The IRS (or Congress) Should Clarify When Structured Installment Sales Will Be Respected

To the Editor:

A recent article[1] contrasts monetized installment sales (MISs), which the IRS has proposed as listed transactions,[2] against structured installment sales (SISs). The authors frequently refer to SISs that are "properly structured" or "properly executed," and they compare these favorably with structured settlements.

I agree that there are conservative ways to do SISs, and I respect that the authors may be doing them this way. However, I have always felt that the distinction between MISs and SISs is really a matter of degree, not of kind.[3] The abusive thing about MISs is that they cause the installment obligation to function so much like equity that the seller experiences the installment sale as a sort of universal nonrecognition transaction (that is, tax-free sale of any asset for any asset, almost). In principle, you could make an SIS do this too, by constructing an annuity whose value depends on the distributions from a single company — that is, the company that the seller wishes to exchange into. If MISs and private placement life insurance had a baby, this would be it.

When SISs were first proposed 20 years ago,[4] the sole stated purpose was to reduce the likelihood that Buyer would default. The idea seemed so innocuous that, even if there was a legal basis to challenge it, it was hard to imagine the IRS being motivated to do so. But when the installment obligation becomes an annuity, and when the method of calculating the payout from that annuity gets increasingly creative, it becomes important to know where courts will draw the line.

Currently, I don't think that answer is knowable. We know that Congress approves of installment obligations in "transactions where the gross profit or the total contract price (or both) cannot be readily ascertained."[5] And we know Treasury interprets this to not permit "transactions with respect to which the installment obligation represents, under applicable principles of tax law, a retained interest in the property which is the subject of the transaction, an interest in a joint venture or a partnership, an equity interest in a corporation or similar transactions."[6] So, to review: We know that installment obligations can have equitylike features — but not too many. This is worse than a debt vs. equity line-drawing game. It is 50 shades of debt vs. equity.

Congress or Treasury should draw a clearer line. To start, Treasury could revise reg. section 15a.453-1(c)(1) to clarify when installment payments may be calculated as other than straight debt and which contingencies may be taken into account. If Treasury identifies arrangements that are nonabusive but illegal, Congress should consider making them legal.

Sincerely,

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[1] *See* George A. Luecke and Patrick J. Hindert, "Structured Installment Sales vs. Monetized Installment Sales," *Tax Notes Federal*, Dec. 23, 2024, p. 2367.

[2] REG-109348-22.

[3] For further discussion, see my comment to the notice of proposed rulemaking.

[4] The earliest description of the transaction that I'm aware of is Robert W. Wood, "Structured Sales: Breathing Life Into Installment Sales," *Tax Notes*, July 11, 2005, p. 201.

[5] Section 453(j)(2).

[6] Reg. section 15a.453-1(c)(1).