations are adopted.

It is anticipated that the regulations will prescribe election rules relating to the treatment of gains from deferred payment sales of property by a nonresident alien. Under the installment method rules of present law, these gains do not become taxable as payments are received after the seller becomes a resident or citizen subject to U.S. income tax for a taxable year subsequent to the year in which the sale was made. It is intended that the election regulations will continue this treatment in appropriate cases.

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[10] *Robert F. Kock*, T.C. Memo 1978–271; *Pacific National Co.* v. *Welch*, 304 U.S. 191 (1938).

F. Related Party Sales (sec. 2 of the bill and new sec. 453(e), (f), and (g) of the Code)

Present law

Under present law, the installment sale statutory provision does not preclude installment sale reporting for sales between related parties. Further, the statutory provision does not preclude installment sale reporting for sales of marketable securities although the seller might readily obtain full cash proceeds by market sales.[11]

Under the existing statutory framework, taxpayers have used the installment sale provision as a tax planning device for intra-family transfers of appreciated property, including marketable securities.[12] There are several tax advantages in making intra-family installment sales of appreciated property. The seller would achieve deferral of recognition of gain until the related buyer actually pays the installments to the seller, even if cash proceeds from the property are received within the related party group from a subsequent resale by the installment buyer shortly after making the initial purchase. In addition to spreading out the gain recognized by the seller over the term of the installment sale, the seller may achieve some estate planning benefits since the value of the installment obligation generally will be frozen for estate tax purposes. Any subsequent appreciation in value of the property sold, or in property acquired by reinvestment of the proceeds from the property sold on the installment basis, would not affect the seller's gross estate since the value of the property is no longer included in his gross estate.

With respect to the related buyer, there is usually no tax to be paid if the appreciated property is resold shortly after the installment purchase. Since the buyer's adjusted basis is a cost basis which includes the portion of the purchase price payable in the future, the gain or loss from the buyer's resale would represent only the fluctuation in value occurring after the installment purchase. Thus, after the related party's resale, all appreciation has been realized within the related group but the recognition of the gain for tax purposes may be deferred for a long period of time.

In the leading case, *Rushing* v. *Commissioner*,[13] the test was held to be that, in order to receive the installment benefits, the "seller may not directly or indirectly have control over the proceeds or possess the economic benefit therefrom." In this case, a sale of corporate stock was made to the trustee of trusts for the benefit of the seller's children. Since the sales were made to trusts created after the corporations had adopted plans of liquidation, the Government made an assignment of income argument. The Court upheld installment sale treatment for the stock sold to the trustee under the "control or enjoyment" test because the trustee was independent of the taxpayer and owed a fidu-

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[11] The receipt of the buyer's obligation payable on demand or a readily tradable evidence of indebtedness is treated as the receipt of payment by the seller. For this purpose, readily tradable items include bonds and notes issued by a corporation or governmental unit with interest coupons attached or in registered form or in any other form designed to make the bond or note readily tradable in an established securities market.

[12] Another technique used for intra-family transfers involves the so-called "private annuity" arrangement. The bill does not deal directly with this type of arrangement.

[13] 441 F. 2d 593 (5th Cir. 1971), *aff'g* 52 T.C. 888 (1969).

ciary duty to the children. The Court rejected the assignment of income argument because it found that no income was being assigned.

The *Rushing* case has been followed in another case where the stock sold to a family trust was that of a corporation which was to be liquidated after the sale.[14] The liquidation was formally authorized after the sale to the trust. In other cases, the Tax Court has rejected the Service's substance over form and constructive receipt arguments and held that the sales to a family trust qualified for installment method reporting.[15] In the *Pityo* case, the taxpayer's wife was the beneficiary of one of the trusts to which the installment sale was made. In the *Roberts* case, the trustees were the seller's brother and personal accountant. In both cases, installment sale reporting was allowed because the Tax Court held that the trustees were independent of the seller and satisfied the *Rushing* control or enjoyment test.

In another case, installment method reporting was allowed for a sale of marketable stock by a wife to her husband although a resale by the husband was contemplated.[16] In this case, the Court held that the husband could not be considered a mere conduit for the wife's sale of the stock since both were "very healthy economic entities" and the husband had an independent purpose for obtaining needed funds for an investment at a low rate of interest.

In the few cases in which the Service has prevailed, installment method reporting has been denied with respect to transactions involving a controlled corporation,[17] a sale to a son where the son was forced to resell the stock and invest the proceeds in other securities held in escrow,[18] and, in the case of a sale by a husband to his wife, where the Court found there was no bona fide purpose for the transaction other than tax avoidance.[19]

Explanation of provision

The bill prescribes special rules for situations involving installment sales to certain related parties who also dispose of the property and for situations involving installment sales of depreciable property between a taxpayer and his spouse or certain trusts, and 80-percent owned corporations or partnerships.

Sales other than sales of depreciable property between certain closely-related parties

Under the bill, the amount realized upon certain resales by the related party installment purchaser will trigger recognition of gain by

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[14] *Carl E. Weaver*, 71 T.C. 443 (1978).

[15] *William D. Pityo*, 70 T.C. 225 (1978); *Claire E. Roberts*, 71 T.C. 311 (1978). Also, in *William J. Goodman*, 74 T.C. No. 53 (July 16, 1980), a prearranged resale was made by the trustees of a family trust one day after the installment sales were made to the trusts of which the installment sellers were the trustees. The two-step installment sales were used because the taxpayers believed that "a cash sale was not attractive because of the income tax liability on such a sale."

[16] *Nye* v. *U.S.*, 407 F. Supp. 1345, 75–1 USTC ¶9150 (M.D.N.C. 1975).

[17] *Griffiths* v. *Helvering*, 308 U.S. 355 (1939). This case involved the creation of a corporation to receive the assignment of a settlement owed to the taxpayer with the corporation agreeing to pay the money received from the settlement to the taxpayer over a 40–year term. The Court held that there had been an anticipatory assignment of income and therefore the income was taxable to the shareholder rather than the corporation.

[18] *Paul G. Lustgarten*, 71 T.C. 303 (1978). The Court held that the taxpayer had constructively received the proceeds from the "resale."

[19] *Phillip W. Wrenn*, 67 T.C. 576 (1976).

the initial seller, based on his gross profit ratio, only to the extent the amount realized from the second disposition exceeds actual payments made under the installment sale. Thus, acceleration of recognition of the installment gain from the first sale will generally result only to the extent additional cash and other property flows into the related group as a result of a second disposition of the property. In the case of a second disposition which is not a sale or exchange, the fair market value of the property disposed of is treated as the amount realized for this purpose.

The excess of any amount realized from resales over payments received on the first sale as of the end of a taxable year will be taken into account. Thus, the tax treatment would not turn on the strict chronological order in which resales or payments are made. If, under these rules, a resale results in the recognition of gain to the initial seller, subsequent payments actually received by that seller would be recovered tax-free until they have equaled the amount realized from the resale which resulted in the acceleration of recognition of gain.

In the case of property other than marketable securities, the resale rule will apply only with respect to second dispositions occurring within 2 years of the initial installment sale. For this purpose, the running of the 2-year period would be suspended for any period during which the related purchaser's risk of loss with respect to the property is substantially diminished. This rule will apply with respect to the holding of a put, the holding of an option by another person, a short sale, or any other transaction which has the effect of substantially diminishing the risk of loss. However, for this purpose, a typical close corporation shareholders' agreement is not intended to be taken into account. Further, the holding of an option is not to be considered to have the effect of substantially diminishing risk of loss if the option purchase price is to be determined by reference to the fair market value of the property at the time the option is exercised.

In the case of marketable securities, the resale rule would apply without a time limit for resales occurring before the installment obligation is satisfied. For this purpose, the term "marketable security" means any security for which, as of the date of disposition, there was a market on an established securities market, or otherwise.[20]

The bill also contains several exceptions to the application of these rules. Since gain from the sale of a corporation's treasury stock is nontaxable and therefore its basis in the stock is irrelevant, this related party rule will not apply to any nonliquidating installment sale of stock to the issuing corporation. In addition, there would be no acceleration of recognition of gain as a result of a second disposition which is an involuntary conversion of the property if the first sale occurred before the threat or imminence of the conversion. Further there would be no acceleration of recognition of gain from a second disposition which occurs after the death of the installment seller or

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[20] The term "marketable securities" includes securities which are listed on the New York Stock Exchange, the American Stock Exchange, or any city or regional exchange in which quotations appear on a daily basis, including foreign securities listed on a recognized foreign national or regional exchange; securities regularly traded in the national or regional over-the-counter market, for which published quotations are available; securities locally traded for which quotations can readily be obtained from established brokerage firms; and units in a common trust fund. Mutual fund shares for which redemption prices are published would also be considered marketable securities.

purchaser. Finally the resale rules will not apply in any case where it is established to the satisfaction of the Internal Revenue Service that none of the dispositions had as one of its principal purposes the avoidance of Federal income taxes.

Generally, the bill limits the specific exceptions to situations where the second disposition is of an involuntary nature. In cases of voluntary transfers, the nontax avoidance exception may apply. However, for these exceptional cases, it is anticipated that regulations would provide definitive rules rather than having complicated legislation prescribe substituted property or taxpayer rules which would not be of general application. In appropriate cases, it is anticipated that the regulations and rulings under the nontax avoidance exception will deal with certain tax-free transfers which normally would not be treated as a second disposition of the property, e.g., charitable transfers, gift transfers, and transfers to a controlled corporation or a partnership. Generally, it is intended that a second disposition will qualify under the nontax avoidance exception when it is of an involuntary nature other than by reason of an involuntary conversion such as casualty or condemnation, e.g., foreclosure upon the property by a judgment lien creditor of the related purchaser or bankruptcy of the related purchaser. In addition, it is intended that the exception will apply in the case of a second disposition which is also an installment sale if the terms of payment under the installment resale are substantially equivalent to, or longer than, those for the first installment sale. However, the exception would not apply if the resale terms would permit significant deferral of recognition of gain from the initial sale when proceeds from the resale are being collected sooner.

Under the bill, the period for assessing a deficiency in tax attributable to a second disposition by the related purchaser will not expire before the day which is 2 years after the date the initial installment seller furnishes a notice that there was a second disposition of the property. The notice is to be furnished in the manner prescribed by regulations. Under the bill, a protective notification may be filed to prevent the tolling of the period of limitations for assessing a deficiency in cases where there are questions as to whether a second disposition has occurred (e.g., a lease which might be characterized as a sale or exchange for tax purposes) or whether there is a principal purpose of Federal income tax avoidance.

For purposes of the related party rules, the bill adopts a definition of related parties which will include spouses, children, grandchildren, and parents but will exclude brothers and sisters. However, it is to be understood that the provisions governing the use of the installment method to report sales between related parties, and the definition of such relationships, are not intended to preclude the Internal Revenue Service from asserting the proper tax treatment of transactions that are shams. In the case of a corporation, it will be considered to be related to another taxpayer if stock which is or might be owned by it is or would be treated as owned by the other taxpayer under the general corporate attribution rules (Code sec. 318). Generally, a related corporation will be one in which a person directly or indirectly owns 50 percent or more in value of the stock in the corporation. Also for this purpose, the principles of the general corporate stock ownership attribution rules (Code sec. 318) will apply in determining the related party status of partnerships, trusts, and estates.

Sales of depreciable property between certain closely-related parties

Under the bill, the accrual method of accounting in effect is required for deferred payment sales of depreciable property between certain closely-related parties.[21] In general, this special rule applies to transactions which are fairly analogous to "self-dealing" transactions involving transfers of depreciable property to obtain income tax deferral benefits. For transactions to which the special rule will apply, the deferred payments will be deemed to be received in the taxable year in which the sale occurs. In the case of sales for contingent future payments, it is intended that, in general, the amount realized in the year of sale will be equal to the value of the property sold.

This special rule will apply only to deferred payment sales between a taxpayer and the taxpayer's spouse; the taxpayer and a trust treated as owned by the taxpayer or the taxpayer's spouse under present law; the taxpayer and a partnership or corporation which is 80-percent owned by the taxpayer and/or the taxpayer's spouse; and between partnerships and corporations which are 80-percent owned by the taxpayer and/or the taxpayer's spouse.[22] To avoid possible application to transactions which may be undertaken other than for tax avoidance purposes, an exception is provided with respect to a deferred payment sale between a taxpayer and his spouse if the sale is incident to a divorce or a separation. Thus, the special rules will not apply, if, at the time of the installment sale, the husband and wife are legally separated under a decree of divorce or separate maintenance. Also, they will not apply if the installment sale occurs pursuant to a settlement in a proceeding which culminates in a decree of divorce or separate maintenance.

The Ways and Means Committee intended that no inference be drawn from these provisions as to the proper treatment of any related party installment sale occurring prior to the effective date provided under the bill.

G. Receipt of Like Kind Property (sec. 2 of the bill and new sec. 453(f)(6) of the Code)

Present law

Under present law, the transfer of property for cash payments and like kind property may qualify both for installment method reporting and, with respect to the gain attributable to the like kind exchange, nonrecognition treatment (Code sec. 1031 and Rev. Rul.

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[21] In the case of transfers which are treated as tax-free transfers to a controlled corporation or to a partnership (Code secs. 351, 362, 721, and 723), the provisions of present law would continue to apply and would not be affected by the provisions. Also, in the case of transactions which are governed by the doctrine of liquidation-reincorporation under present law, the tax treatment for those transactions would continue to be governed by present law and would not be affected by the provision.

[22] In general, the relationships covered by the special rule will be similar to the relationships covered under the provisions of existing law which prescribe special income characterization rules for certain transactions between closely-related taxpayers (Code secs. 1239 and 707(b)(2)). However, ownership by family members other than husband and wife will not be attributed.

65–155, 1965–1 C.B. 356). In this case, the gain to be recognized under installment method reporting is the total gain realized on the transaction less the gain eligible for nonrecognition under the like kind exchange provision. However, the value of the like kind property received by the seller is taken into account in determining the amount of the selling price, the contract price, and payments received for purposes of the installment sale provision.[23] The value of the like kind property received is treated as a payment received in the taxable year in which the sale or exchange is made.

Explanation of provision

Under the bill, property permitted to be received without recognition of gain in an exchange described in Code section 1031(b) [24] will not be treated as payment for purposes of reporting income under the installment method.

Thus, in reporting the gain on the exchange under the installment method where an installment obligation is received in addition to the like kind property, the gross profit will be the amount of gain which will be recognized on the exchange if the installment obligation were satisfied in full at its face amount. Also, the total contract price will not include the value of the like kind property but instead will consist solely of the sum of the money and fair market value of other property received plus the face amount of the installment obligation.

The basis of the like kind property received (determined under section 1031(d)) will be determined as if the obligation had been satisfied at its face amount. [25] Thus, the taxpayer's basis in the property transferred will first be allocated to the like kind property received (but not in excess of its fair market value) and any remaining basis will be allocated ratably among the installment obligation and any cash or nonqualifying property.

The bill also provides that similar treatment applies in the case of an exchange under a plan of corporate reorganization described in section 356(a) which is not treated as a dividend.

These provisions may be illustrated by the following example. Assume that the taxpayer exchanges property with a basis of $400,000 for like kind property worth $200,000, and an installment obligation for $800,000 with $100,000 payable in the taxable year of the sale and the balance payable in the succeeding taxable year. The example compares present law, which takes like kind property into account as payment, with the bill which reverses this rule.

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[23] Rev. Rul. 65–155, 1965–1 C.B. 356; *Clinton H. Mitchell*, 42 T.C. 953, 965 (1964); *Albert W. Turner*, TC Memo 1977–437. A similar case under present law involves the treatment of an installment obligation received as "boot" in exchange by a shareholder under a plan of corporate reorganization (sec. 356(a)(1)). Present law is unclear whether the exchange qualifies for installment sale reporting.

[24] This provision includes like kind exchanges (sec. 1031), exchanges of certain insurance policies (sec. 1035), certain exchanges of stock of the same corporation (sec. 1036), and certain exchanges of United States obligations (sec. 1037).

[25] This is the same rule as presently set forth in Rev. Rul. 65–155, *supra*.

	Rev. Rul. 65–155—Like kind property taken into account	*Like kind property not taken into account*
Contract price	$1, 000, 000	$800, 000
Gross profit	600, 000	600, 000
Gross profit ratio (percent)	(60)	(75)
Gain to be reported for:		
1. Taxable year of sale:		
(a) 60% of $300,000 (payments "received" of $100,000 cash and $200,000 value of like property)	180, 000	
(b) 75% of $100,000 (cash payments)		75, 000
2. Succeeding taxable year:		
(a) 60% of $700,000 (cash received)	420, 000	
(b) 75% of $700,000 (cash received)		525, 000
Total gain recognized	600, 000	600, 000
3. Basis of like kind property received	200, 000	200, 000

H. Installment Obligations Distributed in a 12-Month Corporate Liquidation (sec. 2 of the bill and new sec. 453(h) of the Code)

Present law

Under present law, gain or loss is not generally recognized at the corporate level for sales and exchanges occurring during the 12-month period after the corporation has elected a plan of complete liquidation (Code sec. 337). A special rule provides that in this situation gain or loss generally is not recognized to the liquidating corporation for distributions of installment obligations (Code sec. 453(d)(4)(B)). Gain or loss is recognized by the shareholders with respect to the liquidating distributions. No special exception applies for the distribution of installment obligations to shareholders so that the shareholders may defer reporting gain from the obligations.

Explanation of provision

Under the bill, in the case of a corporate liquidation the receipt by a shareholder (under Code sec. 331) of an installment obligation which was received by the corporation during its 12-month liquidation period (under Code sec. 337) generally will not be treated as the receipt of payment by the shareholder. Instead, the shareholder may report gain from the exchange of stock on the installment method, taking gain into account as payments are received on the installment obligation received as a liquidating distribution. Where a parent liquidating corporation had a subsidiary which received an obligation during the

subsidiary's liquidation (to which sec. 337(c)(3) applied) that obligation also will qualify for installment reporting by the shareholders of the parent corporation. However, in no event will obligations received by the liquidating corporation from the sale of inventory, other than from the bulk sale, qualify for installment treatment by the shareholder.

Where liquidating distributions are received by a shareholder in more than one taxable year, the shareholder will be required to recompute the gain reported from the liquidation by allocating basis in the stock pro rata over all payments received (or to be received). This may require amended returns if the liquidating distributions are not all received during the same taxable year of the shareholder.

The following example will illustrate the operation of this rule. Assume that the taxpayer is the sole shareholder of a corporation with an adjusted basis of $200,000 in the stock (all of the stock having been acquired in the same transaction at the same cost), and is a calendar year taxpayer. Also, assume that the corporation adopts a plan of liquidation in July 1982, that the corporation sells all of its assets in August 1982 to an unrelated purchaser for $1 million, consisting of $250,000 in cash and an installment note for $750,000, that the entire gain qualifies for nonrecognition under section 337, that there is no imputed interest income or original issue discount, that the corporation distributes the cash in November 1982 and that the note is distributed in complete liquidation in June 1983. The taxpayer would initially report a gain of $50,000 in 1982 ($250,000 cash received less $200,000 basis in the stock).

After the distribution of the note in 1983, under the installment method, the taxpayer would recompute the gain reported in 1982 by allocating basis according to the installment sales rules. Thus, 75 percent ($750,000 (face amount of installment obligation) divided by $1 million (total distribution)) of the taxpayer's basis in the stock, or $150,000 (75 percent times $200,000) would be allocated to the installment obligation. Further, 25 percent ($250,000 divided by $1 million) of the taxpayer's basis in the stock or $50,000 (25 percent times $200,000) is allocated to the distribution of the cash. The taxpayer thus is required to file an amended return for 1982 to reflect an additional $150,000 of gain (cash received of $250,000 less the sum of $50,000 basis and $50,000 gain initially reported). Eighty percent of each payment on the note (other than interest) must be reported as gain by the taxpayer (gain of $600,000 ($750,000 face amount of obligation less basis of $150,000) divided by $750,000 (contract price)).

Under the bill, nonrecognition treatment will not be available if the installment purchaser is either the shareholder-distributee's spouse, a trust treated as owned by the shareholder-distributee or his spouse, or a corporation or a partnership which is 80-percent owned by the shareholder-distributee and/or his spouse.[26]

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[26] In general, the relationships covered by the exception to nonrecognition treatment are similar to the relationships covered under the provisions of existing laws which prescribe special income characterization rules for certain transactions between closely related taxpayers (Code secs. 1239 and 707(b)(2). However, ownership by family members other than husband and wife will not be attributed.

In the case of transactions which are governed by the doctrine of liquidation-reincorporation under present law, the tax treatment for those transactions would continue to be governed by present law and would not be affected by this provision.

Finally, if another related party (a person who is not covered by the preceding special recognition rule but who is related within the meaning of new sec. 453(f)(1)) purchases the corporate assets and then disposes of them, the related party disposition rules (as previously described under part F of this report) will apply to the shareholder who received the related party's installment obligations as a liquidating distribution. In other words, in these cases, the shareholder-distributee will be substituted for the liquidated corporation for purposes of applying the related party resale rules provided under the bill.

I. Sales Subject to a Contingency (sec. 2 of the bill and new sec. 453(i) of the Code)

Present law

As a general rule, installment reporting of gain from deferred payments is not available where all or a portion of the selling price is subject to a contingency. The case law holds that the selling price must be fixed and determinable for section 453(b) to apply.[27] An agreement, however, to indemnify the purchaser for breach of certain warranties and representations by offset against the purchase price will not disqualify an installment sale under section 453(b).[28] Exactly how broad such contingencies can be is unclear.

Where an installment sale is subject to a contingency with respect to the price and the installment method is not available, the taxpayer is required to recognize all of the gain in the year of the sale with respect to all of the payments to be made, even though such payments are payable in future taxable years. In the case of a cash-method taxpayer whiere the future payments have no readily ascertainable fair market value, the taxpayer may treat the transaction with respect to those payments as "open" and use the cost-recovery method under *Burnet* v. *Logan*, 2830 U.S. 404 (1931).

Explanation of provision

The bill permits installment sale reporting for sales for a contingent selling price. In extending eligibility, the bill does not prescribe specific rules for every conceivable transaction. Rather, the bill provides that specific rules will be prescribed under regulations.

However, it is intended that, for sales under which there is a stated maximum selling price, the regulations will permit basis recovery on the basis of a gross profit ratio determined by reference to the stated maximum selling price. For purposes of this provision, incidental or remote contingencies are not to be taken into account in determining if there is a stated maximum selling price. In general, the maximum selling price would be determined from the "four corners" of the contract agreement as the largest price which could be paid to the taxpayer assuming all contingencies, formulas, etc., operate in the taxpayer's favor. Income from the sale would be reported on a pro rata basis with respect to each installment payment using the maximum selling price to determine the total contract price and gross profit

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[27] *Gralapp* v. *United States*, 458 F.2d 1158 (10th Cir. 1972); *In re Steen*, 509 F.2d 1398 (9th Cir. 1975).

[28] See Rev. Rul. 77-56, 1977-1 C.B. 135.

ratio. If, pursuant to standards prescribed by regulations, it is subsequently determined that the contingency will not be satisfied in whole or in part, thus reducing the maximum selling price, the taxpayer's income from the sale would be recomputed. The taxpayer would then report reduced income, as adjusted, with respect to each installment payment received in the taxable year of adjustment and subsequent taxable years. If the maximum price is reduced in more than one taxable year, *e.g.*, because of successive changes in the status of the contingency, each such year of reduction would constitute an adjustment year.

Where the taxpayer has reported more income from installment payments received in previous taxable years than the total recomputed income, the taxpayer would be permitted to deduct the excesses in the adjustment year as a loss.

In cases where the sales price is indefinite and no maximum selling price can be determined but the obligation is payable over a fixed period of time, it is generally intended that basis of the property sold would be recovered ratably over that fixed period. In a case where the selling price and payment period are both indefinite but a sale has in fact occurred, it is intended that the regulations would permit ratable basis recovery over some reasonable period of time. Also, in appropriate cases, it is intended that basis recovery would be permitted under an income forecast type method.[29]

The creation of a statutory deferred payment option for all forms of deferred payment sales significantly expands the availability of installment reporting to include situations where it has not previously been permitted. By providing an expanded statutory installment reporting option, the Ways and Means Committee believed that in the future there should be little incentive to devise convoluted forms of deferred payment obligations to attempt to obtain deferred reporting. In any event, the effect of the new rules is to reduce substantially the justification for treating transactions as "open" and permitting the use of the cost-recovery method sanctioned by *Burnet* v. *Logan*, 283 U.S. 404 (1931). Accordingly, it was the Ways and Means Committee's intent that the cost-recovery method not be available in the case of sales for a fixed price (whether the seller's obligation is evidenced by a note, contractual promise, or otherwise), and that its use be limited to those rare and extraordinary cases involving sales for a contingent price where the fair market value of the purchaser's obligation cannot reasonably be ascertained.

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[29] In general, the income forecast method for basis recovery is considered appropriate for a transaction with respect to which it may be demonstrated that receipts will be greater for the earlier years of the payment period and then decline for the later years of the payment period. It is intended that the regulations will deal with the application of this method with respect to sales of property qualifying for depreciation under the income forecast method (e.g., movies), mineral rights when the selling price is based on production, a sale under which the amount payable to the seller is based on a declining percentage of the purchaser's revenues, and similar sales. In developing these regulations, the committee intends that the Treasury Department will prescribe rules for this method to avoid, whenever possible, leaving a seller with an unrecovered basis in the obligation, and thereby creating a capital loss, after the final payment is received. For qualifying transactions, a more rapid basis recovery under this method is to be allowed even if there is a fixed period over which payments are to be received.

J. Cancellation of Installment Obligation (sec. 2 of the bill and new sec. 453B(f) of the Code)

Present law

Under present law, some have argued that the installation obligation disposition rules can be avoided by making gift cancellations of the obligation or the installments as they come due. In other words, by making an installment sale and then cancelling the obligation or a number of installment payments, it is argued that the seller will incur no income tax liability, but possibly some gift taxes, and the buyer will have a cost basis in the property sold although no income tax cost will have been incurred on the transaction. If a direct gift is made, the donee's basis is generally the same as the donor's basis rather than a "cost" basis which reflects future payments which will never be made.

This cancellation technique is based on a District Court's decision in *Miller* v. *Usry*.[30] In that case, the court held that the disposition rules for obligations disposed of other than by sale or exchange were directed at corporate transfers and should not be applied to a cancellation of the obligation where there has been no actual, real, or material gain to the taxpayer. The court did not consider the possible benefit to the donee from acquiring a cost basis through the installment sale. Next, the court held that the disposition rules for satisfaction at other than face value did apply to a cancellation but no tax was incurred because no amount was realized by the taxpayer.

Explanation of provision

The bill makes it clear that the cancellation of an installment obligation is treated as a disposition of the obligation. In the case where the obligor is a related party, the amount taken into account as a disposition triggering recognition of unreported gain attributable to the obligation is not to be less than the face amount of the installment obligation.

K. Bequest of Obligation to Obligor (sec. 3 of the bill and new sec. 691(a)(5) of the Code)

Present law

Under present law, the installment obligation disposition rules do not apply to the transmission of installment obligations at death (Code secs. 453(d)(3) and 691(a)(4)). However, unreported gains attributable to installment obligations are treated as items of gross income in respect of a decedent so that the recipient is taxed upon receipt of the installment payments in the same manner as the deceased seller would have been had he lived to receive the payments. A special rule allows a deduction for the estate taxes attributable to the unreported gain on the installment obligation (Code sec. 691(c)).

Another provision (Code sec. 691(a)(2)) provides that the transfer of an installment obligation to the estate of the deceased seller will not be treated as a transfer requiring the reporting of gain. In addition, this rule applies to a transfer to a person pursuant to the right of such person to receive the installment obligation by reason of the death of the seller or by bequest, devise, or inheritance from the seller.

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[30] 160 F. Supp. 368, 58-1 USTC ¶ 9393 (W.D. La. 1958).

Because of these rules, it has been argued that any unreported gain remaining at the death of the seller will never be taxed if the installment obligation is left to the obligor. In this case, it is argued that there will never be a disposition or collection of the unpaid balance because there has been a merger of interests of obligor and obligee. In other words, the obligor will have acquired a cost basis for depreciation and resale purposes prior to the seller's death, but no income tax cost will have been incurred with respect to the gain unreported by the seller at the time of his death.

Explanation of provision

The bill provides that any previously unreported gain from an installment sale will be recognized by a deceased seller's estate if the obligation is transferred or transmitted by bequest, devise, or inheritance to the obligor or is cancelled by the executor.

In the absence of some act of cancelling the obligation by distribution or notation which results in cancellation under the Uniform Commercial Code or other local law, the disposition will be considered to occur no later than the time the period of administration of the estate is concluded.

If the cancellation occurs at the death of the holder of the obligation, the cancellation is to be treated as a transfer by the estate of the decedent. However, if the obligation were held by a person other than the decedent, such as a trust, the cancellation will be treated as a transfer immediately after the decedent's death by that person.

If the decedent and the obligor were related persons (within the meaning of new Code section 453(f)(1)), the fair market value of the obligation for disposition purposes is not to be treated as less than its face amount.

For purposes of this provision, if an installment obligation becomes unenforceable, it will be treated as if it were cancelled.

L. Foreclosure of Real Property Sold on Installment Method by Deceased Taxpayer (sec. 4 of the bill and sec. 1038 of the Code)

Present law

Under present law, the recognition of gain upon a reconveyance of real property to the seller in partial or full satisfaction of purchase money debt is limited (Code sec. 1038). Losses, including bad debt losses, are also not recognized upon a reconveyance of real property. With respect to gains, the amount of gain required to be recognized upon reconveyance of the real property sold generally is limited to the lesser of the amount of any remaining unreported portion of the original gain or the amount by which the sum of the money and fair market value of property received prior to the reacquisition exceeds the amount of gain previously reported. The Internal Revenue Service has ruled that this provision does not apply to a reconveyance to the estate of a deceased taxpayer who made the original sale (Rev. Rul. 69–83, 1969–1, C.B. 202). In other words, a decedent's estate is not permitted to succeed to the tax treatment which would have been available to the decedent had he lived to receive the reconveyance because the estate is considered to be a separate taxable entity.

Explanation of provision

Under the bill, the estate or beneficiary of a deceased seller will be entitled to the same nonrecognition treatment upon the acquisition of real property in partial or full satisfaction of secured purchase money debt as the deceased seller would have been entitled.

The basis of the property acquired will be the same as if the property had been reacquired by the original seller, increased by an amount equal to the section 691(c) deduction for estate taxes which would have been allowable had the repossession been taxable.

M. Effective Dates (sec. 5 of the bill)

In general, the provisions of the bill are effective for dispositions of property, cancellations and reacquisitions of real property, as the case may be, occurring after the date of enactment. However, the related party installment sale rules would apply to installment sales (first dispositions) after May 14, 1980. The provision relating to the distribution of installment obligations in connection with a 12-month corporate liquidation would apply with respect to installment obligations distributed after March 31, 1980.

N. Revenue Effects

Due to the interaction between the provisions of this bill, revenue effects for each specific provision cannot be determined independently. It is estimated that on balance the provisions of this bill (except related party sales) will not have a significant revenue effect on budget receipts.

Due to the extensive litigation and controversy concerning the treatment of related party sales under present law, the revenue gain for this provision of the bill is indeterminant.

The Director of the Congressional Budget Office and the Treasury Department agree with this statement.

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