*Income Tax Planning for Real Estate Using Estate Planning Techniques*

by

Jerome M. Hesch

*jhesch62644@gmail.com*

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**Jerome M. Hesch,** Miami, Floridaserves as an income tax and estate planning consultant for lawyers and other tax planning professionals throughout the country. He is Special Tax Counsel to Oshins & Associates in Las Vegas Nevada, Dorot & Bensimon, in Aventura, Florida, Jeffrey M. Verdon Law Group, in Newport Beach, California and Meltzer, Lippe, Goldstein & Breitstone, in Mineola, New York. He is the Director of the Notre Dame Tax and Estate Planning Institute, scheduled this year as a virtual program for October 21 and 22, 2021, on the Tax Management Advisory Board, and a Fellow of both the American College of Trusts and Estates Council and the American College of Tax Council. He has published numerous articles, Tax Management Portfolios, and co-authored a law school casebook on Federal Income Taxation, now in its fourth edition. He was elected to the NAEPC Estate Planning Hall of Fame.

He has presented papers for the University of Miami Heckerling Institute on Estate Planning, the University of Southern California Tax Institute, the Southern Federal Tax Conference, the AICPA, and the New York University Institute on Federal Taxation, among others. He participated in several bar association projects, including the Drafting Committee for the Revised Uniform Partnership Act. He received his BA and MBA degrees from the University of Michigan and a JD degree from the University of Buffalo Law School.

He was with the Office of Chief Counsel, Internal Revenue Service, Washington, D.C. from 1970 to 1975, and was a full-time law professor from 1975 to 1994, teaching at the University of Miami School of Law and the Albany Law School, Union University. He is currently an adjunct professor of law, having taught courses in the past at the Vanderbilt University Law School, Florida International University Law School, the University of Miami School of Law Graduate Program in Estate Planning, Nova Universty School of Law and the On-Line LL.M. Programs at the University of San Francisco Law School and the Boston University School of Law.

**Introduction**

Rather than waiting for an income tax-free step-up in basis at death, individuals may prefer to sell an appreciated asset while they are living. Today’s presentation will examine how installment sales to non-grantor trusts and borrowing basis from other assets can be used to defer the reporting of a gain realized from the sale of an asset.

The first portion of this presentation describes how the use of an installment sale to a non-grantor trust postpones reporting the gain realized on the installment sale to a related party so that the gain is reported far in the future. If the related party resells the asset for cash after waiting for at least 24 months, the reporting the gain realized on the installment sale can continue to be postponed until the principal on the installment note is paid.

The second portion of today’s presentation will use income taxable installment sales to examine how the basis from other assets can be used to defer the reporting of the phantom gain (when mortgage liabilities exceed adjusted tax basis) existing in appreciated real estate one intends to sell in the future. This is an alternative to a like-kind exchange.

We will begin each segment by quickly reviewing the fundamental income tax principles we will be using and then illustrate the application of these principles with simple to follow numerical examples.

Today’s program has two primary objectives:

The first is to introduce you to these income tax deferral techniques, or at least refresh your understanding of these techniques.

The second, and perhaps the more practical objective of today’s presentation, is to demonstrate how to communicate somewhat complex techniques in an understandable manner because the installment sale rules, the rules that apply to sales between related parties, the income tax principles for liabilities and the partnership income tax rules can be technically complex and can be difficult for a potential client to understand using tax terminology. I use simple to follow numerical examples so that one can visualize how the solutions work rather than just describing the technique using technical tax terminology.

1. **Using Installment Sales to a Non-Grantor Trust**

The senior business owner is a co-owner with unrelated individuals. The business has a buyout agreement in place where retiring or deceased co-owners are required to sell their interests to the continuing co-owners. The buyout agreement can be structured as a cross-purchase agreement or as a redemption agreement. In the typical buyout situation co-owners intend to withdraw from the business while alive, reporting an income tax gain upon retirement. With buyout agreements, the typical succession plan focuses only on traditional estate planning.[[1]](#footnote-1) Possible income tax savings upon retirement are rarely considered. Since the family will no longer have an interest in the business, the remaining concerns are how to handle the cash sale proceeds. Essentially, continuation of the business is no longer a concern. The typical buyout agreement accomplishes two important functions.

In any sale of a closely-held business, the seller typically feels that the value is far greater than the buyer’s view. Therefore, the first function of a buyout agreement for a closely-held business is to arrive at a valuation formula so that when a principal owner retires, or dies before retirement, there are no arguments as to value between the withdrawing owner and the continuing owners, especially if the withdrawing owner is the decedent’s estate. Since we have a methodology arrived at by parties who are bargaining in their own self-interest, the typical buyout formula is designed to arrive at a value that does not consider valuation discounts for lack of control or lack of marketability, valuation factors that only arise for gift tax and estate tax valuations.

The second function addressed in a buyout agreement is how to fund the buyout of a withdrawing owner. Although life insurance plays a role, most owners plan on withdrawing by retirement and not by dying early. Thus, the funds needed to purchase the retiring owner’s share will have to come from other sources, and the business typically addresses how these funds will be obtained. Frequently, the planning for a buyout of a withdrawing owner does not deal with the income taxes that the retiring owner will have to pay when the buyout payments are received. Thus, the parties are conceding that the retiring owner will have to pay the full capital gain tax upon receiving payments under the buyout agreement.

An owner who is under a buyout agreement, and who anticipates retiring in a few years, can defer the reporting of the capital gain that would otherwise be reported upon the receipt of cash under the buyout.

Consider the following situation.

**Example**. Senior owns a 25% interest in an S corporation. As of today, the formula in the buyout agreement values Senior’s 25% interest at $16,000,000. The other 75% is owned by unrelated third parties. Senior is age 66 and anticipates retiring at age 70, some four years in the future. Senior expects that by the time he retires his 25% interest will appreciate and would like to adopt an estate plan designed to shift all appreciation in his 25% interest to a trust for his descendants without any gift tax.

Most estate planning advisors would recommend an installment sale to a grantor trust for the benefit of Senior’s descendants. The first step in such a situation is to obtain a valuation discount and reorganize the S corporation into voting and nonvoting stock. Then Senior would sell the nonvoting shares for a discounted amount from the $16,000,000 value arrived at in the buyout agreement and taking back an interest-only installment note, with all principal due at maturity in 20 years, for the entire discounted purchase price.

In contrast to the discount and freeze approach of an installment sale to a grantor trust, we recommend that Senior does not discount the value of his 25% interest and sell the shares to a complex trust (a non-grantor trust) for the benefit of his descendants.[[2]](#footnote-2)

The advantages of an income taxable installment sale can be illustrated by the next example.

**Example** Using the above example**,** a familycomplex trust purchases Senior’s 25% interest for $16,000,000 over two tax years, with two $5,000,000 installment sales the first year and two $3,000,000 installment sales the following tax year.[[3]](#footnote-3) Because the sellers are taking the family trust’s interest-only installment notes in satisfaction of the entire purchase price, the trust’s cost for the shares will be $16,000,000. The promissory notes provide for the annual payment of interest only at the prevailing long-term AFR with all principal due at the end of 20 years. If Senior retires some four years later, and the trust receives $18,500,000 upon Senior’s retirement, the trust’s taxable capital gain is limited to $2,500,000, and the sellers can continue to defer the gain realized on the $16,000,000 installment sale for another 16 years to when the note principal is paid.

An estate freeze is accomplished as all appreciation is not in Senior’s gross estate. Since no valuation discount was taken,[[4]](#footnote-4) Senior has conceded that the amount of the foregone discount will be in his gross estate. Senior is willing to make that concession because Senior understands that the income tax deferral is a present benefit and more than makes up for the extra estate tax inclusion in the distant future.

Senior must be advised that the installment sale recommended for Senior not only raises several income tax issues, but also transfer tax concerns. Before we address the specific concerns that arise with the sale of shares in an S corporation, a brief discussion of the installment method of accounting is necessary.

**The installment method in general**

When property is sold at a gain, and on terms that provide for deferred payments, immediate taxation of the entire gain may be inappropriate. For more than eighty years,[[5]](#footnote-5) the Internal Revenue Code has allowed the seller to defer the reporting of the gain under the *installment method* if there is an *installment sale*—one in which one or more payments of the selling prince are to be made in tax years after the year of sale.

The income tax treatment of installment sales is found in § 453, the accounting subpart of the Internal Revenue Code. The installment method is a method of accounting used to determine *when* a gain that has been *realized* on a sale is reported.[[6]](#footnote-6) It is not limited to cash method taxpayers. The installment method of accounting can be used by all taxpayers, regardless of their general methods of accounting, even taxpayers who use the accrual method. The installment method of accounting permits a taxpayer to defer the reporting of a realized gain arising from the tax year the property was sold to the tax years in which payments of the selling price are received by the taxpayer/seller.

To be eligible for the installment method of accounting, payment of a portion of the sales price must be postponed to a tax year following the year of sale.[[7]](#footnote-7) An installment sale occurs where the seller provides the financing (“seller-provided financing”) necessary for the purchase of the property. The installment method of accounting permits both cash method and accrual method taxpayers to postpone the reporting of all or a portion of the gain from the year of the sale to subsequent tax years.

**Payment of Interest on the Deferred Income Taxes**

A special interest charge only applies to an installment sale if the sales price is more than $150,000.[[8]](#footnote-8) Furthermore, the special interest charge is imposed only if the aggregate of all of the deferred payments sales using the installment method for the tax year exceed $5,000,000.[[9]](#footnote-9) The amount of the special interest charge is computed on the deferred tax liability with respect to the gain that is postponed.[[10]](#footnote-10) However, the seller need only pay the special interest charge on a portion of the deferred tax liability.[[11]](#footnote-11) If a taxpayer does not engage in more than $5 million in deferred payment sales for a year reported which are under the installment method, then none of the deferral advantages arising from use of the installment method result in an interest charge.[[12]](#footnote-12) If a taxpayer’s aggregate installment sales are $15 million for the year, then the special interest charge is computed on the income taxes deferred from two-thirds of the gains.

When the seller is a pass-through entity, such as a partnership or S corporation, Notice 88-11[[13]](#footnote-13) provides that the $5,000,000 threshold is applied, and interest calculations are made, at the owner level. For example, if there are two S corporation shareholders, owing 40% and 60% respectively, and if the S corporation sells an eligible asset for a $10,000,000 installment note, then the installment sales are $6,000,000 and $4,000,000 for the shareholders. Thus, the 40% shareholder is not exposed to the special interest charge, and the 60% shareholder has to pay the special interest charge on the postponed gain inherent in only $1,000,000 of the installment note.

A careful reading of § 453A will indicate that the $5,000,000 threshold is an annual one, imposed on each taxpayer. Thus, a taxpayer can engage in a $5,000,000 installment sale on December 31 of year 1 and another $5,000,000 installment sale on January 1 of year 2, and § 453A will not apply.

It is important to remember that a husband and wife who file a joint income tax return for the year are separate taxpayers, even though they have joint and several liabilities for the income taxes due for that year. Since the $5,000,000 threshold is a per person threshold, a husband and a wife can each engage in separate $5,000,000 installment sales for the year,[[14]](#footnote-14) effectively increasing the threshold for the special interest charge under § 453A to $10,000,000 for the year.[[15]](#footnote-15)

**Related Parties: Intra-Family Installment Sales**

As with many other situations, installment sales between related parties provide potential for abuse, particularly when the purchaser obtains the immediate benefit of the purchase price basis for deprecation or other purposes, while the related seller defers the gain, often for a very long time if the sale is for a balloon payment, twenty or more years in the future. Although the same lack of symmetry exists for installment sales among unrelated parties, the potential for planning and abuse is obviously greater within a family or other group with common economic interests. One of the political factors that made simplification and reform of the treatment of deferred payment sales by the Installment Sales Revision Act of 1980 feasible was that the Service became anxious to attack such tax planning exemplified in *Rushing v. Commissioner.[[16]](#footnote-16)*

Section 453(e) was enacted to eliminate the planning technique used in *Rushing*, which is characterized as the family having the cash proceeds of the sale but deferring the tax on the gain. Section 453(g) attacks a similar potential problem when the family obtains a step-up in basis by an intra-family sale of depreciable property, while the Section 1231 gain on the sale, usually capital gain, is deferred, by excluding related party sale of depreciable property from the use of the installment method. Despite the similarity of the issues, the approaches of the two provisions differ. The definition of related person under § 453(e) is the very broad one found in § 318(a) (without the option rule), with extensive attribution that is used for redemptions in family corporations and other purposes, expanded to include the partially overlapping definitions of § 267(b), dealing with loss sales and payment of deductible expenses among related entities. The definition under § 453(f) is the narrower one found under § 1239, characterizing as ordinary income gains on sales of depreciable property (that would probably qualify under § 1231 for capital gain) to related parties. The legislative history does not explain the reason for the difference, simply describing the applicable related party provision in each case.

Section 453(e) accelerates gain only when the purchaser makes a second disposition within two years of the initial installment sale. There are also several exceptions to this 2-year resale rule, including dispositions caused by the death of the seller or the related party purchaser, and where tax avoidance was not a principal purpose of the transaction.

 Section 453(e) does not define the term disposition. It would appear to apply to transactions in which the taxpayer receives consideration other than cash.4[[17]](#footnote-17)9 Thus, it would apply to non-taxable transactions in which the related party received consideration such as a Section 351 incorporation, a Section 721 transfer to a partnership and a Section 1031 like kind exchange. As already stated the term disposition would apply to a sale, exchange, gift, or cancellation of the installment obligation.5[[18]](#footnote-18)0 The term disposition does not refer to: a (1) a sale or exchange of stock by the related party to the issuing corporation;5[[19]](#footnote-19)1 (2) a compulsory or involuntary conversion within the meaning of Section 1033 if the first disposition occurred before the threat or imminence of the conversion;5[[20]](#footnote-20)2 (3) a disposition after the earlier of the death of the taxpayer or related party;5[[21]](#footnote-21)3 or (4) a disposition which did not have as one of its principal purposes the avoidance of Federal income tax.5[[22]](#footnote-22)4

1. ***Encumbered real estate owned by a partnership: How to shift the immediate reporting of phantom gain (mortgage liabilities in excess of basis) to the later payment of the principal on the installment note received upon an installment sale of an appreciated partnership interest to a non-grantor trust for the benefit of one’s descendants****.*

 *With encumbered real estate, especially real estate where the mortgage liabilities exceed the adjusted income tax basis, there has been a tendency for the real estate owner to retain ownership until death to obtain an income tax-free step-up in basis at death. This has created a lock-in effect as owners who may otherwise have sold the real estate while living, decline to do so because they do not want to report and pay income taxes on a large phantom gain. In addition, the real estate owner may no longer be able to obtain the step-up in basis at death because the real estate has been transferred to an irrevocable trust whose assets are not exposed to the estate tax.*

*Today’s presentation will demonstrate how one can defer the reporting of the phantom gain when encumbered real estate with liabilities in excess of income tax basis is sold by the owner (the owner can be an individual or an irrevocable trust and the owner can be a partner in the partnership that owns the encumbered real estate).*

***Where the asset is encumbered by liabilities***, the estate tax is imposed only upon the equity in the property (gross value less liabilities).

**Example:** D owns fully depreciated commercial rental real estate that was placed in service in 1983. Its current value is $54,000,000, and its adjusted income tax basis is $4,000,000. The real estate is encumbered by a $44,000,000 mortgage liability. If the real estate is held by D at death, the 40% estate tax applies only to the $10,000,000 equity, an estate tax cost of only $4,000,000. Since the estate’s income tax basis becomes $54,000,000, a portion of that tax basis can be allocated to the building and be depreciated.

Would the owner of the real estate been willing to pay $4,000,000 of estate taxes to create $54,000,000 of basis where that portion of the basis allocated to the building could create future depreciation deductions that can offset ordinary income? If D does not intend to sell the real estate, D should consider the preferred partnership freeze that is designed to freeze the $10,000,000 or equity as an asset included in D’s gross estate for step-up in basis at death and shift all future appreciation out of D’s estate.

 Had this real estate not obtained a step-up in basis at death, there would have been a $50,000,000 gain if the real estate was sold. Financially, the sale would have created a burden as the income taxes on this gain would have been in the $16,000,000 range, an amount far exceeding the $10,000,000 of cash netted from the sale.

***Evaluating whether to shift an asset out of the estate.***

 As the above example illustrates, the income tax factors need to be evaluated before deciding whether to transfer an asset out of the decedent’s estate. The first step is to determine the estate tax cost for exposing an appreciated asset to the estate tax and compare that estate tax cost to the income tax savings if there is an expectation that the asset will be sold after the decedent dies. Even if there is an expectation that the encumbered real estate will not be sold, one must evaluate the potential income tax savings for the increase in depreciation deductions that can be obtained from the income tax-free set up in basis at death. Remember depreciation creates deductions that can offset ordinary income. If taking advantage of the step-up in basis at death is the primary objective, one should consider the Section 2701 preferred partnership freeze that only exposes the current $10,000,000 of equity to the estate tax and shifts all appreciation over the current $54,000,000 value out of the estate.[[23]](#footnote-23)

With this treatment of negative basis real estate in mind, it is possible to postpone the reporting of all the gain, including the phantom gain, using a partnership. Given that a partner’s partnership interest is treated as a single unitary asset, using the following example, there is $5,000,000 of phantom gain that would be immediately reported if the partnership sold its negative basis real estate, even though the installment method would apply to defer the reporting of the remainder of the gain.

|  |
| --- |
| PARTNERSHIP BALANCE SHEET |
| *Asset* | *Basis* | *Value* | *Liabilities* | *Value* |
| Real Estate | $4,000,000 | $15,000,000 | Mortgage | $9,000,000 |
|  |  |  | *Capital Accounts* |  |
|  |  |  | General PartnerSenior | $0[[24]](#footnote-24)$6,000,000 |
| Total |  | **$15,000,000** |  | **$15,000,000** |

Mortgage in excess of basis is frequently referred to as “phantom gain.” It is also referred to as a negative basis*.* Technically*,* it is a $5,000,000 negative **tax** capital account.

If Senior sold her partnership interest for a $6,000,000 installment note, Senior would realize an $11,000,000 gain but would be able to use the installment method to defer only $6,000,000 of the gain because the $5,000,000 excess of liabilities over basis is treated as a fictional payment of cash at the time of the sale.

The planning calls for Senior to contribute an unencumbered asset with a basis of $5,000,000 to the partnership, increasing Senior’s basis in her partnership interest to $9,000,000. After this additional capital contribution, Senior’s $9,000,000 share of partnership liabilities no longer exceeds the $9,000,000 basis in her partnership interest.

**Step 1:** Senior’s basis for her partnership interest is equal to the partnership $4,000,000 inside basis.

Senior has a separate capital asset with a value and a basis of $5,000,000. Senior contributes this capital asset to the partnership, increasing Senior’s basis in her partnership interest and her capital account by $5,000,000. Senior’s basis in her partnership interest is now $9,000,000. Because all we need is basis, the value of the contributed asset is not relevant and can even be an asset with a built-in loss.

|  |
| --- |
| PARTNERSHIP BALANCE SHEET |
| *Asset* | *Basis* | *Value* | *Liabilities* | *Value* |
| Real Estate | $4,000,000 | $15,000,000 | Mortgage | $9,000,000 |
| Capital Asset | $5,000,000 | $5,000,000 | *Capital Accounts* |  |
|  |  |  | General PartnerSenior | $0[[25]](#footnote-25)$11,000,000 |
| Totals |  | **$20,000,000** |  | **$20,000,000** |

**Step 2:** Senior creates and funds an irrevocable, non-grantor trust for the benefit of Senior’s descendants. As a complex trust, it is a separate taxpayer for Federal income tax purposes, and any sales by Senior to the trust will be an income tax realization event.

**Step 3:** Senior proceeds to sell her entire partnership interest to the complex trust for an interest-only $11,000,000 promissory note,[[26]](#footnote-26) with all principal due in 22 years. The trust’s cost basis in the partnership interest is now $20,000,000 as the trust includes in its cost basis for the partnership interest its share of partnership liabilities.[[27]](#footnote-27) The partnership should not make a Section 754 election to increase its basis in the depreciable real estate by the $5,000,000 special basis adjustment under Section 743(b) because § 1239 will characterize the entire $11,000,000 gain as ordinary income when there is a sale of depreciable property to a related party and because § 453(g) prohibits using the installment method to defer gain realized upon the sale of depreciable property to a related party .

Since the selling partner’s basis in her partnership interest is now $9,000,000, and since Senior’s share of partnership liabilities is only $9,000,000,[[28]](#footnote-28) upon the sale of the partnership interest there are no liabilities in excess of basis. Instead, the gross profit ratio is 100%. Therefore, the reporting for the entire $11,000,000 gain is deferred until the note principal is paid at maturity of the note. Under the installment sale regulations, the $9,000,000 liability is treated as a return of Senior’s basis in the partnership interest it sold, leaving no basis to be allocated to the $11,000,000 installment note. Because Senior now has a zero basis in the $11,000,000 installment note, the entire $11,000,000 of gain will be reported in 20 years upon the maturity of the interest only promissory note.

**Step 4**: After waiting for two years (24 months),[[29]](#footnote-29) the partnership sells the real estate for $15,000,000, receiving only $6,000,000 in cash as the buyer took the real estate subject to the existing mortgage liability. The partnership reports an 11,000,000 gain. Since the trust’s share of partnership liabilities has declined by $9,000,000, the trust reduces its basis for its partnership interest to $11,000,000.[[30]](#footnote-30) The trust increases its basis for its partnership interest by its share of the $11,000,000 gain, to $22,000,000.

**Step 5**: The partnership then terminates[[31]](#footnote-31) *in the same year the sale of the real estate occurre*d, distributing the $6,000,000 cash and the $5,000,000 capital asset to the trust. The trust first reduces the basis in its partnership interest by $6,000,000 of cash received, leaving the trust with $16,000,000 basis to be substituted as the basis in the capital asset received in a liquidating distribution. The trust then sells the capital asset for its $5,000,000 value, reporting an $11,000,000 capital loss that can offset its $11,000,000 capital gain.

By not violating the two-year resale rule (a liquidation of a partnership is treated as a sale of the partnership interest), the $11,000,000 of gain can continue to be deferred by Senior under the installment method.

*Alternative:* If, before the two-year waiting period expires, the partnership distributes the capital asset with a basis and value of $5,000,000 to the trust, the trust’s $20,000,000 basis in its partnership interest is reduced by the $5,000,000 basis the trust takes in the distributed asset, reducing its basis in its partnership interest from $20,000,000 to $15,000,000. The partnership’s only asset will now be the encumbered real estate with a basis of $4,000,000, a value of $15,000,000 and a liability of $9,000,000. After the two-year waiting period expires the partnership sells the encumbered real estate subject to the mortgage, realizing the $11,000,000 gain, but only $6,000,000 of cash. The trust first increases its basis in its partnership interest by the $11,000,000 gain and then reduces its basis in its partnership interest by the $9,000,000 reduction of partnership liabilities. Now the trust’s basis in its partnership interest is $17,000,000. The partnership then terminates by distributing it $6,000,000 of cash, which reduces its outside basis by the $6,000,000 to $11,000,000. As a liquidating distribution, the trust can report its $11,000,000 of unrecovered basis as a capital loss that can be used to offset the $11,000,000 of capital gain if both the capital loss is reported in the same year the capital gain was reported.

1. The succession plan typically limits itself to how the business is valued in the future and how the business will obtain the funds to make the payments to the withdrawing co-owner. And, funding the buyout with life insurance is not satisfactory if the withdrawing co-owner retires while living. [↑](#footnote-ref-1)
2. The spouse cannot be a beneficiary of the trust as that would create a grantor trust. § 677(a)(1). [↑](#footnote-ref-2)
3. Senior previously transferred half of his 25% interest to his spouse as a marital deduction gift of $8,000,000. So, Senior and Senior’s spouse will sell their interests for $5,000,000 each the first year and $3,000,000 each the second year. [↑](#footnote-ref-3)
4. Where no valuation discount is taken, there is a risk that for income tax purposes the IRS may apply a discount, but that is unlikely. [↑](#footnote-ref-4)
5. The installment method was first adopted by the Revenue Act of 1926, Public Law 20-69th, 44 Stat. 9 (1926). [↑](#footnote-ref-5)
6. All *realized* gains are *recognized* unless a non-recognition provision applies. § 1001(c) and Reg. § 1.1002-1. Only after the *realized* gain is *recognized* is it necessary to determine *when* that gain is reported. If the realized gain is not recognized, there is no gain to be reported. Thus, there is no need to go on to determine *when* the gain is reported. [↑](#footnote-ref-6)
7. A taxpayer who uses the calendar year cannot use the installment method if the sale occurs during January of the current year and payment of the sale price is postponed to December of that same year. However, if any payment of the sale price is postponed to January of the following tax year, the deferred payment sale may be eligible for reporting under the installment method. [↑](#footnote-ref-7)
8. § 453A(b)(1). [↑](#footnote-ref-8)
9. § 453A(b)(2)(B). Since a husband and a wife are separate taxpayers, even though they file a joint income tax return, they each have their own $5,000,000. This $5,000,000 is not indexed for inflation. [↑](#footnote-ref-9)
10. § 453A(c). Section 453A(c)(2)(B) provides that the interest rate used to determine the charge for the deferred tax liability is determined under § 6621(a)(2), the deficiency rate for under payments of taxes. The underpayment rate is the short-term AFR for the month the sale takes plus 3 percentage points. [↑](#footnote-ref-10)
11. § 453A(c)(2). [↑](#footnote-ref-11)
12. § 453A(c)(4). [↑](#footnote-ref-12)
13. 1988-2 C.B. 397. [↑](#footnote-ref-13)
14. Under § 1041 and the unlimited gift tax marital deduction, spouses can rearrange their ownership of property without any income tax or gift tax exposure. Thus, a spouse owning an asset valued at $10,000,000 can gift half of that asset to the other spouse so that both spouses can take advantage of the $5,000,000 threshold. [↑](#footnote-ref-14)
15. In *TAM 98-53-002* the Service concluded that for purposes of the $5 million threshold, married taxpayers, each of whom separately owns shares in an S corporation, are treated as separate taxpayers. Congress did not provide for spousal attribution under Section 453A. Accordingly, in the case of married taxpayers, a separate $5 million threshold would apply to each when calculating the interest due. Thus, gifting between spouses can reduce or eliminate the interest charge. [↑](#footnote-ref-15)
16. 441 F.2d 593 (5th Cir. 1971). [↑](#footnote-ref-16)
17. 49  The Senate Report explains the provision as “an acceleration of recognition of the installment gain from the first sale to the extent additional cash and other property flows into the related group as a result of the second disposition.” S. Report 96-1000 at 14. [↑](#footnote-ref-17)
18. 50 See Installment Sales 565 BNA Portfolio, A-29 . [↑](#footnote-ref-18)
19. 51 Section 453(e)(6)(A). [↑](#footnote-ref-19)
20. 52 Section 453(e)(6)(B). [↑](#footnote-ref-20)
21. 53 Section 453(e)(6)(C). [↑](#footnote-ref-21)
22. 54 Section 453(e)(7). [↑](#footnote-ref-22)
23. For an explanation of the preferred partnership freeze, see Hesch and Breitstone, *Income Tax Planning and Estate Planning for Negative Capital Accounts: The Entity Freeze Solution,**53* Tax Management Memorandum 311 (2012). [↑](#footnote-ref-23)
24. The General Partner has a profit only interest as it is a service provider who receives a share of profits in return for providing services. Thus, the GP need not make a capital contribution. [↑](#footnote-ref-24)
25. The General Partner has a profits only interest as it is a service provider who receives a share of profits in return for providing services. Thus, the GP need not make a capital contribution. [↑](#footnote-ref-25)
26. Because of the § 453A interest charge, if Senior is not married, there needs to be three separate sales for $5,000,000, $5,000,000 gain and finally $1,000,000. If Senior is married, Senior and Senior’s spouse can do two $5,000,000 sales in the current year and a $1,000,000 sale the following tax year. [↑](#footnote-ref-26)
27. § 752(c). [↑](#footnote-ref-27)
28. § 752(d). [↑](#footnote-ref-28)
29. As an installment sale to a related party, § 453(e) imposes a two-year waiting period before the related party purchaser can resell the asset purchased. A liquidating distribution of a partnership interest is treated as a disposition of a partnership interest and will then be treated as a second disposition under § 453(e) [↑](#footnote-ref-29)
30. § 752(b). [↑](#footnote-ref-30)
31. A redemption of a partnership interest is a sale (i.e. a second disposition) that needs to satisfy the two-year safe harbor under § 453(e). [↑](#footnote-ref-31)