Internal Revenue Service

Number: **201909002**
Release Date: 3/1/2019

Index Number: 453.00-00, 453.08-00

Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:
, ID No.

Telephone Number:

Refer Reply To:
CC:ITA:B05
PLR-113720-18

Date:
October 16, 2018

LEGEND

Taxpayer =
Shareholder 1 =
Shareholder 2 =
Date 1 =
Year 1 =

:

This letter responds to Taxpayer's request, dated March 21, 2018, for a private letter ruling for permission to revoke its election out of the installment method, pursuant to § 453(d)(3) of the Internal Revenue Code and § 15A.453-1(d)(4) of the Temporary Income Tax Regulations, in connection with the sale of Taxpayer.

FACTS

Taxpayer was an S corporation owned by Shareholder 1 and Shareholder 2 (collectively referred to as "shareholders"). All the stock in Taxpayer was sold on Date 1 to an unrelated corporation. The buyer and the shareholders jointly made an election under § 338(h)(10) to treat the sale of the stock as if Taxpayer sold all of its assets and then immediately liquidated.

In return for the sale of Taxpayer, the shareholders received (1) a cash payment on Date 1, (2) an additional cash payment to be paid in 12 months placed in escrow, subject to certain claims and indemnification (escrow amount); and (3) a contingent earn-out of future payments – based on post-sale performance objectives – to be paid in increments over the three years following the end of Year 1.

Soon after Date 1, Taxpayer's accountant prepared a draft final short year Form 1120S for the year ending Date 1 (short year return) for Taxpayer. Shareholder 1, an officer of Taxpayer, signed the draft short year return. Taxpayer's accountant filed the short year return with the Internal Revenue Service before the effective due date of the short year return. Excepting Shareholder 1, no other party to the sale transaction reviewed the short year return.

On the short year return, Taxpayer's accountant reported the gain on the deemed sale of assets using both the cash payment at closing on Date 1 plus the escrow amount. Taxpayer's accountant did not include the contingent earn-out amounts to be paid over three years as part of the sale proceeds. Taxpayer effectively elected out of the installment method under § 453 by including the escrow amount on the short year return.

Shareholder 1 filed his federal income tax return for Year 1 consistent with the treatment on Taxpayer's return, relying on the K-1 from Taxpayer to govern his reporting. Thus, Shareholder 1 reported as income his portion of the sales proceeds – both the cash received upon the sale of Taxpayer and the escrow amount, but none of the contingent earn-out.

Shareholder 2 determined that his K-1 inadvertently included the escrow amount as part of the amount realized from the sale of Taxpayer. Instead of following the K-1, Shareholder 2 filed his federal income tax return for Year 1 reporting only his portion of the cash received upon the sale of Taxpayer, intending to report the escrow amount and any contingent earn-outs when received in years following Year 1.

Taxpayer's accountant provided an affidavit indicating that the accountant made the erroneous computation of gain (cash payment at closing plus the escrow amount). The affidavit states that the decision to elect out of the installment method under § 453 was made solely by the accountant, who generated the K-1s for the shareholders. Taxpayer's accountant's affidavit also indicates that the shareholders were unaware that the return for Year 1 elected out of the installment method.

Shareholder 1 also provided an affidavit indicating that he did not plan or participate in the decision to elect out of the installment method under § 453 and, although he followed the K-1, Taxpayer's accountant's action was the sole reason the installment method was not used. Shareholder 2 also provided an affidavit, wherein he states that he did not plan or participate in the decision to elect out of the installment method under § 453 and, in fact, he alerted Shareholder 1 of the erroneous election out, and ultimately filed his federal income tax return for Year 1 inconsistent with the K-1 he received from Taxpayer.

Taxpayer and the shareholders have represented that the requested revocation of the election out of the installment method does not have as one of its purposes the avoidance of federal income taxes and no taxable year of Taxpayer or the shareholders in which payments were received is closed to assessment or collection pursuant to § 6501(a).

LAW AND ANALYSIS

Section 453(a) provides that, generally, a taxpayer shall report income from an installment sale under the installment method. Section 453(b) defines an installment sale as a disposition of property for which at least one payment is to be received after the close of the taxable year of the disposition.

Section 15A.453-1(b)(3)(i) defines "payment" to include amounts actually or constructively received in the taxable year under an installment obligation.

Section 453(d)(1) and § 15A.453-1(d)(1) provide that a taxpayer may elect out of the installment method in the manner prescribed by the regulations. Section 15A.453-1(d)(3) provides that a taxpayer who reports an amount realized equal to the selling price including the full face amount of an installment obligation on a timely filed tax return for the taxable year in which the installment sale occurs is considered to have elected out of the installment method.

Except as otherwise provided in the regulations, § 453(d)(2) requires a taxpayer who desires to elect out of the installment method to do so on or before the due date (including extensions) of the taxpayer's federal income tax return for the taxable year of the sale. Section 15A.453-1(d)(4) provides that an election under § 453(d)(1) is generally irrevocable. An election may be revoked only with the consent of the Internal Revenue Service. Section 15A.453-1(d)(4) provides that revocation of an election out of the installment method is retroactive and will not be permitted when one of its purposes is the avoidance of federal income taxes.

In the instant case, Taxpayer's accountant's erroneous action when preparing Taxpayer's short year return led the accountant to inadvertently elect out of the installment method under § 453. The shareholders were not aware of the accountant's action, nor did the shareholders plan or participate in the action. Although Shareholder 1 signed the Taxpayer's return as an officer of the Taxpayer, he was unaware of Taxpayer accountant's action. When the shareholders realized the accountant's erroneous computation, Taxpayer filed a request for permission to revoke its election out of the installment method. The information submitted indicates that Taxpayer and the shareholders' desire to revoke the election out of the installment method is due to inadvertence rather than hindsight by the Taxpayer of shareholders, or a purpose of avoiding federal income taxes.

CONCLUSION

Based on careful consideration of all of the information submitted and the representations made, Taxpayer is granted permission to revoke its election out of the installment method for the sale of Taxpayer on Date 1, and provide corrected K-1's to the shareholders. Permission is granted for the period that ends 75 days after the date of this letter. In order to revoke its election out of the installment method, Taxpayer must file an amended federal income tax return for the short year ending on Date 1 and any other previously filed returns on which a portion of the gain from the sale is reportable under the installment method. A copy of this letter ruling must be attached to any amended return.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter, including the computation of gain to be reported under the installment method. Likewise, no opinion is expressed or implied concerning the tax consequences of any aspect of either shareholder's return for Year 1.

This ruling is directed only to Taxpayer who requested this ruling. Section 6110(k)(3) provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

The rulings contained in this letter are based upon information and representations submitted by Taxpayer's accountant, Shareholder 1, and Shareholder 2, and accompanied by a penalty of perjury statement executed by appropriate parties. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Sincerely,

Christina M. Glendening
Senior Counsel, Branch 5
(Income Tax & Accounting)
Office of Chief Counsel

cc: