

¶ 5.05[15] Elections Out

In certain circumstances, a taxpayer may prefer not to report on an installment basis. For example, acceleration in the recognition of gain through use of another method may permit the taxpayer to take advantage of expiring loss carryovers, to be taxed at a then-favorable tax rate, or otherwise to avoid the risks and uncertainties of changes in tax rates and laws.²⁹²

The rules regarding elections not to use the installment method are set forth in the regulations.²⁹³ They provide that the election must be made on or before the due date for filing the taxpayer's return (including extensions) for the taxable year in which the installment sale occurred. Notwithstanding the availability of forms that can be used for this purpose, the regulations point out that a taxpayer who reports the full amount of the gain on the return for the year in which the sale occurred will be considered to have made a proper election out.²⁹⁴ The fact that the taxpayer or its accountant failed to realize that installment reporting was available and, hence, reported the entire gain in error rather than as the consequence of a deliberate decision may be irrelevant.²⁹⁵

Should a taxpayer fail to elect out from the installment method within the time frame specified, it generally will not be able to do so subsequently.²⁹⁶ However, the regulations provide that such later elections may be available, but "only in those rare circumstances when the Internal Revenue Service concludes that a taxpayer had good cause for failing to make a timely election."²⁹⁷ The regulations also provide that a recharacterization of a transaction, e.g., the recharacterization of a lease to a sale, will not justify a later election.²⁹⁸ In addition, conditional elections will not be permitted.²⁹⁹

Once made, an election may be revoked only with the consent of the IRS. However, no revocation will be permitted when one of its purposes is the avoidance of federal income tax or when the taxable year in which any payment was received has closed.³⁰⁰ In applying these provisions, the courts will take a careful look at particular circumstances offered by taxpayers in support of any attempted revocation, and may give short shrift to any attempt that seems designed to circumvent the regulations.^{300.1}

In addition to the foregoing, assuming a taxpayer has elected out of the installment method, the regulations purport to alter the manner in which other methods of accounting will be applied. For example, the regulations provide that the FMV of the installment obligation will be treated as property received by the taxpayer without regard to whether the obligation is "the equivalent of cash."³⁰¹ In effect, the Treasury is attempting by administrative fiat to eliminate the cash equivalence doctrine.³⁰² The regulations add that FMV is to be determined without regard to whether any provisions of the contract or local law restrict the transferability of the obligation, and without regard to whether the obligation is embodied in a note, an executory contract, or any other instrument, or is an oral promise enforceable under local law. Thus, the Treasury is attempting to reduce the opportunities for use of the cost recovery method of accounting. Apparently, the Treasury is also seeking to discourage taxpayers from electing out. It remains to be seen whether these regulations will be deemed lawful.³⁰³

Notwithstanding the foregoing, there is some evidence that courts may not apply these restrictive provisions broadly. For example, in *Mothe Funeral Homes, Inc.*,^{303.1} an issue involved amounts due the taxpayer for a sale of rights to interment, burial crypts, and cemetery lots. The taxpayer sought to use the cost recovery method. The IRS disallowed that method citing, inter alia, the above-referenced provisions of the installment sales regulations. Without getting into an extended analysis of such provisions, the court held the provisions inapplicable by concluding that under Louisiana law no "sale" had occurred on the date the purchase agreements had been executed.

In determining the FMV of the obligation for purposes of determining gain following an election out, the regulations provide additional rules covering fixed amount obligations and contingent payment obligations.

¶ 5.05[15][a] Fixed Amount Obligations

“Fixed amount obligation” is an installment obligation under which the amount payable is fixed. For purposes of determining whether the amount is fixed, the provisions of [Section 483](#) and any payment recharacterization arrangements must be disregarded.³⁰⁴ Fixed obligations include obligations payable in fungible units or foreign currency that may be measured in terms of U.S. dollars even though the value of those units may vary over time in relation to the dollar. The fixed amount of the obligation is its value in U.S. dollars on the date of the installment sale.

Under the regulations, a cash method taxpayer must treat as the amount realized in the year of sale the FMV of the installment obligation. In no event is the FMV of the obligation to be considered less than the FMV of the property sold. For example, if property with an FMV of \$100 is sold for an installment obligation in the amount of \$100 payable ten years from the date of sale and bearing an appropriate market rate of interest, the amount realized by the taxpayer in the year of sale will be \$100, the FMV of the installment obligation. If the interest rate in the obligation is higher than a market rate so that the FMV of the obligation is in excess of the \$100 face amount, the higher FMV is the amount realized. However, if the interest rate is less than the then-applicable current market rate so that the FMV of the obligation is less than \$100, the amount realized would still be \$100, because the amount realized may not be less than the FMV of the property sold.

An accrual method taxpayer follows essentially the same rules as the cash method taxpayer, except that the accrual method taxpayer must treat the total amount payable under the obligation (rather than its FMV) as the amount realized on the sale. For this purpose, both stated and unstated interest are excluded from the amount realized.

¶ 5.05[15][b] Contingent Payment Obligations

Any installment obligation that is not a fixed amount obligation is considered a contingent-payment obligation. In determining the amount realized on a sale, if an obligation has both fixed and contingent components, the fixed component is subject to the rules governing fixed amount obligations.

The FMV of the contingent payment obligation is determined by disregarding restrictions imposed under the agreement or applicable local law. As with fixed amount obligations, the FMV of the contingent payment obligation must not be less than the FMV of the property sold (less other consideration transferred for the property). The value of the property transferred to the purchaser may be used as the basis for deriving the value of the contingent payment obligation. The regulations warn that only in rare and extraordinary cases will the taxpayer be entitled to assert that there is no reasonably ascertainable FMV and, hence, use the open transaction or cost recovery method of recognizing income.³⁰⁵

²⁹² See, e.g., [Stewart Perry, 59 TCM 533, TC Memo. 1990-228 \(1990\)](#), where the taxpayer's election of the installment method under pre-1980 Act law resulted in unanticipated additional taxes due to subsequent changes in the alternative minimum tax.

²⁹³ [Temp. Reg. § 15a.453-1\(d\)](#).

²⁹⁴ [Temp. Reg. § 15a.453-1\(d\)\(3\)\(i\)](#). The regulations add that “[a] cash method taxpayer receiving an obligation the fair market value of which is less than the face value must make the

election in the manner prescribed by appropriate instructions for the return filed for the taxable year of the sale.”

²⁹⁵ See **Cornelius Wierschem, 82 TC 718 (1984)** .

²⁹⁶ See **Stewart Perry, 59 TCM 533, TC Memo. 1990-228 (1990)** , where under pre-1980 Act law, the court upheld the Commissioner's disallowance of a taxpayer's attempted revocation of an earlier election. The taxpayer sought to revoke the earlier election in order to avoid an unanticipated increase in tax liability due to post-election amendments to the rules governing alternative minimum taxable income.

²⁹⁷ **Temp. Reg. § 15a.453-1(d)(3)(ii)**.

²⁹⁸ **Id.**

²⁹⁹ **Id.** Compare **Warren Jones Co. v. Comm'r, 524 F2d 788 (9th Cir. 1975)** , where the IRS conceded the right of the taxpayer under prior law to make conditional elections in certain circumstances.

³⁰⁰ **Temp. Reg. § 15a.453-1(d)(4)**. See **Priv. Ltr. Rul. 8530096 (Apr. 30, 1985)**, where taxpayer being out of the country and unable to advise the accountant not to elect out was insufficient to cause the IRS to permit a revocation of the election out. But see **Priv. Ltr. Rul. 8639020 (June 25, 1986)**, where IRS permitted the filing of amended returns on an installment basis to correct the erroneous election out made by the taxpayer's former director of taxes, who had been dismissed for numerous tax errors. See also **Priv. Ltr. Rul. 8519010** (date not given), where taxpayer elected out because he had not yet received permission to use an alternative method of basis recovery on a contingent price sale. After getting permission, IRS permitted taxpayer to revoke his prior election out.

^{300.1} See, e.g., **Paul D. Krause, 80 TCM 656, TC Memo. 2000-343 (2000)** , where a taxpayer originally revoked use of the installment method by reporting all gain from a transaction in the year of the transaction. The taxpayer's apparent purpose for electing out from use of the installment method was to benefit from various deductions he had claimed in his return for that year. On audit, the Commissioner disallowed certain of the deductions, and the taxpayer, in response, sought to revoke his prior election out. The court denied the taxpayer this opportunity, referring to the above-described rules, and pointing out that such a revocation will not be permitted when one of the reasons for the revocation is an attempt to apply hindsight in order to obtain retroactively what would have been the most beneficial tax reporting.

³⁰¹ **Temp. Reg. § 15a.453-1(d)(2)(i)**.

³⁰² See discussion at ¶ 3.03[1].

³⁰³ There is no suggestion in the legislative history that Congress intended for the Treasury to include within its regulations any modifications to the operation of other methods of accounting.

^{303.1} **Mothe Funeral Homes, Inc. v. United States, 1995-1 USTC ¶ 50,248 (ED La. 1995)** .

³⁰⁴ **Temp. Reg. § 15a.453-1(d)(2)(ii)**.

³⁰⁵ **Temp. Reg. § 15a.453-1(d)(2)(iii)**.