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Electing Out of the Installment Sales Method

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In a typical year, taxpayers seek to find methods to defer the amount of tax that is due to the government. This is typically accomplished through deferring income or accelerating expenses. One method frequently utilized to defer the taxable income generated from the sale or disposition of certain assets is utilizing the installment sales method under Internal Revenue Code § 453, where the gain on the sale of an asset is spread over the period in which the payment installments on the purchase price of that asset are received.

However, given that the capital gains rates are set to increase by a minimum of 8.8% in 2013 (3.8% as part of the new Medicare taxes under the Patient Protection and Affordable Care Act, and 5% as a result of the long-term capital gains rates increasing from 15% to 20%), and the overall uncertainty in the tax rates going forward, many taxpayers are in the unusual position of attempting to accelerate taxable income that may otherwise be realized in 2013, and defer expenses. One option available to some taxpayers may be to electing out of the installment sales method of reporting gain on the sale or disposition of certain assets, and realizing all of the income from those sales in 2012.

In order to elect out of the installment sales method, a taxpayer must make an election on or before the due date for filing the return for the taxable year in which the underlying sale occurs (note that if a taxpayer is involved in more than one transaction in which the installment sales method would apply, it must make the election for each of the transactions). For activity in 2012, if extended, this deadline will be October 15, 2013 (assuming a calendar year taxpayer). While there are certain forms that are required to make this election, a taxpayer who reports the full amount of any installment obligation on the tax return filed for the taxable year in which the installment occurs will be deemed to have elected out of the installment method. Nevertheless, the taxpayer should consider filing all of the appropriate forms to ensure that the election is made.

Unfortunately for most taxpayers, electing out of the installment sales method will only be available for sales which occurred during 2012 and later. While the IRS may permit a late election out of the installment sales method, it will only do so in circumstances in which the IRS determines that the taxpayer had good cause for failing to make a timely election. It should be noted that the IRS has previously determined that an increase in the capital gains rate in not a sufficient justification for allowing a late election.

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If you have any questions regarding the issues discussed above, please contact the author or any of the other attorneys in Loomis' tax law group.

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