

810-3-44-.01. Installment Basis Sales - Sales of Real Estate and Casual Sales of Personal Property.

(1) (a) For transactions prior to January 1, 1985 - With three important exceptions, Sec. 40-18-44 (as in effect before January 1, 1985) is with regard to the sale of real estate and the casual sale of personal property for a price exceeding \$1,000, essentially the same as provisions of the United States Internal Revenue Code as in effect prior to January 1, 1985. The Department will therefore consider the rules and decisions of the Internal Revenue Service and the Federal courts with respect to this section. The basic differences in the two laws are:

(1) In Sec. 40-18-44(b)(ii), (as in effect prior to January 1, 1985) in order to qualify for the use of the installment method, the Alabama law requires that the principal payments received in the year of sale not exceed forty percent of the selling price.

(2) Alabama law requires that the election to use the installment basis must be made in the return for the year of the sale.

(3) The provision of the Federal Tax Reform Act of 1984 (P. L. 98-369) requiring that depreciation previously expensed be recognized in the year of sale whether or not any payments were received, does not apply.

(b) Installment Sales - Dealers in Personal Property - Prior to January 1, 1985.

1. A taxpayer who regularly sells personal property on the installment plan, may report the income from such sales on the installment basis. The seller may treat as income that proportion of the total payments received in the taxable year from installment sales that the gross profit realized or to be realized on the total installment sales made during each year bears to the total contract price of all such sales made during that respective year.

(i) "Gross profit" means sales less cost of goods sold.

(ii) "Total contract price" includes carrying charges and interest ascertainable at the time of sale, but excludes sales tax.

(l) If state, county and city sales taxes are imposed on the consumer, and collected by the seller and remitted to the taxing agency, such sales taxes must not be included in the total contract price for purposes of computing taxable income from installment sales. Payments received are treated as applying first against the sales taxes.

(II) If carrying charges or interest are not determinable at the time of sale and not included in the total contract price, payments received will be treated as applying to such charges before the gross profit percentage is applied against the balance of the total contract price.

2. The installment method described in section 1. above applies only to dealers and to sales of inventoriable personal property.

(2) Installment Method - Transactions occurring after December 31, 1984 and before January 1, 1987.

(a) Notwithstanding the provisions of Reg. 810-3-13-.03 (Method of Accounting), and subject to the requirements and restrictions of this rule, a taxpayer may elect to report income from installment sales under the installment method.

(b) The election to report income from installment sales on the installment method must be made on or before the due date (with extensions) of the income tax return for the taxable year in which the installment sales occur. The election to report income from installment sales on the installment method may not be made, changed or revoked after the due date (with extensions) for the taxable year in which the installment sales occur.

1. The election to report on the installment method is made by including a statement with the income tax return for the taxable year in sufficient form to indicate the taxpayer is electing to report installment sales on the installment method, and containing details of the amounts of such installment sales, the amounts collected and included in income for the taxable year, and the amounts to be deferred to future taxable years.

2. For purposes of this paragraph (2), the following terms have the meanings ascribed to them:

(i) The term "installment sale" means a disposition of property (other than property of a kind which is required to be included in the inventory of the taxpayer if on hand at the close of the taxable year) where at least one (1) payment is to be received after the close of the taxable year in which the disposition occurs.

(I) The requirements of non-inventoriable property and at least one payment in a subsequent taxable year in section 1. above do not apply if the seller is a person who regularly sells or otherwise disposes of personal property on the installment plan.

(ii) The term "installment method" means a method under which the income recognized for any taxable year from a disposition is that proportion of the

payments received in that year which the gross profit (realized or to be realized when payment is completed) bears to the total contract price.

(I) As used in subsection (ii) above, the total contract price of all sales of personal property on the installment plan includes the amount of carrying charges or interest and sales taxes which are determined with respect to such sales and which are added on the books of account of the seller to the established cash selling price of such property. This subsection (I) does not apply with respect to sales of personal property under a revolving credit plan.

(II) If the carrying charges or interest and sales taxes with respect to sales of personal property, the income from which is reported on the installment method, are not included in the total contract price, payments received with respect to such sales shall be treated as first applying against such carrying charges or interest and sales taxes.

(3) For transactions after December 31, 1986 -

(a) Unless otherwise provided an installment sale must be reported under the installment method. An installment sale means a disposition of property where at least one payment is received after the close of the taxable year in which the disposition occurs.

1. Exceptions to (a) include dealer dispositions. A dealer in real and/or personal property may not use the installment method to report the gain from "dealer dispositions." This includes:

(i) any disposition of personal property by a person who regularly sells such property on the installment plan and

(ii) any disposition of real property that is held by a taxpayer for sale to customers in the ordinary course of the taxpayer's trade or business.

2. A taxpayer may elect to not have an installment sale be reported as an installment disposition. An election not to report an installment sale on the installment method shall be made on or before the due date prescribed by law (including extensions) for filing the taxpayer's return. Such an election shall be the same for Alabama purposes as for Federal purposes. Once the election has been made, it may only be revoked if the IRS allows the election to be revoked for Federal purposes.

(b) Second dispositions by related persons - When a person makes an installment sale of property to a related person (first disposition) who in turn, sells the property before the installment payments are made in full (second disposition), the amount realized by the related party from the second disposition is treated as received by the initial seller at the time of the second disposition. Except in the

case of marketable securities the related party rule will not apply if the second disposition took place more than two years after the first disposition. Further exceptions are:

1. Reacquisitions of stock by the issuing company.
2. A compulsory or involuntary conversion and any transfer thereafter shall be treated as a second disposition if the first disposition occurred before the threat or imminence of the conversion.
3. Second dispositions occurring after the death of the installment seller or the related purchaser.

(c) Depreciable Property Sales. The installment method does not apply to installment sales of depreciable property between related persons. Therefore, all payments are deemed received in the year of disposition unless the disposition did not have as one of its principal purposes the avoidance of tax. For this purpose the term "related person" is as defined in I.R.C. §1239(b) and includes partnerships that are more than 50% owned, either directly or indirectly, by the same person.

(d) Use of Installment Method by Shareholders in Certain Liquidations. If in a liquidation to which I.R.C. §331 applies the shareholder received (in exchange for the shareholder's stock) an installment obligation then the shareholder may report the gain when received. Gain on the transfer of an installment obligation to a shareholder during a liquidation is not immediately taxed to the shareholder. [See I.R.C. §453(h)(1) for restrictions for use of this rule.]

(e) Exceptions to Dealer Dispositions in (a) that may be reported using the installment method include:

1. The disposition of any property used or produced in the trade or business of farming.
2. The disposition of any residential lot, provided the dealer or any related person is not obligated to make any improvements to the lot.
3. The disposition of time-share rights to use or own residential real property for not more than six weeks per year or a right to use specific campgrounds for recreational purposes.

(i) In order to use the installment method for the disposition of residential lots and timeshares, the taxpayer must pay interest (at the applicable state rate) on the amount of tax that is attributable to the installment payments received during the year (See I.R.C. §453(1)(3)(B)).

(f) As this section adopts by reference I.R.C. §453 as in effect from time to time, decisions and interpretations of federal courts and agencies will be given due weight in interpreting this section.

Author: Royce Lader

Authority: §40-18-44, Code of Alabama 1975

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