



# Residential Rentals: Installment Sales

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Course #34052A

Taxes

2 Credit Hours

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# RESIDENTIAL RENTALS: INSTALLMENT SALES

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This course covers the general tax rules governing installment sales and explores more complex provisions that apply to specific property types or conditions. It provides a clear framework for recognizing income, calculating gain, and understanding exceptions and limitations that can affect installment sale treatment.

## LEARNING ASSIGNMENTS AND OBJECTIVES

*As a result of studying each assignment, you should be able to meet the objectives listed below each individual assignment.*

### SUBJECTS

#### Installment Sales

Study the course materials

Complete the review questions at the end of each chapter

Answer the exam questions 1 to 10

#### Objectives:

- Identify the general rules that apply to all installment sales, and the more complex rules that apply only when certain conditions exist or certain types of property are sold.

## **NOTICE**

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## EXAM OUTLINE

- **TEST FORMAT:** The final exam for this course consists of 10 multiple-choice questions and is based specifically on the information covered in the course materials.
- **ACCESS FINAL EXAM:** Log in to your account and click Take Exam. A copy of the final exam is provided at the end of these course materials for your convenience, however you must submit your answers online to receive credit for the course.
- **LICENSE RENEWAL INFORMATION:** This course qualifies for **2** CPE hours.
- **PROCESSING:** You will receive the score for your final exam immediately after it is submitted. A score of 70% or better is required to pass.
- **CERTIFICATE OF COMPLETION:** Will be available in your account to view online or print. If you do not pass an exam, it can be retaken free of charge.

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# CHAPTER 1: INSTALLMENT SALES

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## Chapter Objectives

### After completing this chapter, you should be able to:

- Identify the general rules that apply to all installment sales, and the more complex rules that apply only when certain conditions exist or certain types of property are sold.

## I. REMINDERS

**New reporting form for Qualified Opportunity Fund (QOF) investments.** Form 8997, Initial and Annual Statement of Qualified Opportunity Fund (QOF) Investments, is used to report holdings, deferred gains, and dispositions of QOF investments. See the Instructions for Form 8997 for more information.

**Like-kind exchanges.** Beginning after December 31, 2017, section 1031 like-kind exchange treatment applies only to exchanges of real property held for use in a trade or business or for investment, other than real property held primarily for sale. See *Like-Kind Exchange*, later.

## II. INTRODUCTION

An installment sale is a sale of property where you receive at least one payment after the tax year of the sale. If you realize a gain on an installment sale, you may be able to report part of your gain when you receive each payment. This method of reporting gain is called the installment method. You cannot use the installment method to report a loss. You can choose to report all of your gain in the year of sale.

This chapter discusses the general rules that apply to all installment sales. It also discusses more complex rules that apply only when certain conditions exist or certain types of property are sold.

If you sell your home or other nonbusiness property under an installment plan, you may need to consider only the *General Rules*. If you sell business or rental property or have a like-kind exchange or other complex situation, see the appropriate discussion under *Other Rules*, later.

## III. WHAT IS AN INSTALLMENT SALE

An installment sale is a sale of property where you receive at least one payment after the tax year of the sale.

The installment sales method cannot be used for the following.

**Sale of inventory.** The regular sale of inventory of personal property does not qualify as an installment sale even if you receive a payment after the year of sale. See *Sale of a Business*, later.

**Dealer sales.** Sales of personal property by a person who regularly sells or otherwise disposes of the same type of personal property on the installment plan are not installment sales. This rule also applies to real property held for sale to customers in the ordinary course of a trade or business. However, the rule does not apply to an installment sale of property used or produced in farming.

**Special rule.** Dealers of timeshares and residential lots can treat certain sales as installment sales and report them under the installment method if they elect to pay a special interest charge. For more information, see section 453(l) of the Internal Revenue Code.

**Stock or securities.** You cannot use the installment method to report gain from the sale of stock or securities traded on an established securities market. You must report the entire gain on the sale in the year in which the trade date falls.

**Installment obligation.** The buyer's obligation to make future payments to you can be in the form of a deed of trust, note, land contract, mortgage, or other evidence of the buyer's debt to you.

## IV. GENERAL RULES

If a sale qualifies as an installment sale, the gain must be reported under the installment method unless you elect out of using the installment method.

See *Electing Out of the Installment Method* under *Other Rules*, later, for information on recognizing the entire gain in the year of sale.

**Fair market value (FMV).** This is the price at which property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and both having a reasonable knowledge of all the necessary facts.

**Sale at a loss.** If your sale results in a loss, you cannot use the installment method. If the loss is on an installment sale of business or investment property, you can deduct it only in the tax year of sale.

**Unstated interest.** If your sale calls for payments in a later year and the sales contract provides for little or no interest, you may have to figure unstated interest, even if you have a loss. See *Unstated Interest and Original Issue Discount (OID)*, later.

## FIGURING INSTALLMENT SALE INCOME

You can use the following discussions or Form 6252 to help you determine gross profit, contract price, gross profit percentage, and installment sale income.

Each payment on an installment sale usually consists of the following three parts.

- Interest income.

- Return of your adjusted basis in the property.
- Gain on the sale.

In each year you receive a payment, you must include the interest part in income, as well as the part that is your gain on the sale. You do not include in income the part that is the return of your basis in the property. Basis is the amount of your investment in the property for installment sale purposes. You may have interest income in years you do not receive a payment.

## Interest Income

You must report interest as ordinary income. Interest is generally not included in a down payment. However, you may have to treat part of each later payment as interest, even if it is not called interest in your agreement with the buyer. Interest provided in the agreement is called stated interest. If the agreement does not provide for enough stated interest, there may be unstated interest or original issue discount (OID). You may have to include interest in income even in a year you receive no payment, depending on your regular method of accounting and whether the interest is unstated interest or OID. See *Unstated Interest and Original Issue Discount (OID)*, later.

## Adjusted Basis and Installment Sale Income (Gain on Sale)

After you have determined how much of each payment to treat as interest, you treat the rest of each payment as if it were made up of two parts.

- A tax-free return of your adjusted basis in the property, and
- Your gain (referred to as installment sale income on Form 6252).

**Figuring adjusted basis for installment sale purposes.** You can use *Worksheet 6-A* to figure your adjusted basis in the property for installment sale purposes. When you have completed the worksheet, you will also have determined the gross profit percentage necessary to figure your installment sale income (gain) for this year.

## WORKSHEET 6-A. FIGURING ADJUSTED BASIS AND GROSS PROFIT PERCENTAGE

1.	Enter the selling price for the property.	_____
2.	Enter your adjusted basis for the property.	_____
3.	Enter your selling expenses.	_____
4.	Enter any depreciation recapture.	_____
5.	Add lines 2, 3, and 4. This is your adjusted basis for installment sale purposes.	_____
6.	Subtract line 5 from line 1. If zero or less, enter -0-. This is your gross profit. If the amount entered on line 6 is zero, <b>stop</b> here. You cannot use the installment method.	_____
7.	Enter the contract price for the property.	_____
8.	Divide line 6 by line 7. This is your gross profit percentage.	_____