

Internal Revenue Service

Department of the Treasury

Number: **200404015**
Release Date: 1/23/2004
Index Number: 453.06-06

Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:

CC:ITA:05-PLR-104093-03

Date:

October 9, 2003

Taxpayer =

Month A =

Year 1 =

Year 2 =

Date A =

\$A =

\$B =

A# =

Lender =

Dear :

This letter is in response to (Taxpayer's) request for permission to make a late election out of the installment method with respect to the sale described below.

Taxpayer is a cash method calendar year taxpayer that formerly operated a dairy farm. Taxpayer obtained a substantial portion of its business financing from Lender, a creditor to which it owed a substantial debt prior to ceasing dairy farm operations. During Month A of Year 1, Taxpayer ceased dairy farm operations and sold its cattle and equipment and most of its land and buildings. Almost all of the land and buildings sold were sold pursuant to a \$A land sale contract (the contract) providing for A# monthly payments.

For the taxable year of the sale and several preceding taxable years, Taxpayer reported both regular and alternative tax net operating losses. After the sale Taxpayer

PLR-104093-03

remained liable to Lender on notes totaling approximately \$B (the Lender Debt). Taxpayer currently generates cash from two primary sources: (1) rental income from retained land, and (2) payments received on the contract. These revenue sources are being used to service the Lender Debt as well as certain other continuing expenses. Taxpayer represents that as of Date A it was not in default on any of the Lender Debt.

On its Year 1 federal income tax return, Taxpayer did not elect out of the installment method for reporting gain from the sale of the land and buildings. Taxpayer now requests permission to make a late election out of the installment method with regard to this sale.

Section 453(a)¹ generally requires income from an installment sale to be taken into account under the installment method. With certain exceptions not applicable here, section 453(b)(1) defines an installment sale as a disposition of property where at least one payment is to be received after the close of the taxable year in which the disposition occurs.

Section 453(d)(1) allows a taxpayer to elect out of using the installment method. Under section 15A.453-1(d)(3) of the Income Tax Regulations, a taxpayer who reports an amount realized equal to the selling price, including the full face amount of any installment obligation, on a timely tax return filed for the taxable year of sale is considered to have elected out of using the installment method. A cash method taxpayer who receives an obligation the fair market value of which is less than its face amount must elect out of using the installment method in the manner prescribed by appropriate instructions for the federal income tax return for the taxable year of the sale.

Except as otherwise provided in regulations, section 453(d)(2) requires a taxpayer who desires to elect out of the installment method for a qualifying sale to do so on or before the due date (including extensions) for the taxpayer's federal income tax return for the taxable year of the sale. Section 15A.453-1(d)(3)(ii) provides that late elections out of the installment method will be permitted only in those rare circumstances when the Internal Revenue Service concludes that the taxpayer had good cause for failing to make a timely election out.

Based on all of the facts and circumstances, we conclude that it is appropriate to grant Taxpayer permission to make a late election out of the installment method with respect to reporting gain from the contract. Therefore, subject to the time constraints below, if the \$A sale of the land and associated buildings qualifies as an installment sale, Taxpayer is hereby granted permission to make a late election out of the installment method with regard to that sale.

¹ All section references are to sections of the Internal Revenue Code of 1986 as in effect for the taxable years at issue.

PLR-104093-03

To make the late election out, Taxpayer must file an amended Year 1 federal income tax return within 75 days of the date of this letter reporting the entire amount of gain from the \$A land contract. Taxpayer must also file an amended Year 2 income tax return within 75 days of the date of this letter to remove any gain from the contract previously reported on that return. A copy of this letter must be attached to each of the amended returns.

As noted above, permission to make a late election out of the installment method is conditioned on the \$A land sale contract qualifying as an installment sale. We make no determination regarding whether the sale qualifies as an installment sale.

A sale qualifies as an installment sale only if at least one payment is to be received after the close of the taxable year of the sale. Section 15A.453-1(b)(3) treats the amount of qualifying indebtedness assumed or taken subject to by the purchaser as a payment to the extent the indebtedness exceeds the basis of the property sold (determined after adjustment to reflect selling expenses). Unless incurred by the seller in contemplation of the sale, section 15A.453-1(b)(2)(iv) treats as qualifying indebtedness: (1) a mortgage or other indebtedness encumbering the property sold, and (2) indebtedness not secured by the property sold, but incurred or assumed by the purchaser incident to the purchaser's acquisition, holding, or operation in the ordinary course of business or investment, of the property.

Section 15A.453-1(b)(3)(ii) defines a "wrap-around mortgage" as an agreement in which the buyer initially does not assume and purportedly does not take subject to part or all of the mortgage or other indebtedness encumbering the property ("wrapped indebtedness"). Instead, the buyer issues to the seller an installment obligation the principal amount of which reflects such wrapped indebtedness.

Whether for federal income tax purposes the form of a "wrap-around mortgage" will be respected or the obligor under a wrap-around will be treated as in substance assuming pre-existing mortgage debt or taking property subject to pre-existing mortgage debt depends on the facts of each case. Compare *Professional Equities, Inc. v. Commissioner*, 89 T.C. 165 (1987) (form respected) with *Voight v. Commissioner*, 68 T.C. 99 (1977), *aff'd per curiam*, 614 F.2d 94 (5th Cir. 1980) (treated as assumption of mortgage); *Kline v. Commissioner*, T.C. Memo 1989-317, *aff'd. without published opinion*, 933 F.2d 1014 (9th Cir. 1991); *Goodman v. Commissioner*, 74 T.C. 684 (1980), *aff'd. without published opinion*, 673 F.2d 1332 (7th Cir. 1981) (treated as taking property subject to mortgage).

Taxpayer has not provided the documents and formal representations required to properly characterize the contract and we express no opinion on that issue. If it is appropriate to characterize the entire \$A land sale contract as either an assumption of the Lender Debt or as a taking of property subject to the Lender Debt, the sale would not qualify as an installment sale. This is because no amounts would be treated as payable in any taxable year subsequent to the year of sale. Nevertheless, such a

PLR-104093-03

characterization would give the same result as making an election out of the installment method if there is an installment sale. That is, the entire amount of gain would have to be reported for the taxable year of sale.

Regardless of the proper characterization of the contract, Taxpayer can ensure its right to report all of the gain from the contract for the taxable year of sale by making a late election out of the installment method as set forth in this letter.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. This ruling is directed only to Taxpayer. Section 6110(k)(3) provides that it may not be used or cited as precedent. In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

Sincerely yours,

Roy Hirschhorn
Assistant Branch Chief
Branch 5
Office of Associate Chief Counsel
(Income Tax and Accounting)

cc: