2025
National Income Tax Workbook

Chapter 5: Installment Sales
PP 159 - 200

Land Grant University Tax Education Foundation

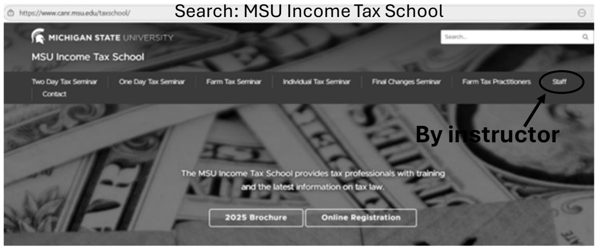
1

Power point slides – 2 ways!

https://www.canr.msu.edu/taxschool/two-day-tax-seminar-powerpoint-slides

Or

Search: MSU Income Tax School



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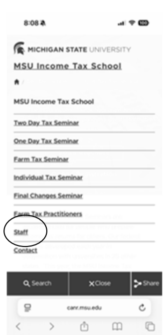

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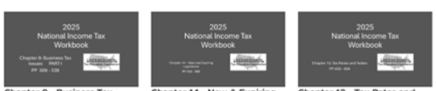
MSU Income Tax School

Power points

Related Work



Chapter 9 - Business Tax Issues (Bill)

Chapter 14 - New & Expiring Legislation (Bill)

Chapter 12 - Tax Rates and Tables (Bill)

5

Tax Workbooks on-line:

In the next couple days, you will get an e-mail from Omnipress. It will provide you with a link to this year's tax book as well as prior years.

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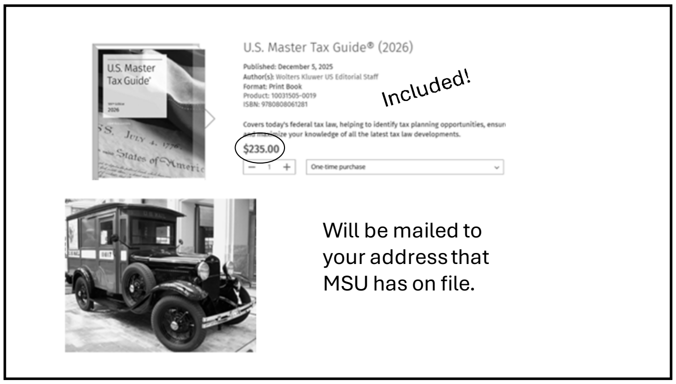
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Included!
Covers today's federal tax law, helping to identify tax planning opportunities, ensur
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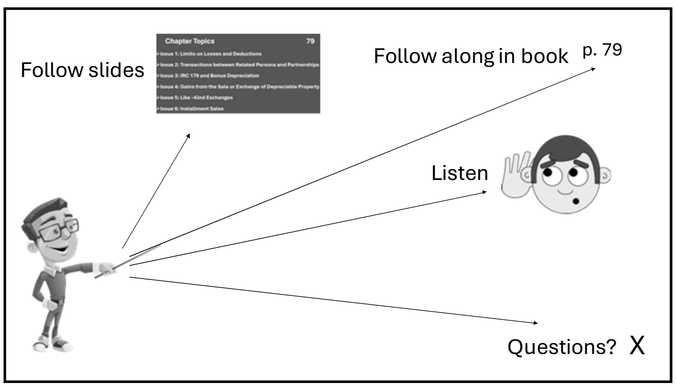
Follow slides
Chapter Topics 79
Issue 1: Limits on Losses and Deductions
Issue 2: Transactions between Related Persons and Partnerships
Issue 3: IRC 179 and Bonus Depreciation
Issue 4: Gains from the Sale or Exchange of Depreciable Property
Issue 5: Like -Kind Exchanges
Issue 6: Installment Sales
Follow along in book p. 79
Listen
Questions? X

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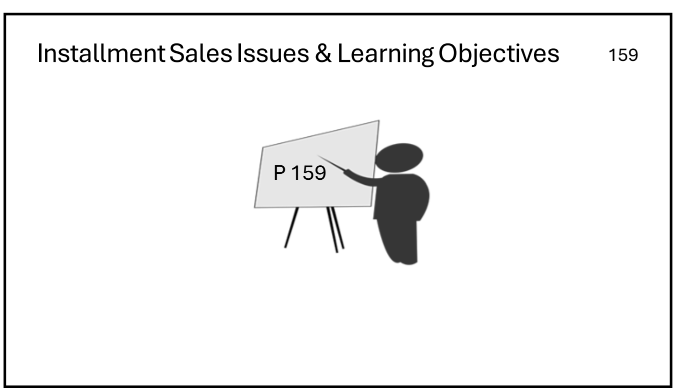

Installment Sales Issues & Learning Objectives 159
P 159

9

Installment sales issues

159

Depreciation Recapture

Sale of a Business

Selling Price Reduced

Electing Out

Certain sales don't qualify

Installment Sales – Basic Rules

Contingent Payments

Related Person sales

Like-Kind Exchanges

Disposition of Installment Obligation

Death of a Noteholder

Repossessions

10

Calculating Installment Sale Income - basics

159

- Defers Income recognition – favorable tax treatment (except depreciation recapture)
- Mandatory, unless elect out
- Certain sales don't qualify:
  - Loss
  - Inventory
  - Personal property - sold on installment plans
  - Real property – held for sale to customers
  - Stock – established security market

11

Calculating Installment Sale Income

161

Get copy!

Sales Agreement

Needed to calculate the Gross profit %

Interest

Selling Price

Contract Price

Applicable Federal Rate P 162-163)

Cash
Seller's debts assumed (Without reduction for a mortgage or selling expenses)

Selling price, less qualifying indebtedness (unless exceeds basis)

12

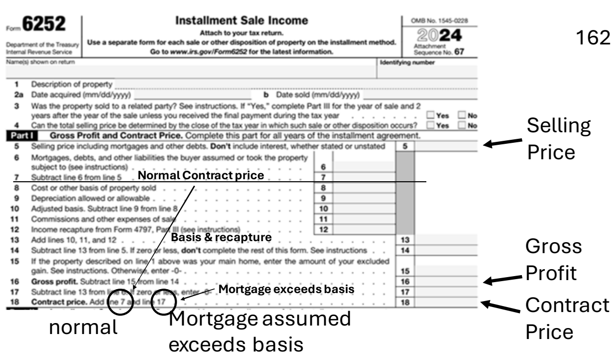
Calculating Gross Profit

162

Form 6252 (see form on page 171)

5. Selling Price		xxx,xxx
6. Qualified indebtedness		(xxx,xxx)
7. Net - Needed for contract price – line 18		
8. Cost	xxx,xxx	
9. Depreciation	(xx,xxx)	
10. Adjusted Basis	xxx,xxx	
11. Commissions	x,xxx	
12. Depreciation recapture	xx,xxx	13. xxx,xxx
14. and 16. Gross Profit		xx,xxx

13


Form 6252 Department of the Treasury Internal Revenue Service
Installment Sale Income
Attach to your tax return.
Use a separate form for each sale or other disposition of property on the installment method.
Go to www.irs.gov/Form6252 for the latest information.
OMB No. 1545-0228 2024 Attachment Sequence No. 67
Name(s) shown on return | Identifying number
1 Description of property
2a Date acquired (mm/dd/yyyy) b Date sold (mm/dd/yyyy)
3 Was the property sold to a related party? See instructions. If "Yes," complete Part III for the year of sale and 2 years after the year of the sale unless you received the final payment during the tax year ☐ Yes ☐ No
4 Can the total selling price be determined by the close of the tax year in which such sale or other disposition occurs? ☐ Yes ☐ No
Part I Gross Profit and Contract Price. Complete this part for all years of the installment agreement.
5 Selling price including mortgages and other debts. Don't include interest, whether stated or unstated 5
6 Mortgages, debts, and other liabilities the buyer assumed or took the property subject to (see instructions) 6
7 Subtract line 6 from line 5 7
8 Cost or other basis of property sold 8
9 Depreciation allowed or allowable 9
10 Adjusted basis. Subtract line 9 from line 8 10
11 Commissions and other expenses of sale 11
12 Income recapture from Form 4797, Part III (see instructions) 12
13 Add lines 10, 11, and 12 13
14 Subtract line 13 from line 5. If zero or less, don't complete the rest of this form. See instructions 14
15 If the property described on line 1 above was your main home, enter the amount of your excluded gain. See instructions. Otherwise, enter -0- 15
16 Gross profit. Subtract line 15 from line 14 16
17 Subtract line 13 from line 6. If zero or less, enter -0- 17
18 Contract price. Add line 7 and line 17 18

162

14

Calculating Gross Profit percentage

163

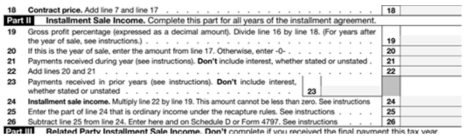
Line 19:

$$\frac{\text{Line 16. Gross Profit}}{\text{Line 18. Contract Price}} = \text{line 19. Gross Profit \%}$$

21 and 22. Payments received during the year	xxx,xxx
Gross profit %	%
24. Installment sale income	xx,xxx

15

Calculating Gross Profit percentage 163


18 **Contract price.** Add line 7 and line 17 . . . 18

Part II **Installment Sale Income.** Complete this part for all years of the installment agreement.

19 Gross profit percentage (expressed as a decimal amount). Divide line 16 by line 18. (For years after the year of sale, see instructions.) . . . 19

20 If this is the year of sale, enter the amount from line 17. Otherwise, enter -0- . . . 20

21 Payments received during year (see instructions). **Don't** include interest, whether stated or unstated . 21

22 Add lines 20 and 21 . . . 22

23 Payments received in prior years (see instructions). **Don't** include interest, whether stated or unstated . . . 23

24 **Installment sale income.** Multiply line 22 by line 19. This amount cannot be less than zero. See instructions 24

25 Enter the part of line 24 that is ordinary income under the recapture rules. See instructions . . . 25

26 Subtract line 25 from line 24. Enter here and on Schedule D or Form 4797. See instructions . . . 26

Part III **Related Party Installment Sale Income. Don't** complete if you received the final payment this tax year

*

Gross Profit %

Payments

Income

* Only sections 1252, 1254 and 1255 recapture

Farm land Oil and gas Property acquired with funds not reported in income

16

Example 5.3 Debt assumed does not exceed basis 164

Paulo

Sold 25,000

Buyer

Basis 20,000
Mortgage 15,000

1. Assumed 15,000
2. 2,000 down payment
3. 2,000/year 4 years

$\frac{\text{Gross profit } 5{,}000}{\text{Contract price } 10{,}000}$ = 50% gross profit %

2025 payments 2,000 x 50% = 1,000 income to report

17

Other side issues of the basic calculation 165

- Buyer pays Seller's expenses. Ends up in 2 places:
  - Payments in year of sale
  - Part of contract price
- Buyer Assumes other debts (not mortgages on property)
  - Treated as if the buyer paid off the debt at the time of sale. Considered a payment to the seller in the year of sale

Like cash

18

Other side issues of the basic calculation 165

- Property received as payment
  - Considered a payment in the year of sale unless like kind exchange provisions apply
- Third-Party notes
  - Considered a payment in the year of sale
- Installment Obligation Used as Security
  - Pledge rule. If the installment obligation is used to secure a debt, net proceeds maybe treated as a payment.

19

Other side issues of the basic calculation 166

- Escrow Account
  - Buyer establishes an escrow account from which installment payments made. NOT eligible to be reported on the installment method. Considered paid in full.

(Unless substantial restrictions on seller right to receive sales proceeds.)

X

20

Other side issues of the basic calculation 166

- Character of gain
  - Short-term or long term is determined at the time of sale, not when payments received
  - Long term, if taxpayer owned property for more than one year.

X

21

Issue #2 – depreciation recapture

167

- Only gain in excess of depreciation recapture may be reported using the installment method.
  PROBLEM – Wouldn't the recapture gain be reported twice?
  1. year of sale on the 4797
  2. as payments received on the 6252
- FIX – the recapture amount is added back to basis for computing gross profit and gross profit %

22

Depreciation recapture

167

Form 4797
Follow 1245/1250 rules
Recapture gain – xx,xxx →

Selling Price	xxx,xxx
Normal Basis	(xxx,xxx)
Recapture gain	(xx,xxx)
Installment sale gain	xx,xxx

23

Example 5.8 Seller financed sale

167- 171

Dale → sold  → Ted

320,000
100,000 down
44,000/yr – 5 yrs

Gain 120,000

Cost 290,000
Depr (90,000)
Basis 200,000

Form 4797 (pg 170)
90,000 ordinary gain

Form 6252 pg 171

Sales price	320,000
"Basis"	(290,000)
Gain	30,000

$\frac{30,000}{320,000}$ x 100,000 = 9,375 gain X

24

172

Issue #3 Sale of a business

Allocate total selling price /payments between classes:

Assets sold at a loss (even if overall gain)	Assets ineligible for installment method Inventory Dealer property Stocks/securities	Depreciation Recapture	Real and personal property eligible for the installment method

$\underbrace{\text{Assets sold at a loss} \quad \text{Assets ineligible for installment method} \quad \text{Depreciation Recapture}}_{4797}$

4797 6252

25

172

Sale of a business

How to allocate the purchase
1. Allocation agreement binding, unless IRS determines amounts are not appropriate

2. Residual Method
allocate assets into 6 classes

IRS
Department of the Treasury
Internal Revenue Service

To be covered in chapter #9

26

Example 5.9 Sale of a business

173 - 175

Sergei → Music Store → Buyer

Cost	218,000
Depr	(67,784)
Basis	150,216

Music Store	
Inven	10,000
Equip	95,000
Truck	6,500
Building	48,000
Land	42,000
Goodwill	18,500
Total	220,000

220,000
Selling – 11,000
100,000 down
120,000 note

Eligible for installment sale reporting

27

Example 5.9 Sale of a business 173 - 175

	Selling	Basis	Gain	Gross Profit %
Building	48,000	38,400	= 9,600	9,600 / 108,500 = 8.85%
Land	42,000	17,100	= 24,900	24,900 / 108,500 = 22.95%
Goodwill	18,500	925	= 17,575	17,575 / 108,500 = 16.20%
	108,500			**48%**

selling price **108,500 (49.3% of total 220,000 sales price)**

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Example 5.9 Sale of a business 173 - 175

Amount received in 2025	100,000
% allocated to assets qualifying for Installment sale treatment	x 49.3%
	49,300
Gross profit % on the assets being Reported on the installment method	x 48%
Installment sale income for 2025	**23,664**

X

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Issue #4 Reporting Installment sale income
Example 5.10 176 - 178

Kevon →  → Buyer

Basis 45,000 selling 30,000

300,000
100,000 down
50,000/yr - 4 years

Pgs 177 & 178

Selling Price	300,000
Basis	(45,000)
Selling	(30,000)
Gross Profit	225,000

Gross profit / Contract price = 225,000 / 300,000 = 75%

Payments 100,000 x 75% = 75,000 X

30

Issue #4 Reporting Installment sale income
Example 5.10

176 - 180

Form 6252 - go to page 177

Schedule D - go to page 178

X

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Issue #5 – selling price reduced

181

- If the selling price is reduced after the year of sale, the gross profit changes and must be recalculated for the remaining payments.
- There is a worksheet in IRS Publication 537 to calculate the new gross profit %.

32

Worksheet B. **New Gross Profit Percentage—Selling Price Reduced**

Keep for Your Records

1.	Enter the reduced 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		
6.	Subtract line 5 from line 1. This is your adjusted gross profit		
7.	Enter any installment sale income reported in prior year(s)		
8.	Subtract line 7 from line 6		
9.	Future installments		
10.	Divide line 8 by line 9. This is your new gross profit percentage*		

* Apply this percentage to all future payments to determine how much of each of those payments is installment sale income.

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Example 5.12 181

2024

Milo →  → Buyer

Basis 40,000

100,000
20,000 down
20,000/yr 4 years

60,000
Gross profit

Gross profit %
60%

Reported: 2024 20,000 x 60% = 12,000 profit
2025 20,000 x 60% = 12,000 profit

34

Example 5.12 - continued 181

2026

Milo →  → Buyer

Basis 40,000

NEW: 85,000 (old 100,000)
NEW: 15,000/yr 3 years

NEW Gross profit	45,000
Reported in prior years	(24,000)
Remaining gross profit	21,000
Future installments	45,000
New Gross Profit %	46.67%

2026, 2027 & 2028:

	15,000
	x 46.67%
Income	7,000

X

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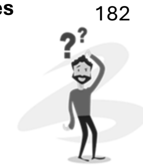
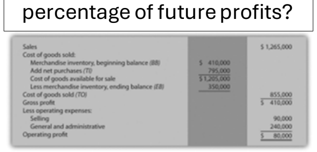
Issue #6 Contingent payment installment sales 182



What if the total sales price cannot be determined by the end of the tax year of sale?

What if the sales price includes a percentage of future profits?



Sales		$ 1,265,000
Cost of goods sold:		
Merchandise inventory, beginning balance (BB)	$ 410,000	
Add net purchases (TI)	795,000	
Cost of goods available for sale	$ 1,205,000	
Less merchandise inventory, ending balance (EB)	350,000	
Cost of goods sold (TO)		855,000
Gross profit		$ 410,000
Less operating expenses:		
Selling		90,000
General and administrative		240,000
Operating profit		$ 80,000

x a % = sales price

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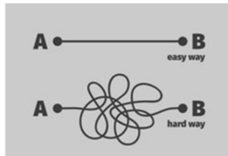
3 different rules to calculate contract price and gross profit % 182

- Stated Maximum Sales price
- Fixed Period
- No Stated Maximum Sales Price or Fixed Period



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Stated Maximum Sales Price 182

The maximum amount of the sales proceeds that a taxpayer may receive can be determined at the end of the tax year of sale. Assumes all contingencies are met. Resolved in a manner to maximize sales price.

Treat the maximum sales price as the sales price. If the sales price is later reduced, the gross profit % is recalculated going forward.

NOTE: this will accelerate the reporting of income.

38

Example 5.13 182

2021 Abigail → Lux Goods Inc Stock → Belinda

Basis 200,000

Profit 1,800,000
Gross profit % 90%

100,000 down
5% of profits for 9 years
Max 2,000,000

	Income		Basis
Payment received	100,000	Beginning basis	200,000
Gross profit %	90%	Used in 2021	(10,000)
Gain reported	90,000	Remaining basis	190,000

39

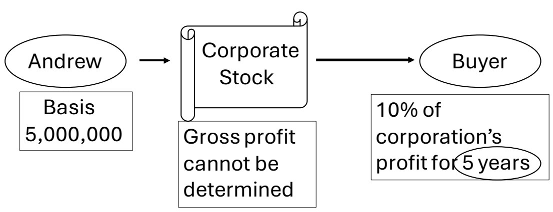
Fixed Period 183

If stated maximum sales price cannot be determined, but the maximum period over which payments may be received is fixed, the taxpayer's basis is allocated to the tax years in which payments may be received.

In no payment received, or less than basis, no loss is allowable. (unless final year) unrecovered basis is carried over.

40

Example 5.14 183



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Example 5.14 continued 183

FIGURE 5.14
Installment Sale—Payments Exceed Basis

Year	Principal Payment	Basis Recovered	Gain on the Sale
1	$1,300,000	$1,000,000	$ 300,000
2	$1,500,000	$1,000,000	$ 500,000
3	$1,400,000	$1,000,000	$ 400,000
4	$1,800,000	$1,000,000	$ 800,000
5	$2,100,000	$1,000,000	$1,100,000

[Temp. Treas. Reg. § 15a.453-1(c)(3)(ii), Example 1]

No loss. Carryover Basis.

42

No Stated Maximum Sales Price or Fixed Period 184

May not even be a sale! Maybe rent or royalties.

If truly a sale, basis recovered over 15 years in equal annual increments.

No loss allowable. Excess basis is allocated over the balance of the 15 years.

X

43

Issue #7 - Electing out of the installment method 185

- Report the entire gain in the year of sale.
- No form to sign or statement to attach. Just report the sale on Form 4797 or 8949.
- If debt instrument involved, use issue price or stated principal amount.
- Must be made by due date for year of sale.
- If taxpayer timely files, without making election, can file an amended return within 6 months.
- Can only be revoked with IRS approval.

X

44

Issue #8 – Installment sale to related person 186

Two different rules for installment sales to related parties:

- Depreciable property
- Nondepreciable property

Special rules apply to a subsequent disposition of the property.

45

Depreciable Property **Not a big problem!** 186

The installment sale method may not be used for the sale of depreciable property between related persons, unless it is established that tax avoidance in not a principal purpose. 1.

2. Related persons does not include an individual's family members.

46

Nondepreciable Property - Sales to a related party 186

Related persons may use the installment method on sales of nondepreciable property.

24 months!

Dispositions by the related party within 2 years require the original seller to recognize all or part of the deferred gain.

47

Related Party Installment Sales 186

Original Sale

All payments

2 years

Earlier of

Related party sells property

Original seller is treated as receiving the amount realized on the 2nd disposition, regardless of whether the related person makes a payment to the original seller.

48

Example 5.17 187- 188

Tasha Mother → Jackie Daughter

2024

Sales price	240,000	Gross profit % = 40%
Basis	(144,000)	
Gain	96,000	

Down payment 60,000 X 40% = 24,000 income for 2024
Promissory note 180,000
(60,000/ year for 3 years)

49

Example 5.17 187 - 188

Tasha Mother → Jackie Daughter

2025

Jackie Daughter → Unrelated party
Sold for 250,000
(not paid to mother)

Installment sale income 2025

24,000	X 40% GPP	60,000 in payments	Form 6252 Part II
48,000	X 40% GPP	120,000 payments deemed received	Form 6252 Part III
72,000		$\boxed{(180,000 – 60,000)}$	
24,000 reported in 2024			
96,000 total gain			

Page 188

X

50

Issue #9 - Like Kind Exchange 190

If the taxpayer receives an installment obligation in addition to like-kind property:

1. Contract price is reduced by the FMV of like like-kind property
2. Gross profit is reduced by any gain on the trade that can be postponed
3. Like-kind property received in the trade is not considered payment on the installment obligation

51

Example 5.19 190

Georgia → 1,000,000 FMV / 400,000 basis

2024

Other party

200,000 FMV 800,000 (100,000 in 2025 , 700,000 in 2026)

Georgia's realized gain is 600,000. Under Like kind exchange rules, she recognizes gain to the extent the gain exceeds the like kind exchange property – 400,000 (600,000 – 200,000).

52

Example 5.19 190

We know Georgia will need to recognize 400,000 gain, and defer 200,000 of the gain under the like kind exchange rules, but in what year?
2024 - Year of sale?
Or, 2025 and 2026 as payments received on the promissory note?

453 is our friend!

53

Example 5.19 - continued 190

Total Gain 600,000

1031 Like-kind exchange — 200,000

400,000 — 453 Installment sale

No gain
Basis reduced to zero

800,000 contract price
Gross Profit % is 50%
2024 – no payments received
2025 – 100,000 x 50% = 50,000
2026 – 700,000 x 50% = <u>350,000</u>
400,000

54

191

Issue #10 - Disposition of an installment obligation being reported on the installment method

- When a taxpayer disposes of an installment obligation, the taxpayer generally has a gain or loss.
- There is an exception to the general rule when the disposition is incident to a divorce.
- Cancellation or accepting partial payment is considered a disposition.
- Death of a noteholder is not a disposition.

55

Gain from a disposition

191

If a taxpayer sells, exchanges or accepts less than face value:
Gain or loss is the difference between basis and amount realized.

If disposed in any other way:
Gain or loss is the difference between basis and its fair market value. Ie: gift or cancels debt.

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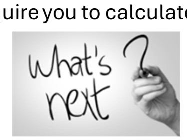
Basis when disposing of an installment obligation

191

Both rules require you to calculate the basis in the obligation.



"The basis in an installment obligation is calculated as the unpaid balance on the obligation multiplied by the gross profit %. That amount is subtracted from the unpaid balance."

57

Basis when disposing of an installment obligation 191

Unpaid balance	xx,xxx	- z,zzz = Basis
x gross profit %	y%	
Result	z,zzz	

58

Example 5.20 – calculating basis 191

2019

Ernie →

→ Olaf

Land contract

Gross profit % = 60%

Got it!

2025

Balance on **contract** = 10,000 — Part is basis 40% bal; Part is untaxed gain 60% 1st

Basis in the **obligation** = 10,000 – (10,000 x 60%) = **4,000**

59

Character of the gain 191

Gain on disposition of an installment obligation

Ordinary

Capital

Go back to original sale. The disposition gain would have the same character.

60

Transfer incident to a divorce

192

Installment agreement

No gain or loss on transfer incident to a divorce

X

61

Issue #11 – Death of a noteholder

193

When an installment noteholder dies and the note is cancelled, the estate may recognize unreported gain.

Second issue is whether the outstanding balance on the note is part of the decedent's estate.

62

IRD Date of death 193

Untaxed income that a decedent earned or had a right to receive during their lifetime	Taxes on IRD are owed by the individual beneficiary or entity that inherits this income
Wages, Commissions, Vacation pay, uncollected rent, retirement income	IRD also counts toward the decedent's estate
Gains from sale of property where sale occurred before death, but proceeds collected after death	Beneficiaries may be able to take a tax deduction for the estate tax paid on the IRD

Installment sales

Not in book

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IRD (Income in Respect of a Decedent) 193

Date of death

Sale occurred.
Gain being reported on installment method.

IRD reported by estate or heir:

Face amount of note	xxx,xxx
Unrecovered basis	(xx,xxx)
IRD	xxx,xxx

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Gross Estate Inclusion 194

Date of death

Sale occurred.
Gain being reported on installment method. Clause that note cancelled if seller dies.

Issue: Is the balance of the note included in gross estate? Depends. Courts have considered whether the loan evidences a bona fide sale for full and adequate consideration or merely a gratuitous transfer.

65

Rev Rul 86-72 193

Taxpayer → Property → Buyer

Cash and installment note, annual installments over 4 years.

All sums extinguished upon seller death

Death

Two installments made and gain reported

Two installments included in income of estate. And, included in gross estate.

66

Practitioner Note – IRC 691 explained

193

Sell property on installment sale with the intent of canceling the obligation to pay on the seller death.

If no 691, seller would not recognize full gain, but the purchaser would get full basis. Pick up IRD and consider a gift.

X

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Issue #12 - Repossession of Installment Sale Property

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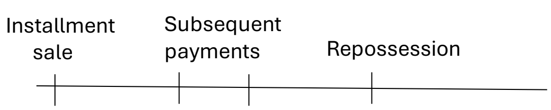

1. Reporting on installment method?
2. Personal or Real Property?

Gain or loss?
Bad debt?
Basis?

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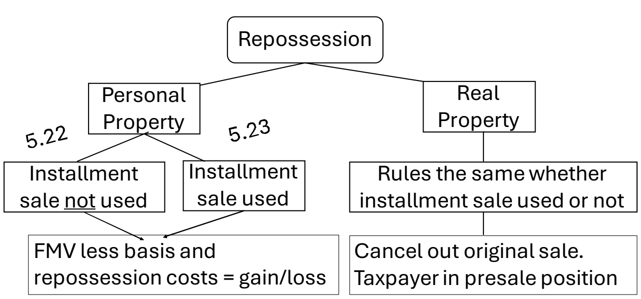

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Comparing Personal and Real Property Repossessions

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Personal	Real
Reflects the FMV at the time of repossession in the computation	Does not factor in the FMV at time of repossession
Compares the FMV with the purchase price, less cash received, plus repossession costs	Cancels out the tax treatment on the original sale and puts the taxpayer in the sale presale tax position

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Personal Property

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Installment sale — Subsequent payments — Repossession

Not reported on installment method

Basis = Value of obligation used in reporting the sale	xxx,xxx
Principal payments received	(xxx,xxx)
Basis	xx,xxx
FMV property taken back	(xx,xxx)
Gain or bad debt	?

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Example 5.22 - Facts

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Tomas →  → Skye

Basis 22,250

2023 – elected out of installment method. reported 66,750 gain

+ 89,000
- 10,000 cash
79,000 note

See pg 197

2024 – received 9,000 in payments

2025 repossessed VW. Costs 3,000. FMV 74,000

1,000 gain

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Example 5.22 - calculations

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Start with FMV at time of repossession		74,000	Personal Property
Need to figure basis:			
Original basis (purchase price)	89,000		
Cash received in 2023	(10,000)		
Note payments received	(9,000)		
Repossession costs	3,000		
Adjusted basis	73,000	73,000	
Gain realized on repossession		1,000	

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Example 5.23 – Used installment method

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Start with FMV at time of repossession			74,000
Original Basis (purchase price)		89,000	
Payments received (10,000 & 9,000)		(19,000)	
Balance due on note		70,000	
	70,000		
Gross profit %	75%		
Unrealized profit	52,500	(52,500)	Accounts for difference
Repossession costs		3,000	
Adjusted basis		20,500	(20,500)
Gain on repossession			53,500

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Examples 5.22 & 5.23 compared

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5.22 - elected out

Gain reported at time of sale:	
Sales price	89,000
Basis	(22,250)
Gain	66,750
Repossession gain	1,000
Total gain	67,750

5.23 – did not elect out

Payments received	19,000
Gross profit %	.75
Gain reported	14,250
Repossession gain	53,500
Total gain	67,750

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Real Property 198

Allows the taxpayer to keep essentially the same adjusted basis in the repossessed property that the taxpayer had before the original sale.

In effect, this cancels out the tax treatment that applied on the original sale and puts the taxpayer in the same presale tax position.

Total payments received from the buyer on the original sale are considered income to the taxpayer. Report as gain any payments not yet included in income. But, total gain reported is limited.

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Real Property 198

These favorable rules for Real Property only apply if the 3 conditions apply as discussed on Pg 198.

Total payments received	xxx,xxx
Gain already reported	(xxx,xxx)
Gain on repossession	xx,xxx

If reported on installment method, character is same as original sale. If not reported on installment method, gain is ordinary.

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Example 5.24 – facts 198 - 199

2023

Gloria →  → Buyer

Basis 19,000

Sales price	25,000
Basis	(19,000)
Selling	(1,000)
Gain	5,000
GP %	20%

5,000 down
20,000 mortgage
(4,000/year)

2023: 5,000 x 20% = 1,000

2024: 4,000 x 20% = 800

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Example 5.24

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2025 default

Gloria ←  ← Buyer

You might think:

Cash received	
5,000 + 4,000 =	9,000
Gain reported	(1,800)
Gain on repossession	7,200

Repossession

Gross profit on sale – 5,000	
Repossession costs	(500)
Gain reported	(1,800)
Gain to report	2,700

But no. Limitation – original profit

What about basis?

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Example 5.25

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Basis in repossessed property – sum of 3 amounts:

1. Adjusted basis in installment obligation
2. Repossession costs
3. Taxable gain on repossession

Installment obligation	20,000
Payment received in 2024	(4,000)
balance	16,000
(16,000 x 20% GP %)	(3,200)
Basis in installment obligation	**12,800**

Repossession costs	**500**
Taxable gain	**2,700**
Total	**16,000**

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Example 5.25

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My method – makes sense:

Original basis	19,000	Start
Selling costs	1,000	+
	20,000	
Cash received	(9,000)	-
Installment sale gain reported	1,800	+
Repossession gain reported	2,700	+
Repossession costs	500	+
Basis	16,000	

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Bad Debt Deduction 200

What about a bad debt deduction? Can't take a bad debt deduction for something never reported as income.
Ie: uncollectable accounts receivable for a cash basis taxpayer.

If a taxpayer took a bad debt deduction in a year before the repossession, taxpayer is considered to have recovered the bad debt, and must pick it up into income in year of repossession.

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