

IRC 453 – Installment Sale Method

STATUTE

(a)

General rule

Except as otherwise provided in this section, income from an installment sale shall be taken into account for purposes of this title under the installment method.

(b)

Installment sale defined

For purposes of this section -

(1)

In general

The term "installment sale" means a disposition of property where at least 1 payment is to be received after the close of the taxable year in which the disposition occurs.

(2)

Exceptions

The term "installment sale" does not include -

(A)

Dealer dispositions

Any dealer disposition (as defined in subsection (1)).

(B)

Inventories of personal property

A disposition of personal property of a kind which is required to be included in the inventory of the taxpayer if on hand at the close of the taxable year.

(c)

Installment method defined

For purposes of this section, the term "installment method" means a method under which the income recognized for any taxable year from a disposition is that proportion of the payments received in that year which the gross profit (realized or to be realized when payment is completed) bears to the total contract price.

(d)

Election out

(1)

In general

Subsection (a) shall not apply to any disposition if the taxpayer elects to have subsection (a) not apply to such disposition.

(2)

Time and manner for making election

Except as otherwise provided by regulations, an election under paragraph (1) with respect to a disposition may be made only on or before the due date prescribed by law (including extensions) for filing the taxpayer's return of the tax imposed by

this chapter for the taxable year in which the disposition occurs. Such an election shall be made in the manner prescribed by regulations.

(3)

Election revocable only with consent

An election under paragraph (1) with respect to any disposition may be revoked only with the consent of the Secretary.

(e)

Second dispositions by related persons

(1)

In general

If -

(A)

any person disposes of property to a related person (hereinafter in this subsection referred to as the "first disposition"), and

(B)

before the person making the first disposition receives all payments with respect to such disposition, the related person disposes of the property (hereinafter in this subsection referred to as the "second disposition"), then, for purposes of this section, the amount realized with respect to such second disposition shall be treated as received at the time of the second disposition by the person making the first disposition.

(2)

2-Year cutoff for property other than marketable securities

(A)

In general

Except in the case of marketable securities, paragraph (1) shall apply only if the date of the second disposition is not more than 2 years after the date of the first disposition.

(B)

Substantial diminishing of risk of ownership

The running of the 2-year period set forth in subparagraph

(A)

shall be suspended with respect to any property for any period during which the related person's risk of loss with respect to the property is substantially diminished by -

(i)

the holding of a put with respect to such property (or similar property),

(ii)

the holding by another person of a right to acquire the property, or

(iii)

a short sale or any other transaction.

(3)

Limitation on amount treated as received

The amount treated for any taxable year as received by the person making the first disposition by reason of paragraph (1) shall not exceed the excess of -

(A)

the lesser of -

(i)

the total amount realized with respect to any second disposition of the property occurring before the close of the taxable year, or

(ii)

the total contract price for the first disposition, over

(B)

the sum of -

(i)

the aggregate amount of payments received with respect to the first disposition before the close of such year, plus

(ii)

the aggregate amount treated as received with respect to the first disposition for prior taxable years by reason of this subsection.

(4)

Fair market value where disposition is not sale or exchange

For purposes of this subsection, if the second disposition is not a sale or exchange, an amount equal to the fair market value of the property disposed of shall be substituted for the amount realized.

(5)

Later payments treated as receipt of tax paid amounts

If paragraph (1) applies for any taxable year, payments received in subsequent taxable years by the person making the first disposition shall not be treated as the receipt of payments with respect to the first disposition to the extent that the aggregate of such payments does not exceed the amount treated as received by reason of paragraph (1).

(6)

Exception for certain dispositions

For purposes of this subsection -

(A)

Reacquisitions of stock by issuing corporation not treated as first dispositions

Any sale or exchange of stock to the issuing corporation shall not be treated as a first disposition.

(B)

Involuntary conversions not treated as second dispositions

A compulsory or involuntary conversion (within the meaning of section [1033](#)) and any transfer thereafter shall not be treated as a second disposition if the first disposition occurred before the threat or imminence of the conversion.

(C)

Dispositions after death

Any transfer after the earlier of -

(i)

the death of the person making the first disposition, or

(ii)

the death of the person acquiring the property in the first disposition, and any transfer thereafter shall not be treated as a second disposition.

(7)

Exception where tax avoidance not a principal purpose

This subsection shall not apply to a second disposition (and any transfer thereafter) if it is established to the satisfaction of the Secretary that neither the first disposition nor the second disposition had as one of its principal purposes the avoidance of Federal income tax.

(8)

Extension of statute of limitations

The period for assessing a deficiency with respect to a first disposition (to the extent such deficiency is attributable to the application of this subsection) shall not expire before the day which is 2 years after the date on which the person making the first disposition furnishes (in such manner as the Secretary may by regulations prescribe) a notice that there was a second disposition of the property to which this subsection may have applied. Such deficiency may be assessed notwithstanding the provisions of any law or rule of law which would otherwise prevent such assessment.

(f)

Definitions and special rules

For purposes of this section -

(1)

Related person

Except for purposes of subsections (g) and (h), the term "related person" means -

(A)

a person whose stock would be attributed under section [318\(a\)](#) (other than paragraph (4) thereof) to the person first disposing of the property, or

(B)

a person who bears a relationship described in section [267\(b\)](#) to the person first disposing of the property.

(2)

Marketable securities

The term "marketable securities" means any security for which, as of the date of the disposition, there was a market on an established securities market or otherwise.

(3)

Payment

Except as provided in paragraph (4), the term "payment" does not include the receipt of evidences of indebtedness of the person acquiring the property (whether or not payment of such indebtedness is guaranteed by another person).

(4)

Purchaser evidences of indebtedness payable on demand or readily tradable

Receipt of a bond or other evidence of indebtedness which -

(A)

is payable on demand, or

(B)
is issued by a corporation or a government or political subdivision thereof and is readily tradable, shall be treated as receipt of payment.

(5)

Readily tradable defined

For purposes of paragraph (4), the term "readily tradable" means a bond or other evidence of indebtedness which is issued -

(A)

with interest coupons attached or in registered form (other than one in registered form which the taxpayer establishes will not be readily tradable in an established securities market), or

(B)

in any other form designed to render such bond or other evidence of indebtedness readily tradable in an established securities market.

(6)

Like-kind exchanges

In the case of any exchange described in section [1031\(b\)](#) -

(A)

the total contract price shall be reduced to take into account the amount of any property permitted to be received in such exchange without recognition of gain,

(B)

the gross profit from such exchange shall be reduced to take into account any amount not recognized by reason of section [1031\(b\)](#), and

(C)

the term "payment", when used in any provision of this section other than subsection (b)(1), shall not include any property permitted to be received in such exchange without recognition of gain. Similar rules shall apply in the case of an exchange which is described in section [356\(a\)](#) and is not treated as a dividend.

(7)

Depreciable property

The term "depreciable property" means property of a character which (in the hands of the transferee) is subject to the allowance for depreciation provided in section [167](#).

(8)

Payments to be received defined

The term "payments to be received" includes -

(A)

the aggregate amount of all payments which are not contingent as to amount, and

(B)

the fair market value of any payments which are contingent as to amount.

(g)

Sale of depreciable property to controlled entity

(1)

In general

In the case of an installment sale of depreciable property between related persons

-

(A)
subsection (a) shall not apply,

(B)
for purposes of this title -

(i)
except as provided in clause (ii), all payments to be received shall be treated as received in the year of the disposition, and

(ii)
in the case of any payments which are contingent as to the amount but with respect to which the fair market value may not be reasonably ascertained, the basis shall be recovered ratably, and

(C)
the purchaser may not increase the basis of any property acquired in such sale by any amount before the time such amount is includible in the gross income of the seller.

(2)
Exception where tax avoidance not a principal purpose
Paragraph (1) shall not apply if it is established to the satisfaction of the Secretary that the disposition did not have as one of its principal purposes the avoidance of Federal income tax.

(3)
Related persons
For purposes of this subsection, the term "related persons" has the meaning given to such term by section [1239\(b\)](#), except that such term shall include 2 or more partnerships having a relationship to each other described in section [707\(b\)\(1\)\(B\)](#).

(h)
Use of installment method by shareholders in certain liquidations

(1)
Receipt of obligations not treated as receipt of payment

(A)
In general

If, in a liquidation to which section [331](#) applies, the shareholder receives (in exchange for the shareholder's stock) an installment obligation acquired in respect of a sale or exchange by the corporation during the 12-month period beginning on the date a plan of complete liquidation is adopted and the liquidation is completed during such 12-month period, then, for purposes of this section, the receipt of payments under such obligation (but not the receipt of such obligation) by the shareholder shall be treated as the receipt of payment for the stock.

(B)
Obligations attributable to sale of inventory must result from bulk sale

Subparagraph (A) shall not apply to an installment obligation acquired in respect of a sale or exchange of -

(i)
stock in trade of the corporation,

(ii)

other property of a kind which would properly be included in the inventory of the corporation if on hand at the close of the taxable year, and

(iii)

property held by the corporation primarily for sale to customers in the ordinary course of its trade or business, unless such sale or exchange is to 1 person in 1 transaction and involves substantially all of such property attributable to a trade or business of the corporation.

(C)

Special rule where obligor and shareholder are related persons

If the obligor of any installment obligation and the shareholder are married to each other or are related persons (within the meaning of section [1239\(b\)](#)), to the extent such installment obligation is attributable to the disposition by the corporation of depreciable property -

(i)

subparagraph (A) shall not apply to such obligation, and

(ii)

for purposes of this title, all payments to be received by the shareholder shall be deemed received in the year the shareholder receives the obligation.

(D)

Coordination with subsection (e)(1)(A)

For purposes of subsection (e)(1)(A), disposition of property by the corporation shall be treated also as disposition of such property by the shareholder.

(E)

Sales by liquidating subsidiaries

For purposes of subparagraph (A), in the case of a controlling corporate shareholder (within the meaning of section [368\(c\)](#)) of a selling corporation, an obligation acquired in respect of a sale or exchange by the selling corporation shall be treated as so acquired by such controlling corporate shareholder. The preceding sentence shall be applied successively to each controlling corporate shareholder above such controlling corporate shareholder.

(2)

Distributions received in more than 1 taxable year of shareholder

If -

(A)

paragraph (1) applies with respect to any installment obligation received by a shareholder from a corporation, and

(B)

by reason of the liquidation such shareholder receives property in more than 1 taxable year, then, on completion of the liquidation, basis previously allocated to property so received shall be reallocated for all such taxable years so that the shareholder's basis in the stock of the corporation is properly allocated among all property received by such shareholder in such liquidation.

(i)

Recognition of recapture income in year of disposition

(1)

In general

In the case of any installment sale of property to which subsection (a) applies -

(A)

notwithstanding subsection (a), any recapture income shall be recognized in the year of the disposition, and

(B)

any gain in excess of the recapture income shall be taken into account under the installment method.

(2)

Recapture income

For purposes of paragraph (1), the term "recapture income" means, with respect to any installment sale, the aggregate amount which would be treated as ordinary income under (or so much of section [751](#) as relates to section [1245](#) or [1250](#)) for the taxable year of the disposition if all payments to be received were received in the taxable year of disposition.

(j)

Regulations

(1)

In general

The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the provisions of this section.

(2)

Selling price not readily ascertainable

The regulations prescribed under paragraph (1) shall include regulations providing for ratable basis recovery in transactions where the gross profit or the total contract price (or both) cannot be readily ascertained.

(k)

Current inclusion in case of revolving credit plans, etc.

In the case of -

(1)

any disposition of personal property under a revolving credit plan, or

(2)

any installment obligation arising out of a sale of -

(A)

stock or securities which are traded on an established securities market, or

(B)

to the extent provided in regulations, property (other than stock or securities) of a kind regularly traded on an established market, subsection (a) shall not apply, and, for purposes of this title, all payments to be received shall be treated as received in the year of disposition. The Secretary may provide for the application of this subsection in whole or in part for transactions in which the rules of this subsection otherwise would be avoided through the use of related parties, pass-thru entities, or intermediaries.

(l)

Dealer dispositions

For purposes of subsection (b)(2)(A) -

(1)

In general

The term "dealer disposition" means any of the following dispositions:

(A)

Personal property

Any disposition of personal property by a person who regularly sells or otherwise disposes of personal property of the same type on the installment plan.

(B)

Real property

Any disposition of real property which is held by the taxpayer for sale to customers in the ordinary course of the taxpayer's trade or business.

(2)

Exceptions

The term "dealer disposition" does not include -

(A)

Farm property

The disposition on the installment plan of any property used or produced in the trade or business of farming (within the meaning of section [2032A\(e\)\(4\)](#) or (5)).

(B)

Timeshares and residential lots

(i)

In general

Any dispositions described in clause (ii) on the installment plan if the taxpayer elects to have paragraph (3) apply to any installment obligations which arise from such dispositions. An election under this paragraph shall not apply with respect to an installment obligation which is guaranteed by any person other than an individual.

(ii)

Dispositions to which subparagraph applies

A disposition is described in this clause if it is a disposition in the ordinary course of the taxpayer's trade or business to an individual of -

(I)

a timeshare right to use or a timeshare ownership interest in residential real property for not more than 6 weeks per year, or a right to use specified campgrounds for recreational purposes, or

(II)

any residential lot, but only if the taxpayer (or any related person) is not to make any improvements with respect to such lot. For purposes of subclause (I), a timeshare right to use (or timeshare ownership interest in) property held by the spouse, children, grandchildren, or parents of an individual shall be treated as held by such individual.

(C)

Carrying charges or interest

Any carrying charges or interest with respect to a disposition described in

subparagraph (A) or (B) which are added on the books of account of the seller to the established cash selling price of the property shall be included in the total contract price of the property and, if such charges or interest are not so included, any payments received shall be treated as applying first against such carrying charges or interest.

(3)

Payment of interest on timeshares and residential lots

(A)

In general

In the case of any installment obligation to which paragraph (2)(B) applies, the tax imposed by this chapter for any taxable year for which payment is received on such obligation shall be increased by the amount of interest determined in the manner provided under subparagraph (B).

(B)

Computation of interest

(i)

In general

The amount of interest referred to in subparagraph (A) for any taxable year shall be determined -

(I)

on the amount of the tax for such taxable year which is attributable to the payments received during such taxable year on installment obligations to which this subsection applies,

(II)

for the period beginning on the date of sale, and ending on the date such payment is received, and

(III)

by using the applicable Federal rate under section [1274](#) (without regard to subsection (d)(2) thereof) in effect at the time of the sale compounded semiannually.

(ii)

Interest not taken into account

For purposes of clause (i), the portion of any tax attributable to the receipt of any payment shall be determined without regard to any interest imposed under subparagraph (A).

(iii)

Taxable year of sale

No interest shall be determined for any payment received in the taxable year of the disposition from which the installment obligation arises.

(C)

Treatment as interest

Any amount payable under this paragraph shall be taken into account in computing the amount of any deduction allowable to the taxpayer for interest paid or accrued during such taxable year.