



Internal Revenue Service

DEPARTMENT OF THE TREASURY

LB&I Process Unit

Unit Name	Interest on Deferred Tax Liability	
Primary UIL Code	453A.03-00	Interest on Deferred Tax Liability

Library Level	Title
Knowledge Base	Corporate/Business Issues & Credits
Shelf	Methods of Accounting and Timing
Book	Installment Methods
Chapter	General Rules

Document Control Number (DCN)	COR-P-022
Date of Last Update	07/15/21

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Process Overview

Interest on Deferred Tax Liability

An installment sale is a disposition of property where the seller will receive at least one payment after the tax year in which the disposition occurs. Unless the seller elects otherwise (or an exception applies), the seller should use the installment method to compute income from an installment sale. The installment method does not apply to an installment sale that results in a loss. An installment sale is reported on Form 6252, *Installment Sale Income*, and completed for each year of the installment agreement.

Under the installment method, the seller recognizes income over the period of tax years in which it receives the installment payments. The seller determines income from such installment sale for the tax year by multiplying the total amount of payments received during the year by the gross profit ratio (or "Gross Profit Percentage"). The Gross Profit Percentage is equal to the ratio of the gross profit on the sale to the total contract price. Therefore, the seller may defer the recognition of gain on the disposition under this method.

If applicable, IRC 453A requires a seller who reports gain on the installment method of accounting to pay interest on the deferred tax liability, thus reducing the time value benefit of the installment method's tax deferral. The purpose of IRC 453A is to require sellers using the installment method to pay an interest charge each year on the portion of the tax liability that was deferred under the installment method. The seller computes the IRC 453A interest charge on the part of the tax liability that it deferred due to reporting gains from the sale of property under the installment method and adds the interest charge as an additional tax on the tax return.

The seller determines whether IRC 453A applies to an installment obligation in the year of the installment sale. If IRC 453A applies, the obligation remains subject to the interest charge in subsequent years if the obligation is outstanding at the close of the year. The seller will not owe the IRC 453A interest in the year the final payment is received. For example, an IRC 453A installment sale occurred in Year 1. If the installment obligation was paid in full and all remaining gain was recognized during Year 8, IRC 453A would only be applicable in Years 1 through 7.

Process Applicability

Interest on Deferred Tax Liability

IRC 453A requires a seller to pay interest on the deferred tax liability that results when it reports a gain under the installment method of accounting provided in IRC 453. The seller owes IRC 453A interest in subsequent taxable years for outstanding year-end obligations.

IRC 453A applies to a disposition of property under the installment method when the sales price of the property exceeds \$150,000 (the "453A Obligation"). Interest is imposed on a 453A Obligation arising during a taxable year only if:

1. The obligation is outstanding as of the close of the taxable year, and
2. The face amount of all 453A Obligations held by the seller that arose during, and are outstanding as of the close of, that taxable year exceeds \$5 million.

Criteria	Resources
<ul style="list-style-type: none"> ▪ Did the seller report gain from the sale of property under the IRC 453 installment method of accounting? <ul style="list-style-type: none"> – The seller must report gain from the sale of property under the installment method for IRC 453A to be applicable. <ul style="list-style-type: none"> ▪ The seller uses a separate Form 6252 for each installment sale or other disposition of property on the installment method. 	<ul style="list-style-type: none"> ▪ IRC 453 – Installment Method ▪ Form 6252 – <i>Installment Sale Income</i> ▪ Practice Unit – <i>Installment Method</i>
<ul style="list-style-type: none"> ▪ Did the sales price of the property exceed \$150,000? <ul style="list-style-type: none"> – The sales price of the property must exceed \$150,000 for IRC 453A to be applicable. – Review the Form 6252 to identify an installment sale with a sales price exceeding \$150,000. – In determining the sales price, treat all sales that are part of the same transaction (or series of related transactions) as one sale. 	<ul style="list-style-type: none"> ▪ Form 6252 – <i>Installment Sale Income</i> ▪ IRC 453A(b)(1) – General ▪ IRC 453A(b)(5) – Sales Price

Process Applicability (cont'd)

Interest on Deferred Tax Liability	
Criteria	Resources
<ul style="list-style-type: none"> ▪ Is the installment obligation to which IRC 453A applies outstanding as of the close of the taxable year? <ul style="list-style-type: none"> – The obligation must be outstanding as of the close of the taxable year for IRC 453A to apply. 	<ul style="list-style-type: none"> ▪ IRC 453A(b)(2) – Interest Payments ▪ H Rept 100-495 at 929 (1987) – Treatment of Certain Installment Sales by Nondealers
<ul style="list-style-type: none"> ▪ Did the face amount of all installment obligations to which IRC 453A applies, that arose during and were outstanding as of the close of that taxable year, exceed \$5 million? <ul style="list-style-type: none"> – IRC 453A is only applicable when the face amount of all installment obligations that arose during and outstanding as of the close of that taxable year exceeds \$5 million. – Example: A calendar-year C corporation sold land for \$7 million during 2017 and received \$3 million in 2017 with the remaining \$4 million balance due in 2018. The C corporation had no other installment sales in 2017. Therefore, the outstanding installment obligation at the end of 2017 is \$4 million (\$7 million sales price less \$3 million payment received). IRC 453A does not apply to this \$4 million outstanding installment obligation because the year-end balance is less than \$5 million. – See slide 17, example 1 for how to determine if the seller's installment obligations exceed the \$5 million threshold for multiple installment sales that originate in the same year. 	<ul style="list-style-type: none"> ▪ IRC 453A(b)(2) – Interest Payments ▪ Notice 88-81 – Explanation on Applying the \$5 Million Threshold of IRC 453A at the Owner Level for Partnerships and S Corporations
<ul style="list-style-type: none"> ▪ Is the seller a dealer in the sale of personal property that regularly sells or otherwise disposes of the same type of personal property? <ul style="list-style-type: none"> – IRC 453A does not apply to dealers because dealers generally cannot use the installment method. – However, dealers in timeshares and residential lots may use the installment method by electing to be subject to a separate interest computation under IRC 453(l). 	<ul style="list-style-type: none"> ▪ IRC 453(b)(2)(A) – Dealer Dispositions ▪ IRC 453(l) – Dealer Dispositions

Summary of Process Steps

Interest on Deferred Tax Liability

Process Steps

The steps below explain the process to calculate the interest due under IRC 453A on a deferred tax liability.

The interest on the deferred tax liability is computed by multiplying the deferred tax liability by the applicable percentage and by the underpayment rate.

Step 1	Compute the Deferred Tax Liability
Step 2	Compute the Applicable Percentage
Step 3	Determine the Underpayment Rate
Step 4	Compute the Interest Due on the Deferred Tax Liability

Step 1: Compute the Deferred Tax Liability

Interest on Deferred Tax Liability

Step 1

Compute the deferred tax liability. Multiply the amount of gain with respect to an obligation which has not been recognized as of the close of the taxable year by the maximum rate of tax for ordinary or long-term capital gains, as applicable for the taxable year.

Considerations	Resources
<p>The deferred tax liability is the amount deferred by reporting the installment sale under the installment method. The installment method allows a seller to report gain from the sale of property in the taxable year(s) in which payments are received, rather than in the year of sale.</p> <p>Use the following steps to compute the deferred tax liability:</p> <ol style="list-style-type: none"> 1. Compute the Gross Profit Percentage, which is Gross Profit divided by Total Contract Price. Treas. Reg. 15a.453-1(b)(2)(i). <ul style="list-style-type: none"> – Gross Profit is the Selling Price less the Adjusted Basis. Treas. Reg. 15a.453-1(b)(2)(v). 2. Compute the Unrecognized Gain at Year-End, which is the Outstanding Installment Obligation multiplied by Gross Profit Percentage. <ul style="list-style-type: none"> – Outstanding Installment Obligation is the outstanding principal balance due on the installment obligation. 3. Compute the Deferred Tax Liability, which is Unrecognized Gain at Year-End multiplied by Maximum Tax Rate. <ul style="list-style-type: none"> – Maximum Tax Rate is the maximum applicable capital gain or ordinary income tax rate in effect for that tax year under IRC 1 or IRC 11. IRC 453A(c)(3)(B). 	<ul style="list-style-type: none"> ▪ IRC 453A – Special Rules for Nondealers ▪ IRC 453A(c)(3) – Deferred Tax Liability ▪ IRC 1 – Tax Imposed (Individuals, Trusts, Estates) ▪ IRC 11 – Tax Imposed (Corporations)

Step 1: Compute the Deferred Tax Liability (cont'd)

Interest on Deferred Tax Liability

[Step 1](#)

Considerations	Resources										
<p><u>Example</u></p> <ul style="list-style-type: none"> ▪ During the 2016 tax year, a calendar-year C corporation sold land for \$32 million with an adjusted basis of \$4 million. ▪ The taxpayer received \$5 million during the year and will receive the \$27 million balance over the next four years. ▪ IRC 453A applies since the sales price exceeds \$150,000 and the face amount of the obligation at the end of the taxable year exceeds \$5 million. <p>Use the following steps to compute the deferred tax liability:</p> <ol style="list-style-type: none"> 1. Compute the Gross Profit Percentage: \$28 million Gross Profit divided by \$32 million Selling Price equals 88%. <table data-bbox="124 992 828 1178" style="margin-left: 20px;"> <tr> <td>Selling Price</td> <td style="text-align: right;">\$32,000,000</td> </tr> <tr> <td><u>Less: Adjusted Basis</u></td> <td style="text-align: right;"><u>(\$4,000,000)</u></td> </tr> <tr> <td>Gross Profit</td> <td style="text-align: right;">\$28,000,000</td> </tr> <tr> <td><u>Divided: Selling Price</u></td> <td style="text-align: right;"><u>\$32,000,000</u></td> </tr> <tr> <td>Gross Profit Percentage</td> <td style="text-align: right;">.88</td> </tr> </table> 	Selling Price	\$32,000,000	<u>Less: Adjusted Basis</u>	<u>(\$4,000,000)</u>	Gross Profit	\$28,000,000	<u>Divided: Selling Price</u>	<u>\$32,000,000</u>	Gross Profit Percentage	.88	<ul style="list-style-type: none"> ▪ IRC 453A – Special Rules for Nondealers
Selling Price	\$32,000,000										
<u>Less: Adjusted Basis</u>	<u>(\$4,000,000)</u>										
Gross Profit	\$28,000,000										
<u>Divided: Selling Price</u>	<u>\$32,000,000</u>										
Gross Profit Percentage	.88										

Step 1: Compute the Deferred Tax Liability (cont'd)

Interest on Deferred Tax Liability

Step 1

Considerations	Resources
<u>Example (cont'd)</u>	
2. Compute the Unrecognized Gain at Year-End: \$27 million Outstanding Installment Obligation multiplied by the 88% Gross Profit Percentage equals \$23.76 million.	
Selling Price	\$32,000,000
<u>Less: Payments Received</u>	<u>(\$5,000,000)</u>
Outstanding Installment Obligation	\$27,000,000
<u>Multiply: Gross Profit Percentage</u>	<u>.88</u>
Unrecognized Gain at Year-End	\$23,760,000
3. Compute the Deferred Tax Liability: \$23.76 million Unrecognized Gain at Year-End multiplied by the 35% maximum tax rate for a C Corporation equals \$8.316 million.	
Unrecognized Gain at Year-End	\$23,760,000
<u>Multiply: Maximum tax rate</u>	<u>.35</u>
Deferred tax liability	\$8,316,000

Step 2: Compute the Applicable Percentage

Interest on Deferred Tax Liability

Step 2

Determine the applicable percentage.

Considerations	Resources
<p>The applicable percentage is determined as follows:</p> $\frac{\text{(Aggregate Face Amount of Outstanding Installment Obligations less \$5 million)}}{\text{Aggregate Face Amount of Outstanding Installment Obligations}}$ <p>The interest computation is the same whether a sale occurred on the last day of the taxable year or on any other day during the taxable year.</p> <p>This applicable percentage does not change as payments are made in later taxable years.</p> <p><u>Example</u></p> <p>Continuing with the example from Step 1. The aggregate amount of Outstanding Installment Obligations arising in 2016 and outstanding at year-end is \$27 million.</p> <p>Calculate the Applicable Percentage as follows:</p> $\frac{\text{(\$27,000,000 less \$5,000,000)}}{\text{\$27,000,000}} = 81\%$	<ul style="list-style-type: none"> ▪ IRC 453A(c)(4) – Applicable Percentage ▪ CCA 201021020 – Computation of Interest on the Deferred Tax Liability Under IRC 453A ▪ H Rept 100-495 at 929 (1987) – Treatment of Certain Installment Sales by Nondealers

Step 3: Determine the Underpayment Rate

Interest on Deferred Tax Liability

Step 3

The seller determines the Underpayment Rate under IRC Section 6621(a)(2) for the interest that will be charged.

Considerations	Resources
<p>The IRC 453A interest computation is based on the IRC 6621(a)(2) rate for the final month of the taxable year, which is the interest rate in effect as of the last day of the seller's taxable year.</p> <p>The IRC 6621(a)(2) underpayment rate is 3% over the federal short-term rate, which is determined by the Treasury Department on a monthly basis.</p> <p><u>Example</u></p> <p>Continuing with the example from Step 1 and Step 2:</p> <ul style="list-style-type: none"> ▪ The taxpayer's last day of its taxable year is December 31, 2016, and uses the IRC 6621(a)(2) interest rate in effect as of that date. ▪ The underpayment interest rate at year-end in 2016 is 4 percent. 	<ul style="list-style-type: none"> ▪ IRC 453A(c)(2)(B) – The Underpayment Rate in Effect ▪ IRC 6621 – Determination of Rate of Interest

Step 4: Compute the Interest Due on the Deferred Tax Liability

Interest on Deferred Tax Liability

Step 4

Compute the interest on the deferred tax liability by multiplying the deferred tax liability by the applicable percentage and by the underpayment rate.

Considerations		Resources																					
<p>Compute the interest due on the deferred tax liability.</p> <ol style="list-style-type: none"> 1. Multiply the amount of the deferred tax liability determined in Step 1 by the applicable percentage determined in Step 2. 2. Multiply the result by the underpayment rate in effect under IRC 6621(a)(2) for the month in which the taxable year ends. <p><u>Example</u></p> <p>Continuing with the example from Steps 1 through 3. Calculate the interest on the Deferred Tax Liability as follows:</p> <table border="1"> <thead> <tr> <th>Step</th> <th>Description</th> <th>Function</th> <th>Amount</th> </tr> </thead> <tbody> <tr> <td>1</td> <td>Deferred Tax Liability</td> <td></td> <td>\$8,316,000</td> </tr> <tr> <td>2</td> <td>Applicable Percentage</td> <td>Times</td> <td>81%</td> </tr> <tr> <td>3</td> <td>Underpayment Rate</td> <td>Times</td> <td>4%</td> </tr> <tr> <td>4</td> <td>Interest on Deferred Tax Liability</td> <td>Equals</td> <td>\$269,438</td> </tr> </tbody> </table>		Step	Description	Function	Amount	1	Deferred Tax Liability		\$8,316,000	2	Applicable Percentage	Times	81%	3	Underpayment Rate	Times	4%	4	Interest on Deferred Tax Liability	Equals	\$269,438	<ul style="list-style-type: none"> ▪ IRC 453A – Special Rules for Nondealers ▪ IRC 6621(a)(2) – The Underpayment Rate 	
Step	Description	Function	Amount																				
1	Deferred Tax Liability		\$8,316,000																				
2	Applicable Percentage	Times	81%																				
3	Underpayment Rate	Times	4%																				
4	Interest on Deferred Tax Liability	Equals	\$269,438																				

Exceptions

Interest on Deferred Tax Liability

Description

Exceptions to the interest rule under IRC 453A include a disposition of:

- Personal use property (within the meaning of IRC 1275(b)(3)) by an individual.
- Property used or produced in farming (within the meaning of IRC 2032A(e)(4) or(5)).
- Residential lots and timeshares - There is a separate interest computation for residential lots and timeshares. IRC 453(l).

Example 1

- A calendar-year C corporation sold a timeshare for \$7 million in the ordinary course of its trade or business to an individual on the installment method.
- The C-Corporation is eligible and elects to pay interest on the timeshare's deferred tax liability under IRC 453(l).
- The interest rules under IRC 453A do not apply to the disposition of the timeshare.

Definitions

Interest on Deferred Tax Liability

Description

- **453A Obligation** - A disposition of property under the installment method where the sales price of the property exceeds \$150,000. IRC 453A(b)(1).
- **Applicable Percentage** - This percentage is determined by dividing: (1) the Aggregate Face Amount of the 453A Obligations arising in and outstanding at the close of the tax year in excess of \$5 million, by (2) the Aggregate Face Amount of these obligations. IRC 453(c)(4).
- **Dealer** - A person who regularly sells or otherwise disposes of personal or real property on the installment plan. IRC 453(l)(1).
- **Deferred Tax Liability** - The tax liability deferred by reporting the installment sale under the installment method. The installment method allows a seller to report gain from the sale of property in the taxable year(s) in which payments are received, rather than in the year of sale. Unrecognized Gain at Year-End multiplied by the Maximum Tax Rate. IRC 453A(c)(3).
- **Gross Profit** - Selling Price less the Adjusted Basis. Treas. Reg. 15a.453-1(b)(2)(v).
- **Gross Profit Percentage** - Gross Profit divided by Total Contract Price. Treas. Reg. 15a.453-1(b)(2)(i).
- **Installment Method** - A method under which the income recognized for any taxable year from a disposition is that proportion of the payments received in that year which the gross profit (realized or to be realized when payment is completed) bears to the total contract price. IRC 453(c).
- **Installment Obligation** - Installment Obligation is the outstanding principal balance due on the installment obligation.
- **Installment Sale** - A disposition of property where at least one payment is received after the close of the taxable year in which the disposition occurs. IRC 453(b)(1).
- **Interest Due on the Deferred Tax Liability** - The interest on the tax deferred since the seller is reporting gain in the year the payment is received, rather than in the year of the sale. Deferred Tax Liability multiplied by the Applicable Percentage multiplied by the Underpayment Rate. IRC 453A(c).
- **Maximum Tax Rate** - The maximum capital gain or ordinary income tax rate in effect for that tax year. IRC 453A(c)(3)(B).

Definitions (cont'd)

Interest on Deferred Tax Liability

Description

- Sales Price - All sales or exchanges in the same transaction (or a series of related transactions) shall be treated as one sale or exchange. IRC 453A(b)(5).
- Underpayment Rate - The interest charged is based on the underpayment interest rate in effect under IRC 6621(a)(2) for the month with or within which the seller's tax year ends. IRC 453A(c)(2).
- Unrecognized Gain at Year End - Outstanding Installment Obligation at Year-End multiplied by Gross Profit Percentage.

Examples of the Process

Interest on Deferred Tax Liability

Description

Example 1

The taxpayer is in the business of making widgets. In Year 1, the taxpayer sells a patent and goodwill under the installment method. See the following sales information:

Year 1	Patent	Goodwill
Sales Price	\$2,500,000	\$5,000,000
Less: Payments Received	\$ 500,000	\$1,000,000
Installment Obligation	\$2,000,000	\$4,000,000

At the end of Year 1, the installment obligations arising from Year 1 dispositions are \$6 million (\$2 million plus \$4 million). The interest rules under IRC 453A apply to the dispositions in Year 1 since the total sales price exceeds \$150,000 and the obligations outstanding at the end of Year 1 exceed \$5 million.

In Year 2, the taxpayer sells an office building under the installment method. See the following sales information:

Year 2	Patent	Goodwill	Building
Sales Price	No Sale of Patent in Year 2	No Sale of Goodwill in Year 2	\$3,000,000
Less: Payments Received	\$1,000,000	\$3,000,000	\$ 300,000
Installment Obligation	\$1,000,000	\$1,000,000	\$2,700,000

- IRC 453A continues to apply at the end of Year 2 to the sale of the patent and the goodwill.
- IRC 453A does not apply to the building disposition in Year 2 since the installment obligation arising from the disposition in Year 2 does not exceed \$5 million.

Examples of the Process (cont'd)

Interest on Deferred Tax Liability

Description

Example 2

- Taxpayer A, a calendar-year C corporation, owns all the stock of X corporation, which has a basis to Taxpayer A of \$12 million. In November 2014, Taxpayer A sells the stock in X corporation to Taxpayer B, an unrelated party, for \$55 million.
- Taxpayer A receives a down payment of \$5 million, and the balance of \$50 million is due in 10 years but no payments were made, or required to be made, by Taxpayer B in 2015 and 2016.
- Taxpayer A reports the sale using the installment method. IRC 453A applies since the sales price exceeds \$150,000 and the obligations outstanding at the end of Year 1 exceed \$5 million.

Selling Price	\$55,000,000	Selling Price	\$55,000,000
Less: Adjusted Basis	(\$12,000,000)	Less: Payments Received	(\$5,000,000)
Gross Profit	\$43,000,000	Outstanding Installment Obligation	\$50,000,000

1. Compute the Deferred Tax Liability

- Gross Profit Percentage = \$43 million Gross Profit divided by \$55 million Selling Price equals 78%.
- Unrecognized Gain at Year-End = \$50 million Outstanding Installment Obligation multiplied by 78% Gross Profit Percentage equals \$39 million.
- Deferred Tax Liability = \$39 million Unrecognized Gain at Year-End multiplied by 35% Maximum Tax Rate for a C corporation equals \$13.65 million.

The 2014 Deferred Tax Liability is \$13.65 million.

Examples of the Process (cont'd)

Interest on Deferred Tax Liability

Description

Example 2 (cont'd)

2. Compute the Applicable Percentage

$$\frac{(\$50,000,000 \text{ Aggregate Face Amount of Outstanding Installment Obligation at Year-End less } \$5 \text{ million})}{\$50,000,000 \text{ Aggregate Face Amount of Outstanding Installment Obligation at Year-End}}$$

The Applicable Percentage is 90%.

3. Determine the Underpayment Rate

The IRC 6621(a)(2) interest rate in effect on the last day of Taxpayer A's 2014 taxable year is 3%.

4. Compute the Interest Due on the Deferred Tax Liability

Interest on Deferred Tax Liability = Step 1, \$13.65 million, Deferred Tax Liability, multiplied by Step 2, 90%, Applicable Percentage, multiplied by Step 3, 3%, Underpayment Rate, equals \$368,550.

The IRC 453A interest amount of \$368,550 is added to Taxpayer A's income tax liability on its 2014 Form 1120.

Step	Description	Function	Amount
1	Deferred Tax Liability		\$13,650,000
2	Applicable Percentage	Times	90%
3	Interest Rate	Times	3%
4	Interest on Deferred Tax Liability	Equals	\$368,550

Examples of the Process (cont'd)

Interest on Deferred Tax Liability

Description

Example 3

Continuing with the example above. Taxpayer B does not make any payments on the installment note in 2015.

What is the interest due on the deferred tax liability in 2015?

1. Compute the Deferred Tax Liability

The Outstanding Installment Obligation in 2015 has not changed. The Maximum Tax Rate for a C corporation in 2015 is 35%. The 2015 Deferred Tax Liability remains at \$13.65 million.

2. Compute the Applicable Percentage

The 2015 Applicable Percentage is still 90%.

3. Determine the Underpayment Rate

The IRC 6621(a)(2) interest rate in effect on the last day of A's 2015 taxable year is 3%.

Examples of the Process (cont'd)

Interest on Deferred Tax Liability

Description

Example 3 (cont'd)

4. Compute the Interest Due on the Deferred Tax Liability

Interest on Deferred Tax Liability = Step 1, \$13.65 million, Deferred Tax Liability, multiplied by Step 2, 90%, Applicable Percentage, multiplied by Step 3, 3%, Underpayment Rate, equals \$368,550.

The IRC 453A interest amount of \$368,550 is added to Taxpayer A's income tax liability on its 2015 Form 1120.

Step	Description	Function	Amount
1	Deferred Tax Liability		\$13,650,000
2	Applicable Percentage	Times	90%
3	Interest Rate	Times	3%
4	Interest on Deferred Tax Liability	Equals	\$368,550

Examples of the Process (cont'd)

Interest on Deferred Tax Liability

Description

Example 4

Continuing with the example above. Taxpayer B makes a \$10 million payment on the installment note in 2016.

What is the interest due on the deferred tax liability in 2016?

1. Compute the Deferred Tax Liability

Gross Profit Percentage is 78% (it does not change)

Unrecognized Gain at Year-End = \$40 million Outstanding Installment Obligation (\$50 million Beginning Balance less \$10 million payment) multiplied by 78% Gross Profit Percentage equals \$31.2 million.

Deferred Tax Liability = \$31.2 million Unrecognized Gain at Year-End multiplied by 35% Maximum Tax Rate for a C corporation equals \$10.92 million.

The 2016 Deferred Tax Liability is \$10.92 million.

2. The Applicable Percentage is 90%, it is computed in the first year and does not change.

3. Determine the Underpayment Rate

The IRC 6621(a)(2) interest rate in effect on the last day of Taxpayer A's 2016 taxable year is 4%.

Examples of the Process (cont'd)

Interest on Deferred Tax Liability

Description

Example 4 (cont'd)

4. Compute the Interest Due on the Deferred Tax Liability

Interest on Deferred Tax Liability = Step 1, \$10.92 million, Deferred Tax Liability, multiplied by Step 2, 90%, Applicable Percentage, multiplied by Step 3, 4%, Underpayment Rate, equals \$393,120.

The IRC 453A interest amount of \$393,120 is added to Taxpayer A's income tax liability on its 2016 Form 1120.

Step	Description	Function	Amount
1	Deferred Tax Liability		\$10,920,000
2	Applicable Percentage	Times	90%
3	Interest Rate	Times	4%
4	Interest on Deferred Tax Liability	Equals	\$393,120

Examples of the Process (cont'd)

Interest on Deferred Tax Liability

Description

Example 5

Continuing with the example above. Taxpayer B makes a \$40 million payment on the installment note in 2017.

What is the interest due on the deferred tax liability in 2017?

The Outstanding Installment Obligation in 2017 is \$0 (\$40 million Beginning Balance less \$40 million payment).

Since the 2017 Outstanding Installment Obligation is \$0, the Deferred Tax Liability is \$0, and the IRC 453A interest on the Deferred Tax Liability is \$0.

IRC 453A is not applicable in 2017 because the face amount of installment obligations outstanding as of the close of the year is \$0 (that is, the installment note was paid in full during 2017).

Other Considerations / Impact to Audit

Interest on Deferred Tax Liability	
Considerations	Resources
<p>Form 1120-S – <i>U.S. Income Tax Return for an S Corporation</i></p> <ul style="list-style-type: none"> For an S corporation, apply the \$5 million threshold and compute the interest at the shareholder level rather than at the entity level. The instructions for Form 1120-S Schedule K-1 provide the S corporation should report any information (for example, the installment note's balance and remaining gross profit) a shareholder needs to compute the interest due on the shareholder's Schedule K-1, Box 17, Code N. 	<ul style="list-style-type: none"> Form 1120-S, Schedule K-1 Instructions Notice 88-81 – Explanation on How Partnerships and S Corporations Should Apply the \$5 Million Threshold of IRC 453A
<p>Form 1065 – <i>U.S. Return of Partnership Income</i></p> <ul style="list-style-type: none"> For a partnership, apply the \$5 million threshold and compute the interest at the partner level rather than at the entity level. The instructions for Form 1065 Schedule K-1 provide that the partnership should report any information (that is, the installment note's balance and remaining gross profit) a partner needs to compute the interest due on the partner's Schedule K-1, Box 20, Code P. 	<ul style="list-style-type: none"> Form 1065, Schedule K-1 Instructions Notice 88-81 – Explanation on How Partnerships and S Corporations Should Apply the \$5 Million Threshold of IRC 453A
<p>Form 1040 – <i>U.S. Individual Income Tax Return</i></p> <ul style="list-style-type: none"> For a passthrough entity owner, apply the \$5 million threshold and compute the interest at the owner level. The instructions for Form 1040 or Form 1040-NR provide the individual should report the interest as Other Taxes and enter the amount of the tax with the code “453A(c)”. 	<ul style="list-style-type: none"> Notice 88-81 – Explanation on How Partnerships and S Corporations Should Apply the \$5 Million Threshold of IRC 453A Form 1040 Instructions
<p>Form 1120 – <i>U.S. Corporation Income Tax Return</i></p> <ul style="list-style-type: none"> U.S. corporations report the interest on Form 1120, Schedule J, line 9f Interest/tax due under Section 453A(c) and/or Section 453(l). Foreign corporations using Form 1120-F report the interest as Other taxes and attach a statement calculating the amounts reported (that is, Form 1120-F, Schedule J, line 8). 	<ul style="list-style-type: none"> Form 1120 Instructions, Schedule J, line 9f Form 1120-F Instructions

Other Considerations / Impact to Audit (cont'd)

Interest on Deferred Tax Liability	
Considerations	Resources
Maximum tax rate refers to tax assessed under IRC 1 (individuals, trusts, estates income tax) or IRC 11 (corporate income tax), as applicable. It does not include the additional 3.8% tax on certain types and amounts of net investment income under IRC 1411.	<ul style="list-style-type: none"> ▪ IRC 1 – Tax Imposed (Individuals, Trusts, Estates) ▪ IRC 11 – Tax Imposed (Corporations) ▪ IRC 1411 – Imposition of Tax
A seller cannot obtain a refund of interest paid in an earlier year under IRC 453A where the seller later estimates it will not receive the Selling Price used to compute the deferred tax liability for a contingent installment obligation.	<ul style="list-style-type: none"> ▪ TAM 9853002 (Sept. 11, 1998) – Special Rules for Nondealers of Real Property
Spouses who each have separate ownership in a business or asset(s) sold are treated as separate sellers for the purpose of applying the \$5 million limitation of IRC 453A.	<ul style="list-style-type: none"> ▪ TAM 9853002 (Sept. 11, 1998) – Special Rules for Nondealers of Real Property
Section 453A is personal interest and not deductible by individuals.	<ul style="list-style-type: none"> ▪ IRC 163(h)(2)(A) – Disallowance of Deduction for Personal Interest ▪ Treas. Reg. 1.163-9T(b)(2)(i)(A) – Personal Interest ▪ <i>Carlson v. Commissioner</i> – 112 TC 240 (1999)

Index of Referenced Resources

Interest on Deferred Tax Liability

IRC 1 – Tax Imposed (Individuals, Trusts, Estates)

IRC 11 – Tax Imposed (Corporations)

IRC 163 – Interest

IRC 453 – Installment Method

IRC 453A – Special Rules for Nondealers

IRC 1275(b)(3) – Personal Use Property

IRC 1411 – Imposition of Tax

IRC 2032A(e)(4), (5) – Definitions of Farm and Farming Purposes

IRC 6621(a)(2) – Underpayment Rate

Treas. Reg. 1.163-9T(b)(2)(i)(A) – Personal Interest

Treas. Reg. 15a.453-1 – Installment Method Reporting for Sales of Real and Causal Sales of Personal Property

Notice 88-81 – Explanation on How Partnerships and S Corporations Should Apply the \$5 Million Threshold of IRC 453A

CCA 201021020 – Computation of Interest on the Deferred Tax Liability Under IRC 453A

Carlson v. Commissioner – 112 TC 240 (1999)

H Rept 100-495 at 929 (1987) – Treatment of Certain Installment Sales by Nondealers

TAM 9853002 (Sept. 11, 1998) – Special Rules for Nondealers of Real Property

Form 1040 Instructions

Index of Referenced Resources (cont'd)

Interest on Deferred Tax Liability

Form 1065, Schedule K-1 Instructions

Form 1120 Instructions

Form 1120-S, Schedule K-1 Instructions

Training and Additional Resources

Interest on Deferred Tax Liability	
Type of Resource	Description(s)
Saba Meeting Sessions	<ul style="list-style-type: none">▪ Overview of Installment Sales - MAT IPG Community Meeting - 2013-11
White Papers / Guidance	<ul style="list-style-type: none">▪ Audit Tool – IRC 453AFAQs▪ Audit Tool – IRC 453A FlowChart▪ Audit Tool – IRC 453A Job Aid
Reference Materials	<ul style="list-style-type: none">▪ Form 6252 – <i>Installment Sale Income</i>▪ Pub. 537 – <i>Installment Sales</i>

Glossary of Terms and Acronyms

Term/Acronym	Definition
CCA	Chief Counsel Advice
H Rept	House Report
IRC	Internal Revenue Code
Pub	Publication
TAM	Technical Advice Memorandum
Treas. Reg.	Treasury Regulation

Index of Related Practice Units

Associated UIL(s)	Related Practice Unit
453.10-00	<i>Installment Method</i>