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Form 1040 Reporting of Owner Financing & Nontraditional Loans *(Installment Sales 101)*

American Institute of Certified Public Accountants



<http://www.aicpa.org/INTERESTAREAS/TAX/Pages/TaxHomepage.aspx>



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Today's Agenda

- Key concepts
- Practical applications
- Special situations
- Related tax forms
- Wrap-up and questions

Please ask questions as we go!



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Installment Sale Defined

- Sale of property
- Multiple payments
- Over more than one tax year

* Taxpayer plays role of the banker



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Payment Components

- Return of investment
 - Basis
- Gain on sale
 - Treatment varies
- Interest
 - Stated
 - Imputed under §483
 - Original issue discount under §§ 1271-1274



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Terms You Need To Know & Understand

- Sales price
- Selling expenses
- Adjusted basis
- Installment sale basis



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Terms You Need To Know & Understand

- Contract price
- Gross profit
- Gross profit percentage
- Depreciation recapture



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When to Use

- Sale of business
 - Buyer lacks financing
- Selling to trusted employee
 - Gradual phase-in
- Tax planning
 - Spreading income over time



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Required Information

- Sales agreement
 - Sales price & fees
 - Interest rate & terms
- Basis of property sold
 - Including depreciation taken
- Amortization schedule
 - Actual payments
 - Interest allocation



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Example – Sale of Land

Sales price \$300,000, payable over 5 years in equal installments with 3% interest

Asset	Sales Price	Installment Sale Basis	Gross Profit
Land	\$300,000	\$10,000	\$290,000

- Gross profit percentage:
- Land – $290,000/300,000 = 96.67\%$



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Example – Sale of Land

Treatment by year

Year	Principal	Gross Profit %	Gain	Interest
One	\$56,506	96.67%	\$54,622	\$9,000
Two	58,201	96.67%	56,261	7,304
Three	59,948	96.67%	57,950	5,558
Four	61,746	96.67%	59,688	3,760
Five	63,599	96.67%	61,479	1,907
	\$300,000		\$290,000	\$27,529



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Example – Sale of Land

Wages \$145,000, impact of net investment income tax (NIIT)

No installment sale

Wages	Gain	Total Income	NIIT Exclusion	NIIT Rate	NIIT Tax
\$145,000	\$290,000	\$435,000	(\$200,000)	3.8%	\$8,930

With installment sale treatment

Wages	Gain	Total Income	NIIT Exclusion	NIIT Rate	NIIT Tax
\$145,000	\$54,620	\$199,622	(\$200,000)	3.8%	\$0



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Areas to Watch

- Inventory
- Passive activity
- Related parties
 - 1st & 2nd sale rules
- Imputed interest
- Interest on deferred tax



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Example – Sale of Business

Sales price \$250,000, payable over 5 years in equal installments

Asset	Fair Market Value	Depreciation Claimed	Adjusted Basis
Inventory	\$25,000	\$0	\$20,000
Land	50,000	0	10,000
Building	150,000	25,000	125,000
Truck	10,000	15,000	5,000
TOTAL	\$235,000	\$40,000	\$160,000



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Example – Sale of Business

Asset	Sales Price	Adjusted Basis	Gain
Inventory	\$25,000	\$20,000	\$5,000
Land	50,000	10,000	40,000
Building	150,000	125,000	25,000
Truck	10,000	5,000	5,000
Goodwill	15,000	0	15,000
TOTAL	\$250,000	\$160,000	\$90,000

Inventory – ineligible asset for installment sale

Gain on truck – less than depreciation recapture, report fully in year 1

Building – straight line depreciation, OK to include in installment sale calculation



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Example – Sale of Business

Asset	Sales Price	Installment Sale Basis	Gross Profit
Land	\$50,000	\$10,000	\$40,000
Building	150,000	125,000	25,000
Goodwill	15,000	0	15,000
TOTAL	\$215,000	\$135,000	\$80,000

Gross profit percentages:

Land – $40,000/215,000$ → 18.60%

Building – $25,000/215,000$ → 11.63%

Goodwill – $15,000/215,000$ → 6.98%

TOTAL - $80,000/215,000$ → 37.21%

*Percentage of assets reported on installment sale basis:

$\$215,000/\$250,000 = 86.00\%$



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Example – Sale of Business

- Year 1
 - Report full gain of \$10,000 on inventory and truck
 - Installment sale gross income is \$43,000 ($\$50,000 \times 86\%$)
 - Taxable income is \$16,000 ($\$43,000 \times 37.21\%$)
- Years 2 through 5
 - Installment sale gross income is \$43,000 ($\$50,000 \times 86\%$)
 - Taxable income is \$16,000 ($\$43,000 \times 37.21\%$)
- All Years
 - Don't forget to report interest income received



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Electing Out

When does it makes sense?

- Net investment income tax
- Taxable retirement income
 - Medicare surcharge
 - Social Security benefits



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Treatment of Dispositions

- Gifts
- Death transfers
- Sale of right to future payments
- Assumption of payment obligation
- Buyer default



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Tax Forms

Form 6252	Installment Sale Income		OMB No. 1545-0228
Department of the Treasury Internal Revenue Service	<p align="center">▶ Attach to your tax return.</p> <p>▶ Use a separate form for each sale or other disposition of property on the installment method.</p> <p>▶ Information about Form 6252 and its instructions is at www.irs.gov/form6252.</p>		2013 Attachment Sequence No. 79
Name(s) shown on return			Identifying number
1 Description of property ▶			
2a Date acquired (mm/dd/yyyy) ▶		b Date sold (mm/dd/yyyy) ▶	
3 Was the property sold to a related party (see instructions) after May 14, 1980? If "No," skip line 4			<input type="checkbox"/> Yes <input type="checkbox"/> No
4 Was the property you sold to a related party a marketable security? If "Yes," complete Part III. If "No," complete Part III for the year of sale and the 2 years after the year of sale			<input type="checkbox"/> Yes <input type="checkbox"/> No
Part I Gross Profit and Contract Price. Complete this part for the year of sale only.			
5 Selling price including mortgages and other debts. Do not include interest, whether stated or unstated			5
6 Mortgages, debts, and other liabilities the buyer assumed or took the property subject to (see instructions)	6		
7 Subtract line 6 from line 5	7		
8 Cost or other basis of property sold	8		
9 Depreciation allowed or allowable	9		
10 Adjusted basis. Subtract line 9 from line 8	10		
11 Commissions and other expenses of sale	11		
12 Income recapture from Form 4797, Part III (see instructions)	12		
13 Add lines 10, 11, and 12			13
14 Subtract line 13 from line 5. If zero or less, do not complete the rest of this form (see instructions)			14
15 If the property described on line 1 above was your main home, enter the amount of your excluded gain (see instructions). Otherwise, enter -0-			15
16 Gross profit. Subtract line 15 from line 14			16
17 Subtract line 13 from line 6. If zero or less, enter -0-			17



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Tax Forms

SCHEDULE D (Form 1040) Department of the Treasury Internal Revenue Service (99)	Capital Gains and Losses ► Attach to Form 1040 or Form 1040NR. ► Information about Schedule D and its separate instructions is at www.irs.gov/scheduled . ► Use Form 8949 to list your transactions for lines 1b, 2, 3, 8b, 9, and 10.				OMB No. 1545-0074 2013 Attachment Sequence No. 12
Name(s) shown on return			Your social security number		
Part I Short-Term Capital Gains and Losses—Assets Held One Year or Less					
See instructions for how to figure the amounts to enter on the lines below. This form may be easier to complete if you round off cents to whole dollars.		(d) Proceeds (sales price)	(e) Cost (or other basis)	(g) Adjustments to gain or loss from Form(s) 8949, Part I, line 2, column (g)	(h) Gain or (loss) Subtract column (e) from column (d) and combine the result with column (g)
1a Totals for all short-term transactions reported on Form 1099-B for which basis was reported to the IRS and for which you have no adjustments (see instructions). However, if you choose to report all these transactions on Form 8949, leave this line blank and go to line 1b .					
1b Totals for all transactions reported on Form(s) 8949 with Box A checked					
2 Totals for all transactions reported on Form(s) 8949 with Box B checked					
3 Totals for all transactions reported on Form(s) 8949 with Box C checked					
4 Short-term gain from Form 6252 and short-term gain or (loss) from Forms 4684, 6781, and 8824 .				4	
5 Net short-term gain or (loss) from partnerships, S corporations, estates, and trusts from Schedule(s) K-1				5	



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Form 4797	Sales of Business Property (Also Involuntary Conversions and Recapture Amounts Under Sections 179 and 280F(b)(2))					OMB No. 1545-0184	
Department of the Treasury Internal Revenue Service	▶ Attach to your tax return. ▶ Information about Form 4797 and its separate instructions is at www.irs.gov/form4797 .					2013 Attachment Sequence No. 27	
Name(s) shown on return					Identifying number		
1 Enter the gross proceeds from sales or exchanges reported to you for 2013 on Form(s) 1099-B or 1099-S (or substitute statement) that you are including on line 2, 10, or 20 (see instructions)					1		
Part I Sales or Exchanges of Property Used in a Trade or Business and Involuntary Conversions From Other Than Casualty or Theft—Most Property Held More Than 1 Year (see instructions)							
2	(a) Description of property	(b) Date acquired (mo., day, yr.)	(c) Date sold (mo., day, yr.)	(d) Gross sales price	(e) Depreciation allowed or allowable since acquisition	(f) Cost or other basis, plus improvements and expense of sale	
						(g) Gain or (loss) Subtract (f) from the sum of (d) and (e)	
3	Gain, if any, from Form 4684, line 39					3	
4	Section 1231 gain from installment sales from Form 6252, line 26 or 37					4	
5	Section 1231 gain or (loss) from like-kind exchanges from Form 8824					5	
6	Gain, if any, from line 32, from other than casualty or theft.					6	
7	Combine lines 2 through 6. Enter the gain or (loss) here and on the appropriate line as follows:					7	
Partnerships (except electing large partnerships) and S corporations. Report the gain or (loss) following the instructions for Form 1065, Schedule K, line 10, or Form 1120S, Schedule K, line 9. Skip lines 8, 9, 11, and 12 below.							
Individuals, partners, S corporation shareholders, and all others. If line 7 is zero or a loss, enter the amount from line 7 on line 11 below and skip lines 8 and 9. If line 7 is a gain and you did not have any prior year section 1231 losses, or they were recaptured in an earlier year, enter the gain from line 7 as a long-term capital gain on the Schedule D filed with your return and skip lines 8, 9, 11, and 12 below.							
8	Gain or (loss) from section 1231 loss recapture (see instructions)					8	



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Questions?



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