

Rev. Rul. 82-122
1982-1 C.B. 80, 1982-25 I.R.B. 6.
Internal Revenue Service
Revenue Ruling

DISPOSITION OF AN INSTALLMENT OBLIGATION
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SECTION 453B.—GAIN OR LOSS DISPOSITION OF INSTALLMENT OBLIGATIONS

Disposition of an installment obligation. The increase in the interest rate on an installment obligation coupled with the substitution of a new obligor does not constitute a disposition of the installment obligation. Rev. Rul. 75-457 amplified.

ISSUE

Under the circumstances described below, will the substitution of a new obligor and a change in the rate of interest be considered a satisfaction or disposition of an installment obligation within the meaning of section 453B(a) of the Internal Revenue Code?

FACTS

In 1980 the taxpayer sold real property to A for 550x dollars. Taxpayer received 150x dollars in cash and a note and mortgage in the amount of 400x dollars. The note provides for annual interest at 13 percent and equal monthly payments of principal for a period of 10 years. The note further provides that, unless the taxpayer consents, the note will become fully due and payable if the property is sold or otherwise transferred by A prior to the note being fully paid. The taxpayer has reported gain realized from the sale on the installment method under section 453 of the Code.

In 1981 A sold the property to B, who, with the taxpayer's consent, assumed the mortgage held by the taxpayer. The taxpayer and B agreed to increase the interest rate to 15 percent. The monthly payments were accordingly increased to reflect the higher rate of interest and A was released from further liability on the note. No other changes were made in the terms and conditions of the original note.

LAW AND ANALYSIS

Section 453B(a) of the Code provides that if an installment obligation is satisfied at other than its face value or distributed, transmitted, sold, or otherwise disposed of, gain or loss shall result to the extent of the difference between the basis of the obligation and (1) the amount realized, in the case of satisfaction at other than face value or a sale or exchange, or (2) the fair market value of the obligation at the time it is distributed, transmitted, or disposed of other than by sale or exchange. This provision was previously contained in section 453(d), before Pub. L. 96-471, 1980-2 C.B. 489, added a new section to the Code dealing exclusively with the disposition of installment obligations.

In Rev. Rul. 68-419, 1968-2 C.B. 196, the buyer purchased stock with a note providing for five, equal annual payments. The buyer encountered financial difficulties and asked the seller to modify the note by deferring each payment for 5 years. The seller agreed and in return the buyer agreed to increase the interest rate from 6 to 7 percent. Rev. Rul. 68-419 holds that these modifications of the note are not to be considered a disposition or satisfaction of an installment obligation within the meaning of section 453(d) of the Code. Similarly, see *Rhombar Co. v. Commissioner*, 47 T.C. 75 (1966), acq., 1967-2 C.B. 3, aff'd on other grounds, 386 F.2d 510 (1967), in which the court held that a taxpayer corporation was not in constructive receipt of payments owed under the terms of an installment obligation when the corporation agreed to postpone the due dates of the payments and take a higher rate of interest on the amounts owed. The court observed that the parties dealt at arm's length, the modification of terms benefited both parties, the deferral was requested for a valid business purpose, and there was no tax avoidance motive on the taxpayer's part.

In Rev. Rul. 74-157, 1974-1 C.B. 115, the taxpayer sold a parcel of land for cash and a promissory note secured by a deed of trust on the land. Because the purchaser wanted to divide the property into two parcels, the seller agreed to accept substitution of two promissory notes, each secured by a deed of trust on a parcel of land for the original unpaid note and deed. The revenue ruling holds that the substitution of the deeds and notes is not a satisfaction or disposition of an installment obligation under section 453(d) of the Code.

In Rev. Rul. 75-457, 1975-2 C.B. 196, a taxpayer sold real estate to individual A for cash, a deed of trust, and a promissory note providing for monthly payments over a 15-year term. The terms of the deed and note allowed A to resell the property, provided that the subsequent buyer executed a new note under the same terms and conditions as the original deed of trust. A subsequently sold the property to B, who assumed the obligation by executing a new deed of trust and note in favor of the taxpayer under the same terms and conditions as the original deed of trust and note. A was released from liability on the original note. Rev. Rul. 75-457 holds that the substitution of obligors, deeds of trust, and promissory notes, without any other changes, was not to be considered a satisfaction or disposition of an installment obligation under section 453(d) of the Code. A satisfaction or disposition under section 453(d) occurs when the rights of the seller under the installment sale disappear or are materially changed so that the need to postpone recognition of gain ceases. See *Cunningham v. Commissioner*, 44 T.C. 103 (1965), acq., 1966-2 C.B. 4, in which the taxpayer sold shares of corporate stock to a corporation for cash and an installment obligation payable over 10 years. The buyer subsequently sold the stock to another corporation which assumed liability for the obligation. The court held that the change in the obligor on the note was not a disposition of an installment obligation under section 453(d) because the rights of the seller were not materially changed and the seller held essentially the same note.

Actions of the obligor that result in a change in the installment obligation, such as a transfer to a third party or a change in the form of the note, are not ordinarily treated as a disposition because the effect is merely to continue the seller's right to receive installment payments, without substantially changing the rights arising from the original transaction. Furthermore, an increase in the interest rate that the parties bargained for is not a material change in the obligation.

In the present situation, the terms of the note held by the taxpayer were changed when A, the initial obligor, sold the property to B. The taxpayer will be paid a higher rate of interest in return for releasing A from liability and allowing B to assume the mortgage. Based on Rev. Rul. 68-419, Rev. Rul. 74-157, and Rev. Rul. 75-457, the changes in the obligor, and the interest rate neither eliminate nor materially alter the rights of the taxpayer.

HOLDING

The substitution of a new obligor on the note and an increase in the interest rate, together with an increase in the amount paid monthly to reflect the higher interest rate, will not be considered a satisfaction or disposition of an installment obligation within the meaning of section 453B(a) of the Code.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 75-457 is amplified.

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