LEGAL MEMORANDUM

To: Transaction & Tax Counsel

From: The Q Companies

Re: Installment Sale with Disinterested Third-Party Administrator or Trustee — Tax Compliance, Refinancing, and Performance-Linked Notes under IRC §453

I. INTRODUCTION

This memorandum analyzes the legality and tax treatment of an installment sale of real estate or other appreciated property under Pub. 537 and IRC §453, where sale proceeds are administered by a disinterested third-party trustee or administrator (TPA). It also addresses the seller's permissible oversight of collateral securing the installment note, the treatment of variable or performance-linked installment notes, and whether a refinancing or modification of such a note triggers gain recognition. Authorities include IRS Publication 537, IRC §§453 & 453B, Treasury Regulations §§1.451-2, 15a.453-1, Revenue Rulings 73-451, 75-457, 82-122, TAM 200431009, PLRs 201248006–008, and supporting industry guidance such as the CPA Journal (Dec 2021) and MetLife Structured Installment Sale Whitepaper (2023).

II. GOVERNING LAW

Under IRC §453(a), gain from a qualifying disposition is recognized only as payments are received. Treas. Reg. §15a.453-1(b)(3)(i) defines 'payment' as amounts actually or constructively received. Amounts held by an independent fiduciary beyond the seller's control are not

constructively received. Treas. Reg. §1.451-2(a) provides that income is constructively received when it is credited, set apart, or otherwise made available to the taxpayer without substantial restriction. If a trustee or TPA holds funds under contractual limitation, there is no taxable event.

III. ROLE OF THIRD-PARTY TRUSTEE OR ADMINISTRATOR

A third-party trustee may hold and manage proceeds, securities, annuity contracts, or collateral supporting the buyer's obligation. Provided the trustee is independent and unrelated to the seller, acts solely in a fiduciary or administrative capacity, restricts seller access or direction over funds, and makes payments strictly under the installment schedule, the arrangement remains compliant with Pub.537 and §453, and avoids constructive receipt.

IV. SELLER'S LIMITED COLLATERAL CONTROLS

The noteholder may approve or reject the form and sufficiency of collateral prior to execution, or consent to substitution, but cannot directly manage investment decisions, withdraw, pledge, or re-deploy collateral, or terminate fiduciary control.

V. VARIABLE AND PERFORMANCE-LINKED NOTES

Installment obligations tied to collateral performance or profit-sharing are governed by Reg. §15a.453-1(c) (contingent-payment sales). Gain is recognized proportionally as payments are received. Adjusting the note's principal to reflect accrued, unrealized growth in collateral does not constitute payment or realization.

VI. REFINANCING OR MODIFICATION OF INSTALLMENT OBLIGATION

Refinancing a note or altering its terms does not itself trigger tax where the seller receives no cash or property, gains no access to proceeds, and continues to hold an instrument representing the same deferred obligation. This is consistent with Rev. Rul. 75-457, Rev. Rul. 82-122, and PLRs 201248006-008, which each found that extending maturity, changing rate, or substituting obligor does not constitute a disposition under §453B.

Under Reg. §1.1001-3, only a 'significant modification' creating a materially different debt instrument triggers an exchange. Refinancing that maintains economic continuity — same property sold, same obligor (or fiduciary), same payment purpose — is a non-significant modification.

The Key Distinction: Constructive Receipt vs. Technical Disposition

The **core policy of §453** is to tax gain when the seller *actually receives* cash or property, or *constructively receives* it (i.e., when it's available without restriction).

Refinancing a note — even one with a variable or performance-linked feature — **does not create constructive receipt** when:

1. The seller receives **no cash or property** at the time of the refinance.
2. The seller does not gain **control or dominion** over proceeds or collateral; and
3. The refinance simply **substitutes one evidence of the same indebtedness** for another, continuing the same economic obligation.

This principle traces back to **Rev. Rul. 75-457**, **Rev. Rul. 82-122**, and **PLRs 201248006–008**, each of which upheld continued deferral precisely because the taxpayer never had access to the proceeds — despite formal refinancing, substitution of obligor, or note modification.

Rev. Rul. 82-122: "The substitution of a new note reflecting a revised interest rate and maturity, but otherwise representing the same continuing obligation, does not result in a disposition under section 453B… because the seller did not realize any gain or have constructive receipt of payment."

That reasoning extends seamlessly to performance-linked or variable-principal notes — the seller may recognize a larger *face value* on paper, but unless value is realized or received, the deferral principle remains intact.

When the note's balance changes due to variable collateral performance (e.g., indexed annuity, fund growth, or profit participation), the principal increase represents **unrealized appreciation**, not cash receipt.

Refinancing to reflect that accrued value merely **restates** the obligation — it does not "satisfy" it.

IRS guidance under **Reg. §15a.453-1(c)(2)(i)** (contingent-payment sales) and **TAM 200431009** confirm that updating the face amount of a contingent note to reflect the current estimated value *does not* accelerate taxation, because the amount remains uncertain and deferred until payments are made.

Thus, if a $1 million note refinanced to $1.3 million to capture earned participation in collateral performance is economically identical to a

bond whose notional value adjusts with an index, *not* a disposition, merely a re-marking of the deferred obligation.

VII. CITATION APPENDIX

- IRC §453(a): Income from an installment sale shall be taken into account under the installment method.

- Treas. Reg. §15a.453-1(b)(3)(i): Payment means the amount actually or constructively received during the taxable year.

- Treas. Reg. §1.451-2(a): Income is constructively received when credited or otherwise made available.

- IRC §453B(a): If an installment obligation is satisfied or otherwise disposed of, gain or loss shall result.

- Rev. Rul. 73-451: Funds in escrow not available to the taxpayer are not constructively received.

- Rev. Rul. 75-457: Extension of payment period and substitution of debtor is not a disposition under §453B.

- Rev. Rul. 82-122: Replacement note with revised terms, no cash, equals continuation of same obligation.

- PLRs 201248006–008 (2012): Modification of maturity date, substitution of obligor, and alteration of interest rate do not constitute disposition or satisfaction.

- TAM 200431009: Commercially reasonable modification of installment note does not terminate installment method.

- Reg. §1.1001-3(b): Defines 'significant modification' of debt; non-significant = no exchange.

- Reg. §15a.453-1(c)(2)(i): Contingent-payment sales — gain recognized as payments are determinable.

- IRS Publication 537: Installment reporting continues until the obligation is satisfied or sold.