IRS Allows Do-Over for Installment Method Election

By Patrick Hoehne • Wood & Porter • San Francisco

It is easy to recall those childhood moments on the playground or sandlot when it was commonplace to cry out "do-over!" if a game didn't go your way. As an adult, those "do-overs" are few and far between, especially when it comes to taxing agencies.

However, the IRS recently issued LTR 200627012 [Apr. 4, 2006], granting a taxpayer corporation's request to amend its tax return in order to elect the installment method for the sale of shareholders' stock. While the regulations provide that an election to use the installment method must be made on an *original* tax return, the taxpayer cried out "do-over!" and the IRS listened.

In LTR 200627012, the shareholders of the taxpayer entered into an agreement to sell their stock to a third party for cash. The buyer made a partial cash payment and gave the shareholders promissory notes for the balance. The promissory notes provided for equal semi-annual payments of principal and accrued interest over a number of years.

The buyer filed a Code Sec. 338(h)(10) election to treat the stock sale as a deemed asset sale. Due to the Code Sec. 338(h)(10) election, the entire gain from the sale of stock was reported on the taxpayer's return for that year. When the shareholders' tax returns were being prepared, the shareholders realized that the entire gain from the deemed asset sale would be recognized immediately because the installment method had *not* been elected. Shortly thereafter, the taxpayer filed an amended return, reporting the sale as an installment sale.

The federal income tax return for each shareholder was timely filed. Each return reflected the sale as if it had been properly reported as an installment sale on the taxpayer's return. Each shareholder reported taxable income for the year of the sale based upon the installment method.

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Section 453(a) of the Internal Revenue Code provides that a taxpayer must report income from an installment sale under the installment method. An installment sale is a disposition of property for which at least one payment is to be received after the close of the tax year of the disposition.

Temporary Reg. §15a.453-1(b)(3)(I) defines "payment" to include amounts actually or constructively received in the tax year. Of course, a taxpayer can elect out of the installment method, and that election generally occurs by simply doing nothing. Thus, a taxpayer who reports an amount realized equal to the selling price, including the full face amount of an installment obligation on a timely filed tax return for the taxable year in which the installment sale occurs, is considered to have elected out of the installment method. [*See* Temporary Reg. §15a.453-1(d)(3).]

In other words, the filing of the original return constitutes an election out of the installment method which is generally irrevocable. A taxpayer may not file an amended tax return to use the installment method without prior consent from the IRS. A revocation of an election out of the installment method is retroactive, and will not be permitted when one of its purposes is the avoidance of federal income taxes. [*See* Temporary Reg. §15a.453-1(d)(4).]

Oops

Here, the parties said that they always intended to use the installment method. As soon as the shareholders realized that the entire gain had been reported on the taxpayer's original return, they took prompt, though improper, action. They filed an amended return for the taxpayer as though no election out of the installment method had been made. The shareholders filed their individual returns consistent with that amended return. A short time after filing their individual

returns, the shareholders submitted a request for a ruling seeking consent to revoke the taxpayer's election out of the installment method.

A taxpayer's mistake often leads to additional taxes, penalties and interest. However, here the IRS granted consent for the revocation of the taxpayer's election out of the installment method. Put simply, the IRS allowed a "do-over," and that was even after the amended (*a.k.a.* "do over") return was already filed.

Of course, you can't plan for this. Relying on the IRS to grant such a consent seems risky. It is probably best to leave "do-overs" to childhood memories.