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Internal Revenue Service (I.R.S.)

Revenue Ruling

INSTALLMENT OBLIGATION; SUBSTITUTED OBLIGORS

Published: 1975

26 CFR 1.453-9: Gain or loss on disposition of installment obligations

Installment obligation; substituted obligors. The substitution of the obligors, deeds of trust, and promissory notes, with no changes from the terms or conditions of the original deeds and notes, does not constitute a satisfaction or disposition of an installment obligation under section 453(d) of the Code.

Advice has been requested whether, under the circumstances described below, the substitution of obligors, deeds of trust, and promissory notes will result in a satisfaction or disposition of an installment obligation within the meaning of section 453(d) of the Internal Revenue Code of 1954.

The taxpayer sold real property to A for a total purchase price of 670x dollars. Of this amount, 70x dollars was paid at the time of sale. The remainder of the purchase price is evidenced by a deed of trust and a promissory note bearing 8 percent interest payable monthly over a 15 year term. The taxpayer elected to report the gain realized from the sale of the land on the installment method of accounting as provided by section 453(b) of the Code.

The deed of trust and promissory note provide that the original buyer, A, or subsequent buyers are permitted to reconvey all or part of the real property provided the subsequent buyer executes a new deed of trust and promissory note in favor of the taxpayer.

In the following year A sold the property to B, and the taxpayer released A from liability, substituting B as the obligor under the same terms and conditions as in the original deed of trust and promissory note.

Under section 453 of the Code a taxpayer may, under certain conditions, elect to report the gain from the sale of real property using the installment method of accounting. Under this method the taxpayer must include in his gross income each year that proportion of the installment payments actually received which the gain, realized or to be realized when payment is completed, bears to the total contract price.

Section 453(d) of the Code provides, in part, that if an installment obligation is satisfied at other than its face value or distributed, transmitted, sold, or otherwise disposed of, gain or loss shall result to the extent of the difference between the basis of the obligation and (A) the amount realized, in the case of satisfaction at other than face value or a sale or exchange, or (B) the fair market value of the obligation at the time of distribution, transmission, or disposition, in the case of the distribution, transmission, or disposition otherwise than by sale or exchange.

Rev. Rul. 74-157, 1974-1 C.B. 115, concerns the substitution of two promissory notes, each secured by a deed of trust on a parcel of land, for the original unpaid note and deed for the total land sold. That Revenue Ruling holds that such substitution is not a satisfaction or disposition of an installment obligation within the meaning of section 453(d) of the Code.

In John I. Cunningham, 44 T.C. 103 (1965), acq., 1966-2 C.B. 4, The Tax Court of the United States considered a case wherein the petitioner sold shares of stock in corporation X to corporation A for cash and an installment obligation represented by a promissory note. Subsequently, corporation A transferred its shares of corporation X to corporation B which assumed the installment obligation of corporation A on the promissory notes held by the petitioner, and the petitioner released A of liability. The court held that this was not a disposition by the petitioner of his installment obligation.

Generally, a satisfaction or disposition under section 453(d) of the Code occurs when the rights accruing to the seller under an installment sale either disappear or

are materially disposed of or altered so that the need for postponing recognition of gain otherwise realized ceases. The mere substitution and release of the original obligor on an installment obligation, and the assumption of the installment obligation by a new obligor, without any other changes, will not in itself constitute a satisfaction or disposition under [section 453\(d\)](#).

Accordingly, in the instant case, the substitution of obligors, deeds of trust, and promissory notes for the existing obligors, deeds of trust, and promissory notes was not a satisfaction or disposition of an installment obligation within the meaning of [section 453\(d\)](#) of the Code.

Rev. Rul. 75-457, 1975-2 C.B. 196, 1975 WL 34907 (IRS RRU)

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