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From: [redacted]
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To: [redacted]
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Subject: Installment Sale Analysis

This is in response to your request for our analysis regarding "Monetized Installment Sale" transactions. Note that because there are multiple promoters/sub-promoters, there could be variations in the way transactions are structured. Some of the points below might not apply to every transaction. However, there do seem to be common features that make the transactions problematic. And we generally agree that the theory on which promoters base the arrangements is flawed. The general structure raises a number of issues including, but not limited to, the following:

1. No genuine indebtedness. At least one promoter contends that the seller receives the proceeds of an unsecured nonrecourse loan from a lender, but a genuine nonrecourse loan must be secured by collateral. A "borrower" who is not personally liable and has not pledged collateral would have no reason to repay a purported "loan." See Estate of Franklin v. CIR, 544 F.2d 1045 (9th Cir. 1976). Therefore, the loan proceeds would be income.

2. Debt secured by escrow. In one arrangement, the promoter states that the lender can look only to the cash escrow for payment. It appears that, in effect, the cash escrow is security for the loan to taxpayer. If so, taxpayer economically benefits from the cash escrow and should be treated as receiving payment under the "economic benefit" doctrine for purposes of section 453. Compare Reed v. CIR, 723 F.2d 138 (1st Cir. 1983).

3. Debt secured by dealer note. Alternatively, the Monetization Loan to taxpayer is secured by the right to payment from the escrow under the installment note from the dealer. This would result in deemed payment under the pledging rule, under which loan proceeds are treated as payment of the dealer note. Section 453A(d).

4. Section 453(f). The intermediary does not appear to be the true buyer of the asset sold by taxpayer. Under section 453(f), only debt instruments from an "acquirer" can be excluded from the definition of payment and thus not constitute

payment for purposes of section 453. Debt instruments issued by a party that is not the "acquirer" would be considered payment, requiring recognition of gain. See Rev. Rul. 77-414, 1977-2 C.B. 299; Rev. Rul. 73-157, 1973-1 C.B. 213; and Wrenn v. CIR, 67 T.C. 576 (1976) (intermediaries ignored in a back-to-back sale situation).

5. Cash Security. To the extent the installment note from the intermediary to the seller is secured by a cash escrow, taxpayer is treated as receiving payment irrespective of the pledging rule. Treas. Reg. section 15a.453-1(b)(3)("Receipt of an evidence of indebtedness which is secured directly or indirectly by cash or a cash equivalent . . . will be treated as the receipt of payment.")

6. NSAR 20123401F is distinguishable. The case addressed in the memorandum did not involve an intermediary. Further, loans to a disregarded entity wholly owned by seller were secured by the buyer's installment notes, but the pledging rule of section 453A(d) was not applicable. There is an exception to the pledging rule for sales of farm property, which applied in the case.

Thank you, and please let us know if you have any questions.