ARTICLES >>

The Basics of Installment Sale Method, by Asel Mukeyeva

In the aftermath of the 2008 financial crisis, many sellers and buyers of real and personal property were forced to seek unconventional financing due to tightened lending practices. A common alternative to conventional financing was seller financing where sellers sold property to buyers on an installment sale basis and carried back promissory notes earning a stated interest rate over the course of several years.

The installment sale method continues to be a popular alternative to conventional financing. It offers many benefits to both buyers and sellers. Buyers do not have to have a good credit history or make a down payment on the purchase of property. Since the financing is based on the terms of a purchase agreement that both a buyer and a seller may modify, amend or terminate, the terms of the agreement may be flexible and may be drafted to match the needs of the contracting parties. Sellers prefer the installment sale financing method because they can earn interest income on the outstanding balance of the installment note and defer recognition of gain until future years as payments are received.
Section 453 of the Internal Revenue Code (the “Code”) and the Treasury regulations thereunder set forth the rules for the application of the installment sale method. The Code defines an installment sale as a disposition of property in which at least one payment is to be received after the close of the tax year in which the sale occurs.\(^1\) The main tax advantage of the installment method is that the gain from the sale may be deferred and recognized in portions as payments are received over the entire installment sale period. Treasury Regulation § 15A.453-1(b)(2) sets forth the computation of the gain that should be recognized under the installment method as follows:

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\text{Selling Price} = \text{gross selling price without reduction for selling expenses}; \\
\text{Adjusted Basis} = \text{adjusted basis as determined under basis rules}; \\
\text{Gross Profit} = \text{Selling Price} – \text{Adjusted Basis}; \\
\text{Contract Price} = \text{Selling Price} – \text{Qualified Indebtedness (not to exceed basis)}; \\
\text{Gross Profit Percentage} = \frac{\text{Gross Profit}}{\text{Contract Price}}; \\
\text{Gain to be reported} = \text{Payment (not including interest)} \times \text{Gross Profit Percentage}
\]

The installment sale method may not be used for purposes of recognizing a loss, or in the case of sales of inventory items, sales by dealers, sales of publicly traded property, gain on sales of depreciable property to related persons, the gain attributable to depreciation recapture, sales of personal property under revolving credit plans.\(^2\)

Usually, if a sale is qualified under the installment method, then the installment method applies automatically. If a seller does not want to report the gain under the installment sale method, the seller must make an election not to use the installment sale method on a timely filed tax return by completing the appropriate form (Schedule D or other) and recognizing the entire gain in the year of sale.

There are many other rules that apply to the installment sale method, such as interest charge (the so called “excise tax”), related party rules and other rules that are important to be aware of in order to determine if the installment sale method will benefit the taxpayer the most.

\(^1\) §453(b)(1).  
\(^2\) §453(b),(k),(q),(i).  
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Final IRS Regulations Make Tax-Exempt Bond Project Identification and Accounting Crucial
By: Rachel Orr
Gilmore & Bell, P.C.

Background

In the municipal bond market, tax-exempt interest is king. In order to maintain the tax-exempt status of interest on municipal bonds, there are restrictions on private businesses using more than a de minimis amount of facilities financed with tax-advantaged bonds (“Bonds”). The term “tax-advantaged bonds” includes all bonds the interest on which is exempt from taxation under I.R.C. § 103 and interest subsidy bonds, such as Build America Bonds.

To avoid exceeding the limits on private use, users of Bond proceeds have historically financed portions of projects expected to be used in a private use with amounts other than proceeds of Bonds (e.g., hospital revenues). By carving out portions of projects with other funds, the proceeds of Bonds are not treated as used in a private use, and the king stays in the castle. On October 27, 2015, final Treasury Regulations were published that override regulations proposed in 2006 and set forth new rules for how private use will be measured for these mixed-use projects.

Private Use Measurement – “Floating Equity”

The final regulations effectively adopt a floating equity concept when measuring private use of eligible mixed-use projects. An eligible mixed-use project is one owned entirely by a governmental entity (or a 501(c)(3) in the case of a qualified 501(c)(3) Bond) that is financed both with proceeds of a Bond and qualified equity. Treas. Reg. § 1.141-6(b)(2). Proceeds of Bonds and qualified equity must also be spent on a project under the same plan of financing. Treas. Reg. § 1.141-6(b)(2).

So what is qualified equity? Qualified equity consists of amounts other than proceeds of Bonds that finance the same project as the Bonds, but does not include contributions of property. Treas. Reg. § 1.141-6(b)(3). For example, revenues or donations may be qualified equity, but land contributed upon which a facility is constructed would not be qualified equity.

To illustrate the same plan of financing concept, suppose County plans to construct a new addition to its hospital. The addition will cost $10 million and consist of 10,000 square feet. Once constructed, a retail pharmacy will lease 1,000 square feet of the addition. Because of this impending private use, County plans to issue Bonds for $9

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3 For governmental Bonds, this de minimis amount is 10%, and for qualified 501(c)(3) Bonds, 5%.

4 The term “tax-advantaged bonds” includes all bonds the interest on which is exempt from taxation under I.R.C. § 103 and interest subsidy bonds, such as Build America Bonds.

5 The final regulations are published at 80 Fed. Reg. 65637. The final regulations also make technical changes to the measurement of private use by partnerships and the remedial action rules. Those changes are beyond the scope of this article.

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million and pay $1 million from funds on hand. If County spends its $1 million to pay capital expenditures for the addition no earlier than 60 days prior to the date County adopted an official intent for the addition, and no later than the date the addition is placed in service, those amounts are spent pursuant to the same plan of financing. Treas. Reg. § 1.141-6(b)(4); Treas. Reg. § 1.150-2(d)(2).

Private use is calculated annually, allocating private use first to the portion of the project financed with qualified equity and then to Bond proceeds. Treas. Reg. § 1.141-6(b)(1); Treas. Reg. § 1.141-3(g)(4). In our hospital example, the 10% used by the pharmacy is allocated entirely to County’s $1 million. Suppose the pharmacy later closes, and County instead leases 1,750 square feet to a physician group. The first 1,000 square feet of private use is allocated to County’s $1 million. The remaining 750 square feet, or 8% of the addition financed with Bond proceeds (750/9,000), is used in a private use that year.

These final regulations may be applied to Bonds currently outstanding and must be applied to all Bonds issued on or after January 25, 2016. Treas. Reg. §§ 1.141-15(i), 1.141-15(l). Under the final regulations, timely identification of projects and financing sources are the keys to the kingdom.

**Congress Makes Permanent Several Tax Deductions for Individual Taxpayers**

*By: Adam B. Landy*

On December 18, 2015, President Obama signed the Protecting Americans from Tax Hikes Act of 2015 ("PATH") which made permanent several popular tax deductions. Many of these tax deductions were scheduled to expire on December 31, 2015 absent congressional action. These tax deductions now made permanent include:

- **Conservation Easements:** PATH makes permanent the present charitable deduction for contributions of real property for conservation purposes. A taxpayer may claim a deduction of the fair market value of a qualified contribution up to 50% of a taxpayer’s contribution base over the amount of all other allowable charitable contributions. The deduction may be carried over for 15 years. For qualified farmers and ranchers, the allowable deduction is 100%. This is deduction is an increase from the former law which provided a 30% contribution base limitation on contributions of capital gain property by taxpayers.

- **Individual Retirement Account (IRA) Transfers:** Under the prior law, taxpayers who are age 70½ or older could make tax-free distributions to a charity of their choice from an IRA of up to $100,000 per year. Although the transfers are not deductible, PATH permanently allows a taxpayer to exclude from income up to $100,000 of distributions from an IRA trustee to a charitable organization.
• **Section 179 Expense Deduction:** PATH makes permanent the $500,000 Section 179 expensing limit which will allow a small business to elect to expense up to $500,000 of investment in new equipment and other qualifying property instead of having to depreciate the cost over a specific number of years. The deduction is subject to a phase out for annual expenditures exceeding $2,000,000, but the phase out limit is indexed for inflation.

• **Child Tax Credit:** This credit allows taxpayers to claim a credit in the amount of $1,000 for each qualifying child under the age of 17 who is claimed by taxpayers as a dependent. This credit is also subject to a phase out at certain income thresholds. A taxpayer may be eligible for a refundable credit equal to 15% of earned income in excess of the threshold dollar amount.

  Additionally, PATH also makes permanent the American Opportunity Tax Credit, Earned Income Tax Credit, the above-the-line deduction of $250 for eligible elementary and secondary school teachers making qualifying classroom expenses, and the state and local tax deduction is also permanent for taxpayers itemizing their deductions.

**UPCOMING EVENTS >>**

• March 7, 2016, 1 pm – 2 pm – Tax Law Committee teleconference on You’ve Got the Right Stuff, Baby: What Corporate Counsel looks for in Outside Counsel

• March 21, 2016, 1 pm – 2:35 pm ET – webinar on I’ve Got Your Back; You’ve Got My Ear: Suicide Prevention in the Legal Profession. Suicide and factors associated with suicide, like depression and substance abuse, pose a significant danger in the legal profession. ABA’s Free CLE Series seeks to educate attorneys, judges, and law students of how to recognize the warning signs of suicide, the effective ways to help colleagues who may be at risk for suicide. Participants will learn about the ethical responsibilities when, as a result of a mental health or an addiction problem, the performance of a colleague falls below the standards set by the Model Rules of Professional Conduct or applicable state rules. More information is available on the ABA website.


• May 5 – 7, 2016, YLD Spring Conference in St. Louis, MO

• August 4 – 7, 2016, ABA Annual Meeting in San Francisco, CA

• August 4 – 7, 2016, ABA Fall Conference in Detroit, MI

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• Please view the upcoming events section on the ABA website homepage for more information.

IMPORTANT TAX DEADLINES >>

The 2016 tax season opened on January 19, 2016. The Internal Revenue Service began accepting individual electronic returns. IRS estimates that 70 percent of taxpayers are eligible for IRS Free File program. Taxpayers may also use some commercial software for free if they meet certain income thresholds ($62,000 or less). In addition, Volunteer Income Tax Assistance (VITA) and Tax Counseling for the Elderly (TCE) offer free tax help to taxpayers who qualify. For more information, taxpayers may search for “free tax prep” on the irs.gov website. Below are some filing deadlines to remember:

➢ MARCH 15, 2016
   First deadline to file tax returns for C and S corporations

➢ APRIL 18, 2016
   First deadline to file individual tax returns
   First deadline to file partnership returns
   First deadline to file tax returns for trusts and estates

➢ JUNE 30, 2016
   Deadline to file FBAR report