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PROPOSAL TO COMBAT MONETIZED INSTALLMENT SALES AND SIMILAR ABUSES BY REQUIRING CONTINUITY OF BUSINESS ENTERPRISE IN §15A.453-1

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I. Introduction

Developed by Stan Crow in 2015, the Monetized Installment Sale ("MIS") has increasingly been the target of IRS enforcement efforts, including a proposed listing notice in August 2023[1] and a complaint filed by the DOJ Tax Division on March 27, 2025.[2] I agree that MISs are abusive.[3] However, I think the IRS should be more ambitious—it should make a comprehensive attack on Intermediary Installment Sales (IISs), the five-decade-old family of transactions of which MISs are only the latest example. In this paper, I propose a way to do this, which can be accomplished either by legislation or by regulation, which would eliminate IISs (including but not limited to MISs) once and for all, with only a minimal and acceptable burden on installment sale transactions as a whole.

My proposal is to add a Continuity of Business Enterprise ("COBE") requirement for installment sales. A watered-down COBE requirement already exists for related-party installment sales, in IRC 453(e). My proposal is to make this more rigorous (i.e. akin to the COBE requirement for corporate reorgs) and to extend it to non-related sales. While two years of continuity is currently required for related party sales, in the non-related context six months of continuity would be sufficient to accomplish these goals.

While COBE and installment sales are not normally discussed in the same context, the fit is natural—in fact, it is surprising that installment sales have gotten away without this requirement for this long. In Part II of this paper, I show how COBE and 453 go naturally together, based on a review of the history of corporate reorgs and installment sales. In Part III, I survey IIS transactions going back to the 1970s. In Part IV, I describe what a COBE regulation for installment sales might look like; I show how this would shut down IIS transactions with minimal impact on legitimate sales; and I explain why I believe Treasury has the authority to make this change.

II. Intro to Reorgs and Installment Sales

A. History of Corporate Reorganizations

The Revenue Act of 1918 provided for tax-free stock-for-stock exchanges in a “reorganization, merger, or consolidation.” The Revenue Act of 1921 limited this treatment to “reorganizations,” but defined the term to include “a merger or consolidation (including the

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[1] https://www.irs.gov/newsroom/treasury-and-irs-issue-proposed-regulations-identifying-certain-monetized-installment-sales-as-listed-transactions

[2] https://dockets.justia.com/docket/idaho/iddce/1:2025cv00177/56675

[3] I have spoken and written numerous times on this subject. I am the author or presenter of: Limits on the Installment Method of Accounting for Gain, CEB blog, 10/15/20; The Installment Method: Misuses that Make Me Lose Sleep, Bloomberg Real Estate Journal, 5/18/22; Installment Sales, Presentation to Portland Tax Forum, 4/20/ 23; Comment posted on regulations.gov, 10/3/2023, ID IRS-2023-0037-0003; IRS Issued Proposed Regulations for Monetized Installment Sales, presentation to ABA Tax Section, 1/20/24; Tax Risks in Promoted Installment Sale Transactions, presentation to Beverly Hills Bar Association, 6/4/24; The IRS (or Congress) Should Clarify When Structured Installment Sales Will Be Respected, Tax Notes Federal, 1/6/25.

acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or of substantially all the properties of another corporation).” Steven Bank writes:

> Although this definition resolved the principal ambiguities in the 1918 Act, [it] contained a potentially more serious ambiguity of its own. The parenthetical clause, which broadened the definition of reorganization to include the acquisition by one corporation of a majority of the stock or of substantially all the properties of another corporation, failed to specify the consideration required for the transaction to constitute a reorganization. Thus, a sale of substantially all of a corporation's assets for cash appeared to qualify for nonrecognition treatment as a reorganization under the 1921 Act, despite the fact that this seemed contrary to the intentions of Congress in enacting the reorganization provision. ... It was not until 1934 that the ambiguity concerning the 1921 Act's parenthetical clause was finally resolved, although several judicial doctrines had been employed in the interim to plug the gap in the statute.[4]

These “judicial doctrines” appeared in, for example, Pinellas Ice & Cold Storage Co. v. Comm'r, 287 U.S. 462,470 (1933) (holding that "to be within the exemption the seller must acquire an interest in the affairs of the purchasing company more definite than that incident to ownership of its short-term purchase-money notes") and Cortland Specialty Co. v. Comm'r, 60 F.2d 937, 940 (2d Cir. 1932) (stating that the Revenue Act retains the "primary requisite" that in a reorganization, there must be "some continuity of interest on the part of the transferor corporation or its stockholders in order to secure exemption").

Today, Treas. Reg. § 1.368-1(d) describes the “continuity of business enterprise” or COBE requirement. This requires either “asset continuity” (P must “use a significant portion of T's historic business assets in a business") or “business continuity” (P must “continue the target corporation's (T's) historic business,” i.e. the business T conducted most recently). For this purpose, subsidiary corporations or partnerships are generally looked through.

B. History of Installment Method

The early history of the installment method is aptly described in a 1978 article by Patricia Cane.[5] When the federal income tax was introduced, there was a practice called selling on the "installment plan.” This meant the seller was willing to accept a small down payment (usually 25% of the sales price or less) and receive the balance in monthly payments over a period of several years. The plan first developed among mercantile houses dealing in "furniture, pianos, phonographs, household appliances and farm machinery." Its purpose was to expand the market for such articles by making them available to the low-salaried employee who could not otherwise purchase them." Also at this time most taxpayers kept their books on the accrual method. Thus, when the income tax was introduced, they became accrual taxpayers. For accrual-method

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[4] Steven A. Bank, Mergers, Taxes, and Historical Realism, 75 TUL. L. REV. 1 (2000).

[5] Patricia A. Cain, Installment Sales by Retailers: A Case for Repeal of Section 453(a) of the Internal Revenue Code, 1978 Wis. L. Rev. 1 (1978).

merchants making long-term sales under the installment plan, this created a hardship. The accrual method led to early payment of taxes which could lead to a drain on cash reserves, and could curtail capital expansion, or threaten the business. Making this problem worse, even though merchants quite often received negotiable promissory notes from their customers representing the installment sale debt, it was rare that these notes could be discounted or factored at local banks. Based on this history, the installment method amounted to, effectively, a subsidy to merchants who were financing their buyers' consumers debts without the involvement of outside lenders.

However, beginning in 1980, Congress abandoned this rationale for the installment method. First, since 1980, when Congress passed the Installment Sales Revision Act of 1980, the installment method is not available to most sales by dealers. This probably reflects the huge improvements in the consumer credit market, for example with the explosion in the use of credit cards. Second, and also as part of the 1980 Act, Congress added 453(j)(2), which instructed Treasury to prescribe regulations "providing for ratable basis recovery in transactions where the gross profit or the total contract price (or both) cannot be readily ascertained." With this gesture, Congress declared for the first time that it was open to installment obligations which are not in the form of straight debt (with a principal and an interest).

As a result, in 1981, Treasury issued Temporary Treas Reg. 15a.453-1. These regulations allow the installment method where there is a contingent sale price—that is, a price that is uncertain as to timing, or amount, or in some cases both. The contingent sales price rules depend on whether a maximum sales price is determinable, and on whether a last day for payment is determinable.

- The case of a maximum stated sales price is just like an installment sale.
- Where there is no maximum sales price but a known last day for payment, basis is recovered ratably between the sale date and the final year.
- And where there is no maximum sales price and no known last day for payment, then according to the temporary reg, a question arises whether a sale has really occurred, or whether in reality the so-called seller really is the owner of the asset. The regulation continues: "Arrangements of this sort will be closely scrutinized."

Even so, the temporary regs say that the installment method won't apply to 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".

C. Since 1980, Installment Sales Resemble Reorgs

In the corporate setting, COBE requires "a continuance of interest on the part of the transferor in the properties transferred" under "modified corporate forms." See Cortland Specialty Co. v. Comm'r, 60 F. 2d 937 (2nd Cir. 1932). Thus, COBE denies nonrecognition where Target merges into Acquiror, which then replaces Target's old assets with a different assets in a different line of business.

After the Installment Sales Revision Act of 1980, a conventional installment sale can be structured to resemble a reorg: (i) The installment sale resembles a tax-free drop-down of

Asset by Seller into an entity jointly owned by Buyer and Seller, in exchange for an installment obligation that resembles equity. (ii) Then, because the Asset now has a cost basis, it can be rolled over tax-free into a new asset.

Nevertheless, the installment sale regulations do not incorporate a COBE requirement. As explained in the next section, this lack of a COBE rule for installment sales is exploited by certain promoted transactions, such as the monetized installment sale.

III. History of Promoted Arrangements Involving Installment Method

A. Overview of Intermediary Installment Sales

IIS transactions exploit two features of the installment method:

(i) an asymmetry between buyer (who gets a cost basis) and seller (who does not immediately recognize gain), and
(ii) ambiguity as to whether installment obligations can have equity-like features.

The novelty of installment sales is their asymmetry: Buyer gets an immediate cost basis, while Seller is not taxed until receipt of principal. As a result, a conventional installment sale can resemble a tax-free drop-down of an asset into an entity, followed by a tax-free rollover of that asset into a new asset. That is: using his immediate cost basis, Buyer can sell OldCo for tax-free for cash and use the cash to buy NewCo, while Seller gets indirect rights to the economic value of NewCo because he rolled OldCo into an “installment obligation” with Buyer.

Where this analogy breaks down is that installment obligations are typically thought of as debt instruments, not equity. But nothing in the Code says that must be so. The term “installment obligation” is never defined in the Code. And since 1980, Code § 453(j)(2) has authorized regulations (now appearing at Temp. Reg. § 15A.453-1) which allow for contingent installment sales in some cases, thus allowing for a degree of equity treatment.

The boundary between debt and equity is famously blurry. Promoters of IISs stretch it to its breaking point, in order to create a transaction which effectively allows Seller to do a tax-deferred exchange of any property for any other property—as long as it is not an asset expressly excluded from the installment method, and subject to the eventual recovery of principal under the note (often, 30 years). In effect, these promoters view the installment method of accounting as permitting a sort of universal nonrecognition transaction—§ 453 as nonrecognition skeleton key.

There are a wide variety of promoted tax arrangements which, in some way or another, incorporate the installment method of accounting. These go by various names, some of which are used generically (e.g., monetized installment sale, intermediary installment sale, structured installment sale or structured sale) and some of which are trade names (e.g., Deferred Sales Trust). In my experience, tax professionals use these labels inconsistently. My own preference is to use the term "intermediary installment sale" (IIS) as a generic umbrella term for all these transactions.

IISs have been around since at least the 1970s. According to one contemporary, the transaction was motivated by increases in the capital gains tax under the 1969 Tax Reform Act.[6] The nature of the transaction has evolved.

B. Intra-Family Sales

Prior to the Installment Sales Revision Act of 1980, the typical transaction involved a parent selling an asset to his child on the installment method, followed by the child selling the asset for cash.[7] The transaction looks like this:

- Step 1: Father sells building to daughter for $X on the installment method.
- Step 2: Daughter sells to third party for $X in cash.
- Step 3: Daughter uses cash to buy widget.

Or instead of daughter, one could use a nongrantor trust for the benefit of daughter. (It has to be nongrantor, to create a taxable sale.)

If all goes well, the family unit has effectively done a tax-free exchange of building for widget, subject to the taxes arising under the installment obligation between father and daughter. Of course, this is subject to doctrinal issues, such as assignment of income. The IRS is going to want to see facts and circumstances showing that daughter's ownership of the asset was a reality. Among other things, the longer she holds it the stronger that argument becomes.

In addition, in 1980, Congress targeted this transaction, by passing 453(e). As a practical matter this didn't change the rule much. Basically, it codified the already-existing requirement that daughter's ownership needed to be real. 453(e) did this by stating that an ownership period of two years or less would never be sufficient, and by stating that for the two-year test, the IRS would not count intervals during which daughter's risk of loss is diminished by contract, for example by holding a put right.

C. Non-Family Sales

To avoid the strictures of the 2-year rule in 453(e), promoters of intermediary installment sales looked to substitute daughter with a non-related party (a for-profit company). That company may purport to buy the asset from the taxpayer, as the child previously did (e.g., Deferred Sales Trust); it may also arrange for a favorable loan to the taxpayer (e.g., Monetized Installment Sale); or it may induce the buyer to pay consideration in the form of a private annuity whose value is calculated with respect to some other asset. (In this last case, the company does not act as an intermediary; instead, it acts as guarantor for the annuity.)

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[6] Munot W. Tripp Jr., Installment Sales to Related Parties, 52 Taxes 261 (1974).

[7] These are described in the report of the Senate Committee on Finance Report on the Installment Sales Revision Act of 1980, available at https://www.finance.senate.gov/imo/media/doc/Rpt96-1000.pdf

D. Government Response

The federal government's responses to these arrangements have been similarly eclectic. In the 1970s, it brought cases against the transactions.[8] These were generally unsuccessful, until Congress passed the Installment Sales Revision Act of 1980. More recently, responding to the "monetized installment sale" promoted by the S. Crow Collateral Corporation ("SCCC") and others, the IRS issued ECC 202118016 (published 10/31/2020), as well as REG-109348-22, entitled "Identification of Monetized Installment Sale Transactions as Listed Transactions." I am also aware of several recent cases involving monetized installment sales.[9]

Over fifty years, the IRS has not had meaningful success against these transactions. While it is possible the IRS may eventually shut down "monetized installment sales," I'm aware of no public effort to confront the Deferred Sales Trust or other variations.

The IRS has good arguments on its side. Generally, these are about substance-over-form. One argument which the IRS has made is that the intermediary acts, in substance, as the taxpayer's agent; thus, the cash sale to the third-party buyer is really a cash sale by the taxpayer himself. Another argument, which I have not seen the IRS make, is that the taxpayer (in substance) retains ownership over the asset sold.

Both these arguments could win in individual cases. However, going case-by-case is inefficient. Promoters continue to come up with creative ways to say that these arguments don't apply to them. It would be more efficient if Treasury passes a regulation (or Congress passes a law) that draws a bright line, in a manner which makes these abusive transactions infeasible, and in a way that does not meaningfully impact non-abusive transactions.

IV. <u>My Proposal</u>

A. Adding COBE to the Installment Method

In the related-party context, 453(e) provides that the seller will be denied the installment method if the buyer re-sells the asset within 2 years. I am proposing that Treasury introduce an identical rule for all installment sales, for a shorter period (six months). The rule should contain a look-through provision just like the COBE rule for corporate reorganizations.[10]

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[8] Id.

[9] US v. Steve Vaught et al.; No. 1:18-cv-00452; Stanley D. Crow v. IRS; No. 1:20-cv-00518; David Michael Bishop et al. v. US et al.; No. 2:22-cv-00340; Nat S. Harty et al. v. Commissioner; No. 23354-21; Stanley D. Crow et al. v. United States; No. 1:23-cv-00046; United States v. Stanley D. Crow and S. Crow Collateral Corp., No.: 1:25-cv-00177.

[10] Congress or Treasury might also wish to clarify that the 2-year rule in 453(e) also has a look-through component. This would shut down the practice, which purportedly does not trigger 453(e), by which (i) Parent sells a partnership interest to Children's trust with a 754 election, after which (ii) Partnership sells its assets to a third party.

A six-month interval should disrupt the IIS industry, for the same reason that a two-year interval disrupted the related-party installment sale: It forces the intermediary to bear some risk of loss. Unrelated parties are even more sensitive to this issue, which is why a shorter interval of time should work. In the related-party setting, if daughter buys the asset for $10M and sells it for $9M, the family unit will not be impacted so much by the loss itself (after all, it is a family; the father can give the extra $1M back to daughter one way or another). The real impact is that father will owe $1M of extra tax in the form of installment gains. (He cannot access daughter's $1M loss to shelter these gains.) This is painful, but it is made less painful by the fact that he might not owe the tax for 30 years.

By contrast, in the unrelated-party setting, promoters are acutely sensitive to the risk of loss. Their business model only works because they have zero risk: The promoter will not agree to pay $10M for an asset unless he is absolutely sure, beforehand, that there is a buyer waiting in the wings who has effectively committed to pay $10M already.[11]

The tax reporting for this proposal would be similar to the reporting that is currently done for related-party sales. Currently, Form 6252 ("Installment Sale Income") has Part III, entitled "Related Party Installment Sale Income." Line 28 asks, "Did the related party resell or dispose of the property ("second disposition") during this tax year?" A similar question could be asked in a (new) Part IV.

In the unrelated-party setting, a difficulty with this question is that the taxpayer may not have a continuing relationship with the buyer. For this reason, the shorter (six-month) interval is more realistic. Also, the following text might be inserted, either in the margin next to the question or in the instructions: "If unknown, don't answer. The statute of limitations remains open until two years after you answer by amending this return."

An advantage of a six-month reporting period (versus a 2-year period) is that the taxpayer is more likely to have this information. Also, reporting will not span more than one year. For example, if the asset is sold on December 31, then the six-month period will end on or around June 30. To report this transaction, the taxpayer would take an extension in March or April, so that they would be able to answer these questions by the extended return deadline in September or October.

B. Feasibility of Proposal

Although the authority for such a revision is not explicitly stated in the statute, I believe Treasury does have authority to do this, under 453(j)(2). When Congress added this provision authorizing contingent payments, its desire was to authorize earnouts, i.e. it only wanted to authorize

[11] For this reason, the IRS rightly argues that the intermediary is really just an agent of the seller, so that the installment method does not apply.

contingencies related to the performance of the asset sold.[12] It was not thinking that payment would be measured by the performance of some other asset, such as the performance of a basket of unrelated stocks—if that could be allowed, the installment method would become a skeleton key to nonrecognition castle.

The line between earnouts and non-earnouts can be blurred. IISs have already figured out how to abuse this: Seller sells Asset to Intermediary on the installment method; Intermediary sells Asset to Buyer for cash (tax-free); Intermediary uses the cash to buy a replacement asset of Seller's choosing. In my view, the way to defeat this abuse is to introduce a "continuity of business enterprise" (COBE) requirement, like the requirement that applies in corporate reorgs.[13] To translate that into the context of earnouts, the requirement would be that the buyer must either continue Seller's historic business or use a significant portion of Seller's historic business assets in a business.

The COBE requirement seems narrowly tailored to implement Congress's intent that contingent sales be limited to earnouts. And the COBE requirement is virtually indistinguishable from the above-mentioned rule in 453(e). The rule in 453(e) is a COBE requirement, expressed in different words. For this reason, I believe Treasury does have the authority to implement this rule, without additional Congressional authorization.

To support this conclusion, Treasury should make the time period between purchase and sale no longer than needed. A six-month delay supports this.

Taxpayers would not be significantly inconvenienced. It would be rare for an asset to be re-sold within six months in a legitimate transaction. After this rule is implemented, Sellers might seek to negotiate for a promise from Buyer not to re-sell the asset within six months, as a matter of normal deal diligence. Or, less ambitiously, Sellers might obtain a promise from Buyer to inform them if they do resell the asset in the six-month time period. (Of course, where the asset is real property—as is typical of most installment sales—determining whether the asset has been resold would be a matter of public record.)

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[12] This can be seen in the Senate Committee on Finance Report, which indicates that the provision was in response to cases such as *Gralapp v. United States* (dealing with a contingent payment measured as a percent of "estimated future net revenues"), and which states that "in appropriate cases, it is intended that basis recovery would be permitted under an income forecast type method."

[13] See 26 CFR 1.368-1(d)