

IRS Targets Monetized Installment Sales

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1. Introduction

In an effort to combat tax evasion and abusive tax transactions, the Internal Revenue Service (IRS) and the U.S. Treasury Department have recently released [proposed regulations](#) targeting monetized installment sale transactions. These transactions, along with substantially similar schemes, have been classified as listed transactions—a category of reportable transactions that requires special disclosure and reporting.

2. Understanding Monetized Installment Sales

Monetized installment sale transactions are complex tax planning *strategies* used by taxpayers to sell appreciated assets while deferring capital gains taxes on the sale. The process typically involves an intermediary (too often the promoter) where the taxpayer sells the appreciated property to the intermediary, who subsequently sells it to a buyer in exchange for cash. The taxpayer receives an installment note and secures a loan, with interest payments on both matching each other. Both the installment agreement and the loan are structured to have interest due over the same periods, with principal due in a balloon payment at or near the end of the term of the installment agreement and loan. The gain on the sale is deferred until the maturity of the installment obligation, allowing taxpayers to receive cash today while deferring taxes on the majority of their gain for an extended period.

Imagine John owns a valuable commercial property he wants to sell for \$2 million. Instead of paying immediate capital gains taxes, he enters a transaction where a middleman helps him sell the property to a buyer for cash. John receives an "installment note" from the middleman, deferring the tax on the sale. Simultaneously, John takes a loan with an amount and payment terms matching the installment obligation. He receives the cash upfront, but the tax on the profit is postponed until the installment obligation matures, potentially years later.

The IRS sees these transactions as potentially abusive tax schemes. They have proposed regulations to challenge their legitimacy. Taxpayers must report such transactions as "listed transactions," which have specific disclosure requirements. Failing to report a listed transaction can lead to severe penalties. Tax professionals must be aware of these regulations and inform clients about the potential risks involved in engaging in such transactions.

3. The Effect of Being a Listed Transaction

The proposed regulations classify monetized installment sales and substantially similar transactions as listed transactions. A "listed transaction" designation means that these transactions are considered tax-avoidance schemes with a potential for abuse. Consequently, participants engaged in such transactions, including taxpayers and material advisors, are required to disclose them to the IRS using Form 8886 (Reportable Transaction Disclosure Statement) and

Form 8918 (Material Advisor Disclosure Statement). Failure to comply with disclosure requirements may result in substantial penalties and an unlimited statute of limitations for IRS audits.

Being classified as a "listed transaction" carries significant consequences for taxpayers and material advisors. One judge once referred to it as a "scarlet letter". Taxpayers must ensure they properly disclose their participation in such transactions, as failure to do so can lead to severe penalties. For individuals, penalties can reach up to \$100,000, while businesses may face penalties of up to \$200,000. In addition, the IRS may impose an increased accuracy-related penalty of 30% rather than the normal 20% accuracy-related penalty. Furthermore, if the IRS determines that the transaction lacked economic substance, a 40% penalty may be applied. These penalties, along with an unlimited statute of limitations for audits, can have far-reaching financial and reputational implications for taxpayers and material advisors involved in listed transactions.

4. IRS's Plan to Challenge Reporting these Transactions as Installment Sales

The IRS has indicated its intent to challenge the reporting of these transactions as installment sales under section 453. The agency plans to use multiple legal arguments to attack the structure of these transactions, including questioning the intermediary's status as a bona fide purchaser and treating the installment note as receipt of payment for the seller. The IRS may also apply economic substance rules, the step transaction doctrine, and the conduit theory to recharacterize these transactions, potentially negating the intended tax benefits.

5. Importance of Public Comment Period and Public Hearing

The IRS has provided a window for taxpayers and tax professionals to provide comments on the proposed regulations until September 3, 2023. Additionally, a public hearing is scheduled for October 12, 2023, in Washington, DC, where the public can present their viewpoints and concerns. As tax lawyers and CPAs, active participation in this process is essential to voice concerns, offer insights, and contribute to shaping the final regulations. Clients should also be made aware of the significance of these public input opportunities and encouraged to be proactive in engaging with the regulatory process.

6. What does it mean for taxpayers that were involved in such transaction or CPAs advising such clients?

The proposed regulations targeting monetized installment sale transactions underscore the IRS's commitment to curbing such transactions as abusive tax practices.

Tax professionals should be aware of the reporting obligations and potential risks for their clients, while clients should understand the potential consequences of engaging in listed transactions.

Tax professionals must guide their clients through these developments regarding monetized installment sale transactions. During this window of time before the disclosure obligation takes

effect, taxpayers and their advisors should take proactive steps. Educate your clients about the implications of engaging in listed transactions and emphasize the importance of compliance.

For taxpayers, carefully assess past transactions to understand potential risks and compliance issues. If you believe that you got involved in such a scheme, contact your trusted advisor to determine whether your transaction is subject to these proposed rules and evaluating potential remediation options.

Compliance with the reporting requirements is paramount, and seeking professional advice to navigate these complex regulations is strongly recommended.

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