

**DESCRIPTION OF REVENUE PROVISION INCLUDED IN
THE GENERALIZED SYSTEM OF PREFERENCES EXTENSION ACT**

Scheduled for Markup

By the

SENATE COMMITTEE ON FINANCE

on June 22, 1999

Prepared by the Staff

of the

JOINT COMMITTEE ON TAXATION



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JCX-37-99

INTRODUCTION

This document,¹ prepared by the staff of the Joint Committee on Taxation, provides a description of a revenue provision included in the "Generalized System of Preferences Extension Act." The Act is an original bill to be considered by the Senate Committee on Finance on June 22, 1999.

¹ This document may be cited as follows: Joint Committee on Taxation, *Description of Revenue Provision Included in the Generalized System of Preferences Extension Act* (JCX-37-99), June 18, 1999.

DESCRIPTION OF REVENUE PROVISION

The following revenue provision would be included in the "Generalized System of Preferences Extension Act."

Modify Installment Method and Prohibit Its Use By Accrual Method Taxpayers

Present Law

An accrual method taxpayer is generally required to recognize income when all the events have occurred that fix the right to the receipt of the income and the amount of the income can be determined with reasonable accuracy. The installment method of accounting provides an exception to this general principle of income recognition by allowing a taxpayer to defer the recognition of income from the disposition of certain property until payment is received. Sales to customers in the ordinary course of business are not eligible for the installment method, except for sales of property that is used or produced in the trade or business of farming and sales of timeshares and residential lots if an election to pay interest under section 453(1)(2)(B)) is made.

A pledge rule provides that if an installment obligation is pledged as security for any indebtedness, the net proceeds² of such indebtedness are treated as a payment on the obligation, triggering the recognition of income. Actual payments received on the installment obligation subsequent to the receipt of the loan proceeds are not taken into account until such subsequent payments exceed the loan proceeds that were treated as payments. The pledge rule does not apply to sales of property used or produced in the trade or business of farming, to sales of timeshares and residential lots where the taxpayer elects to pay interest under section 453(1)(2)(B), or to dispositions where the sales price does not exceed \$150,000.

An additional rule requires the payment of interest on the deferred tax that is attributable to most large installment sales.

Description of Proposal

Prohibit use of installment method for accrual method dispositions

The proposal generally would prohibit the use of the installment method of accounting for dispositions of property that would otherwise be reported for Federal income tax purposes using an accrual method of accounting. The proposal would not change present law regarding the availability of the installment method for dispositions of property used or produced in the trade or business of farming. The proposal also would not change present law regarding the

² The net proceeds equal the gross loan proceeds less the direct expenses of obtaining the loan.

availability of the installment method for dispositions of timeshares or residential lots if the taxpayer elects to pay interest under section 453(l).

The proposal does not change the ability of a cash method taxpayer to use the installment method. For example, a cash method individual owns all of the stock of a closely held accrual method corporation. This individual sells his stock for cash, a ten year note, and a percentage of the gross revenues of the company for the next ten years. The proposal would not change the ability of this individual to use the installment method in reporting the gain on the sale of the stock.

Modify pledge rule

The proposal would also modify the pledge rule to provide that entering into any arrangement that gives the taxpayer the right to satisfy an obligation with an installment note will be treated in the same manner as the direct pledge of the installment note. For example, a taxpayer disposes of property for an installment note. The disposition is properly reported using the installment method. The taxpayer only recognizes gain as it receives the deferred payment. However, were the taxpayer to pledge the installment note as security for a loan, it would be required to treat the proceeds of such loan as a payment on the installment note, and recognize the appropriate amount of gain. Under the proposal, the taxpayer would also be required to treat the proceeds of a loan as payment on the installment note to the extent the taxpayer had the right to "put" or repay the loan by transferring the installment note to the taxpayer's creditor. Other arrangements that have a similar effect would be treated in the same manner.

The proposed modification of the pledge rule would only apply to installment sales where the pledge rule of present law applies. Accordingly, the proposal would not apply to installment method sales made by a dealer in timeshares and residential lots where the taxpayer elects to pay interest under section 453(l)(2)(B), to sales of property used or produced in the trade or business of farming, or to dispositions where the sales price does not exceed \$150,000, since such sales are not subject to the pledge rule under present law.

Effective Date

The proposal would be effective for installment sales entered into on or after the date of enactment.