TAXLOGIC

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We provide a prompt, professional, personal one-on-one tax preparation service from the comfort of your home or office. We are competitively priced; in addition we offer a number of additional services as well as comprehensive information from our web site – http://www.taxlogic.com.

Last week, we discussed the sale of a residence and the sale of rental property, and many of you do sell property on the installment method; so we thought this would be a good time to highlight some of those issues.

Installment Sales

If a sale qualifies as an installment sale, the gain must be reported under the installment method unless:

1. You elect out of using the installment method, or

2. You use an accrual method accounting.

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.

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 assets, you can deduct it only in the tax year of the sale. You cannot deduct a loss on the sale of property owned for personal use.

Unstated interest. If your sale calls for payments in a later year and the sale contract provides for little or no interest, you may have to figure unstated interest, even if you have a loss. Part of the stated principal amount of the contract may be recharacterized as interest. In general, an installment sale contract provides for adequate stated interest if the stated interest rate (based on appropriate compounding period) is a least equal to the test rate of interest, which is determined by the applicable federal rates. The applicable federal rates are published monthly in the Internal Revenue Bulletin. The minimum rate at this time is 4.73% For sales or exchanges of property (other than new section 38 property, which includes most tangible personal property) involving seller financing of $3,960,100 or less, the test rate of interest cannot be more than 9%, compounded semiannually.

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

1. Interest income - You must report interest as ordinary income. Interest is generally not included in a down payment.

2. Return on your adjusted basis in the property. The rest of each payment is treated as if it were made up of two parts. One part is tax-free return of your adjusted basis in the property.

3. Gain on the sale. The other part is your gain.

Figuring Gain Part of Payment. To figure what part of any payment is gain, multiply the payment (less interest) by the gross profit percentage.

1) Selling Price	________
2) Installment sale basis:	
Adjusted basis of property	________
Selling expenses	________
Depreciation recapture	________
3) Gross Profit (line 1-line 2)	________
4) Contract Price	________
5) Gross profit % (Line 3 divide by Line 4)	________

Selling price. The selling price is the total cost of the property to the buyer. It includes any money and the fair market value of any property you are to receive. It also includes any debt the buyer pays, assumes, or takes, to which the property is subject. The debt could be a note, mortgage, or any other liability, such as a lien, accrued interest, or taxes you owe on the property. If the buyer pays any of your selling expenses, that amount is also included in the selling price.

Adjusted basis. Basis is a way of measuring your investment in the property. The basis of property you bought is generally its cost.

Selling expenses. Selling expenses are any expenses that relate to the sale of the property. They include commissions, attorney fees, and any other expenses paid on the sale. Selling expenses are added to the basis of the sold property.

Depreciation recapture. If you took depreciation deductions on the asset, you may need to recapture part of the gain on the sake as ordinary income.

Gross profit. Gross profit is the total gain you report on the installment method.

Contract price. The contract price is the total of all principal payments you are to receive on the sale. If part of the selling price is paid in cash and you hold a mortgage payable from the buyer to you for the remainder, then the contract price equals the selling price

Gross profit percentage. A certain percentage of each payment (after subtracting interest) is reported as gain from the sale. It is called the “gross profit percentage” and is figured by dividing your gross profit from the sale by the contract price. The gross profit percentage generally remains the same for each payment you receive.

Example. You sell property at a contract price of $2,000 and your gross profit is $500. After subtracting interest, you report 25% of each payment, including the down payment, as gain from the sale for the tax year you receive the payment.

Each year as you receive payments on the installment sale, multiply the payments (less interest) by the gross profit percentage to determine the amount you must include in income for the tax year.

Form 6252. Use Form 6252 to report an installment sale in the year it takes place and to report payments received in later years. Attach it to your tax return for each year.

Form 6252 is divided into the following parts:

1. Part I, Gross Profit and Contract Price is completed for the year of the sale.

2. Part II, Installment Sale Income, is completed for the year of sale and for any year you receive payment.

3. Part III, Related Party Installment Sale Income, is completed if you sold the property to a related person.

The installment sales can also be a complicated tax mater; so for more information please, visit our website at http://www.taxlogic.com.