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IRS Lists Monetized Installment Sales As Abusive Transactions

If you are a seller of appreciated property, it may be attractive to sell it on the installment method. That way, you pay tax over time as you get the installment payments, rather than paying the tax all at once. Subject to technical rules and limits, that is perfectly legal, section 453 of the tax code allows it. But what if you pay tax in installments, but arrange it so you get most or all of your cash up front? The IRS has issued proposed regulations identifying certain monetized installment sale transactions and substantially similar transactions as listed transactions.

That means the IRS has called them abusive tax transactions that must be reported to the IRS. Material advisors and certain participants in these listed transactions are required to file disclosures with the IRS and are subject to penalties for failure to disclose these transactions. The IRS listed monetized installment sales this year as part of the agency's Dirty Dozen list of common tax scams and schemes. Monetized installment sale transactions generally include the following elements:

- A seller of appreciated property, or a person acting on the seller's behalf, identifies a buyer who is willing to purchase the property in exchange for cash or other property.
- The seller enters into an agreement to sell the property to an intermediary in exchange for an installment obligation, which provides for interest payments from the intermediary to the seller.
- The seller then purportedly transfers the property to the intermediary, although the intermediary never actually takes title or takes title to the property only briefly before transferring title to the buyer in exchange for the buyer's cash or other property.
- The seller also obtains a loan with an agreement that provides for interest payments from the seller to the lender that equal the amount of interest that the intermediary pays the seller under the installment obligation.
- Both the installment agreement and the loan provide for interest due over the same periods, with principal due in a balloon payment at or near the end of the term of the installment agreement and loan.
- The sales proceeds received by the intermediary from the buyer, reduced by certain fees, are provided to the lender to fund the loan to the seller or transferred to an escrow account of which the lender is a beneficiary.
- The lender agrees to repay these amounts to the intermediary over the course of the term of the installment obligation.

- The seller then treats the sale as an installment sale under section 453 on a Federal income tax return for the year of the purported sale and defers recognition of gain until the year in which the seller receives the principal balloon payment.

Written comments regarding the proposed regulations must be submitted by Sept. 3, 2023. A public hearing has been scheduled for October 12, 2023. As part of the Dirty Dozen awareness effort, the IRS encourages people to report individuals who promote improper and abusive tax schemes as well as tax return preparers who deliberately prepare improper returns. For more information, see Abusive Tax Schemes and Abusive Tax Return Preparers.

Check out my website.