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Please Address Reply to:

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Submitted Electronically
IRS REG-109348-22

RE: Comments and Recommendations Regarding Proposed Regulations Published in IRS REG-109348-22

To U.S. Department of the Treasury and the Internal Revenue Service:

The American College of Trust and Estate Counsel ("ACTEC") is pleased to submit its comments regarding the proposed regulations issued under section 6011 of the Internal Revenue Code of 1986 ("Code") published in the Federal Register on August 4, 2023 ("Proposed Regulations"). The Proposed Regulations identify monetized installment sale transactions and substantially similar transactions as listed transactions.

ACTEC is a nonprofit association of lawyers and law professors. Its more than 2,400 members are called "Fellows" and practice throughout the United States, Canada and other foreign countries with extensive experience in the preparation of wills and trusts, estate planning, and administration of trusts and estates of decedents, minors and incompetents. Fellows of ACTEC are elected to membership by their peers on the basis of professional reputation and ability in the fields of trusts and estates and on the basis of having made substantial contributions to those fields through lecturing, writing, teaching, and bar association activities. Fellows of ACTEC have extensive experience in providing advice to taxpayers on matters of estate, gift, and fiduciary income tax planning. ACTEC offers technical comments about the law and its effective administration but does not take positions on matters of policy or political objectives.

ACTEC's comments and recommendations regarding the Proposed Regulations are set forth in the attached memorandum. If you or your staff would like to discuss the contents of this memorandum with the ACTEC Fellows who created it, please contact Carl L. King, Esq. (704-973-5337, clk@ceclaw.com) and S. Gray Edmondson, Esq. (662-371-4110, gedmondson@esapllc.com), who led the relevant task force of the Fiduciary Income Tax Committee (with substantial participation from members of the Business Planning Committee and input from the Chair of the Estate and Gift Committee) or Deborah McKinnon, ACTEC Executive Director (202-684-8460, domckinnon@actec.org).

Respectfully submitted,

Kurt A. Sommer
ACTEC President 2023-2024

Comments of the American College of Trust and Estate Counsel ("ACTEC") on Proposed Regulations under Code Section 6011 Concerning Monetized Installment Sale Transactions

Treasury Notice 88 Fed. Reg. 149 (issued August 4, 2023) (the "Notice") requested comments on proposed regulations issued under section 6011 of the Code[1] ("Proposed Regulations").[2] Section 6011(a) provides, "When required by regulations prescribed by the Secretary any person made liable for any tax imposed by this title, or with respect to the collection thereof, shall make a return or statement according to the forms and regulations prescribed by the Secretary. Every person required to make a return or statement shall include therein the information required by such forms or regulations."

The Proposed Regulations identify monetized installment sale transactions as listed transactions and would require taxpayers that participate in monetized installment sale transactions and substantially similar transactions to disclose such transactions in accordance with regulations issued under section 6011. Furthermore, the Proposed Regulations would require material advisors with respect to monetized installment sale transactions to disclose such transactions and maintain lists in accordance with sections 6111 and 6112, respectively.

In this comment memorandum, we focus on the overbreadth of the Proposed Regulations in their application to trusts and estates. We commend Treasury and the IRS for their efforts in drafting such a well-organized package of Proposed Regulations, and we appreciate the opportunity to comment on the Proposed Regulations.

BACKGROUND

Section 453 provides an exception to the general rule[3] that gain from the sale of property must be recognized in the year of sale. Instead, income from an installment sale is accounted for under the installment method.[4] An installment sale is a sale where at least one payment is to be received after the close of the taxable year in which the disposition occurs.[5] Under the installment method, a taxpayer who participated in an installment sale recognizes income from the sale as payments are actually or constructively received, such gain recognition being equal to payments received in that tax year multiplied by the proportion the gross profit of the installment sale bears to the total contract price.[6]

Monetized installment sale transactions are those transactions that purport to convert a cash sale of appreciated property by a seller to a buyer into an installment sale from the seller to an intermediary, who then enters into a cash sale for the same property to the buyer. Typically, the intermediary purchases the property from the seller on an installment note, then subsequently sells

[1] Unless otherwise stated, references herein to "section(s)" or to "Code" are to the Internal Revenue Code of 1986, as amended. References herein to "§" are to relevant sections of the Treasury regulations.
[2] The Proposed Regulations can be found at the following link: https://www.federalregister.gov/documents/2023/08/04/2023-16650/identification-of-monetized-installment-sale-transactions-as-listed-transactions
[3] Section 1001(c).
[4] Section 453(a).
[5] Section 453(b)(1).
[6] Section 453(c).

the property to the buyer for cash, which the intermediary places in escrow. The seller then obtains a nonrecourse loan from a third-party lender which is secured by the escrowed funds. The repayment terms on the loan from the third-party lender generally mirror those of the installment note issued by the intermediary to the seller -- typically interest-only payments with a balloon payment of principal upon maturity. Ultimately, by entering into such monetized installment sale transaction, the seller obtains approximately the total purchase price of the property in the year of sale while simultaneously deferring full recognition of gain under the installment method on the installment note issued by the intermediary.

The Internal Revenue Service ("IRS") has known of the susceptibility of abuse of monetized installment sale transactions prior to issuance of the Proposed Regulations. In 2019, the IRS Office of Chief Counsel advised IRS attorneys of potential issues that could be used to scrutinize monetized sale transactions.[7] In such Chief Counsel Advice, the IRS contends (1) no genuine indebtedness exists in relation to the transaction, as a genuine nonrecourse loan must be secured by collateral, and a borrower who is not personally liable and has not pledged collateral would have no reason to repay a purported loan,[8] and as such, the loan proceeds would be income; (2) the cash escrow is security for the loan to the seller, and if so, the seller economically benefits from the cash escrow and should be treated as receiving payment under the "economic benefit" doctrine for purposes of section 453,[9] (3) alternatively, the loan from the third-party lender to seller is secured by the right to payment from the escrow under the installment note from the intermediary, and thus results in deemed payment under the pledging rule, under which loan proceeds are treated as payment of the dealer note;[10] (4) the intermediary is not the true buyer of the property sold by seller, and section 453(f) provides that only debt instruments from an "acquirer" can be excluded from the definition of payment, therefore not constituting payment for purposes of section 453, and debt instruments issued by a party not an "acquirer" would be considered payment, requiring recognition of gain;[11] and (5) to the extent the installment note from the intermediary to the seller is secured by a cash escrow, seller is treated as receiving payment irrespective of the pledging rule.[12]

Shortly after releasing the aforementioned CCA in 2021, the IRS added "Improper Monetized Installment Sales" to its "Dirty Dozen" list, a list on which it has remained for years 2022 and 2023. In its 2023 "Dirty Dozen" list, the IRS described monetized installments sales as follows:

> In these potentially abusive transactions, promoters find taxpayers seeking to defer the recognition of gain upon the sale of appreciated property. They facilitate a purported monetized installment sale for the taxpayer in exchange for a fee. These installment sales occur when an intermediary purchases appreciated property from a seller in exchange for an installment note. The notes typically provide for payments of interest only, with principal being paid at the end of term. In these arrangements, the seller gets the lion's

[7] As seen in CCA 202118016, released May 7, 2021.
[8] *See Estate of Franklin v. CIR*, 544, F.2d 1045 (9th Cir. 1976).
[9] *Reed v. CIR*, 723 F.2d 138 (1st Cir. 1983).
[10] Section 453A(d).
[11] *See* Rev. Rul 77-414, 1977-2 C.B. 299; Rev. Rul. 73-157, 1973-1 C.B. 213; and *Wrenn v. CIR*, 67 T.C. 576 (1976).
[12] Treas. Reg. § 15a.453-1(b)(3). Such CCA also noted that NSAR 20123401F is distinguishable from monetized installment sale transactions, as the case discussed therein did not involve an intermediary.

share of the proceeds, but improperly delays the recognition of gain on the appreciated property until the final payment on the installment note, often years later.[13]

Proposed Regulation § 1.6011-13(a) provides that a transaction that is the same as, or substantially similar to, a monetized installment sale transaction described in Proposed Regulation § 1.6011-13(b) is a listed transaction for the purposes of § 1.6011-(4)(b)(2) and sections 6111 and 6112. § 1.6011-4(c)(4) broadly defines "substantially similar" to include any transaction that is expected to obtain the same or similar tax consequences and that is either factually similar or based on the same or similar tax strategy.

Proposed Regulation § 1.6011-13(b) describes a monetized installment sale transaction as a transaction which includes the following elements:

> (1) A taxpayer (seller), or a person acting on the seller's behalf, identifies a potential buyer for appreciated property (gain property) who is willing to purchase the gain property for cash or other property (buyer cash); (2) the seller enters into an agreement to sell the gain property to a person other than the buyer (intermediary), in exchange for an installment obligation; (3) the seller purportedly transfers the gain property to the intermediary, although the intermediary either never takes title to the gain property or takes title only briefly before transferring it to the buyer; (4) the intermediary purportedly transfers the gain property to the buyer in a sale of the gain property in exchange for buyer cash; (5) the seller obtains a loan, the terms of which are such that the amount of the intermediary's purported interest payments on the installment obligation correspond to the amount of the seller's purported interest payments on the loan during the period. On each of the installment obligation and loan, only interest is due over identical periods, with balloon payments of all or a substantial portion of principal due at or near the end of the instruments' terms; (6) the sales proceeds from the buyer received by the intermediary, reduced by certain fees (including an amount set aside to fund purported interest payments on the purported installment obligation), are provided to the purported lender to fund the purported loan to the seller or transferred to an escrow or investment account of which the purported lender is a beneficiary. The lender agrees to repay these amounts to the intermediary over the course of the term of the installment obligation; and (7) on the seller's Federal income tax return for the taxable year of the purported installment sale, the seller treats the purported installment sale as an installment sale under section 453.

Proposed Regulation § 1.6011-13(c) provides that a "transaction may be substantially similar to a transaction described in paragraph (b) …if the transaction does not include all of the elements described in that paragraph."

By designating monetized installment sale transactions, as well as transactions substantially similar to such, as listed transactions for the purposes of § 1.6011-4(b)(2), the Proposed Regulations, if finalized, will require taxpayers who have participated in monetized installment sale transactions, and importantly, transactions substantially similar to monetized sale transactions, as well as those taxpayers who enter into such transactions after the Proposed

[13] IR-2023-65, March 31, 2023, which can be found at this link: https://www.irs.gov/newsroom/dirty-dozen-watch-out-for-schemes-aimed-at-high-income-filers-charitable-remainder-annuity-trusts-monetized-installment-sales-carry-risk

Regulations are finalized, to disclose to the IRS such transactions, past or future, unless the statute of limitations for all tax years in which the transactions were entered has lapsed.

§ 1.6011-4(d) and (e) provide that the disclosure statement Form 8886, *Reportable Transaction Disclosure Statement*, must be attached to the taxpayer's Federal tax return for each taxable year for which a taxpayer participates in a reportable transaction, and a copy of such Form 8886 must be sent to the Office of Tax Shelter Analysis ("OTSA") at the same time such Form is filed with the tax return. Taxpayers who have participated in monetized installment sale, or substantially similar, transactions and filed their respective Federal tax returns in years preceding the finalization of the Proposed Regulations, but for whom the statute of limitations has not yet lapsed for assessment for such respective tax year(s), must file Form 8886 with OTSA disclosing such transactions within ninety (90) calendar days from the date the Proposed Regulations are finalized.[14]

Taxpayers who are required, but fail, to disclose such transactions under § 1.6011-4 are subject to penalties under section 6707A. Section 6707A(b) provides that the amount of the penalty is seventy-five percent (75%) of the decrease in tax shown on the return as a result of the reportable transaction, or which would have resulted from such transaction if such transaction were respected for Federal tax purposes, subject to minimum and maximum penalty amounts. The minimum penalty amount is $5,000 in the case of a natural person and $10,000 in any other case. For a listed transaction, the maximum penalty amount is $100,000 in the case of a natural person and $200,000 in any other case.

Additional penalties may also apply. Section 6662A imposes a 20 percent (20%) accuracy-related penalty on any understatement[15] attributable to an adequately disclosed reportable transaction. Further, if the taxpayer is required, but does not adequately disclose participation in a reportable transaction in accordance with the regulations under section 6011, the imposed penalty increases to thirty percent (30%) of any understatement.[16]

Importantly, taxpayers who are required, but fail, to disclose participation in a listed transaction are subject to an extended statute of limitations.[17] The time of assessment of any tax with respect to the transaction will not expire before the date that is one year after the earlier of the date on which the Secretary is furnished the required information or the date a material advisor discloses the participation pursuant to a written request under section 6112(b)(1)(A). In essence, for transactions entered into prior to finalization of the Proposed Regulations for which the state of limitations has not yet lapsed, such statute of limitations will be tolled until the taxpayer, or such taxpayer's material advisor, adequately discloses the transactions.

Additionally, a material advisor with respect to monetized installment sale, or substantially similar, transactions are subject to reporting requirements. A material advisor is any person who provides any material aid, assistance, or advice with respect to organizing, managing, promoting, selling, implementing, insuring, or carrying out any reportable transaction, and directly or indirectly derives gross income in excess of the threshold amount as defined in § 301.6111-3(b)(3) for the material aid, assistance, or advice.[18] Material advisors must disclose transactions on Form

[14] § 1.6011-4(e)(2)(i).
[15] As defined in section 6662A(b)(1).
[16] Section 662A(c).
[17] Section 6501(c)(10).
[18] § 301.6111-3(b)(1).

8918, *Material Advisor Disclosure Statement*,[19] and such disclosure statement for a reportable transaction must be filed with OTSA by the last day of the month that follows the end of the calendar quarter in which the advisor becomes a material advisor with respect to a reportable transaction or in which the circumstances necessitating an amended disclosure statement occur.[20] A material advisor who fails to file a timely disclosure, or files an incomplete or false disclosure statement, is subject to a penalty.[21] For listed transactions, the penalty is the greater of $200,000 or fifty percent (50%) of the gross income derived by the material advisor (75% in the case of an intentional failure to act) with respect to aid, assistance, or advice which is provided with respect to the listed transaction before the date the return is filed.[22]

Furthermore, a material advisor with respect to any reportable transaction must maintain a list identifying each person to whom the advisor was a material advisor with respect to such transaction and containing such other information as the Secretary may by regulations require.[23] A material advisor may be subject to a penalty[24] for failing to maintain a list under section 6112(a) and failing to make the list available upon written request to the Secretary in accordance with section 6112(b) within twenty (20) business days after the date of such request. The penalty, under section 6708(a), for failing to provide such list is $10,000 per day for each day of the failure to provide such list after the twentieth (20th) day. Here, material advisors are given some reprieve, as no penalty will be imposed with respect to the failure on any day if such failure is due to reasonable cause.

EXECUTIVE SUMMARY OF ACTEC'S RECOMMENDATIONS

ACTEC's comments address the following aspects of the Proposed Regulations and are briefly summarized, below:

1. Require Monetization. Exclude from the definition of "substantially similar" under Prop. Reg. § 1.6011-13(c) transactions that do not involve monetization, including transactions without the presence of the elements described in Prop. Reg. § 1.6011-13(b)(5) or (6).

2. Specify Income Tax Deferral. Exclude from the definition of "substantially similar" under Prop. Reg. § 1.6011-13(c) transactions designed to create transfer tax, estate planning, business planning or related planning benefits without the income tax result described in Prop. Reg. § 1.6011-13(b).

3. Related Persons under Section 453(f). Exclude from the definition of "substantially similar" under Prop. Reg. § 1.6011-13(c) transactions where the "intermediary" is a related person as defined in section 453(f) (*vis-à-vis* the seller) because section 453(e) already precludes related persons from obtaining the purported income tax results described in

[19] § 301-6111-3(d) and (e).
[20] § 301-6111-3(e).
[21] Section 6707(a).
[22] Section 6707(b)(2).
[23] Section 6112(a); §301.6112-1(e).
[24] Section 6708.

Prop. Reg. § 1.6011-13(b). Also, exclude from the definition of "intermediary" under Prop. Reg. § 1.6011-13(b) or "participant" under Prop. Reg. § 1.6011-13(d) persons who are related persons as defined under section 453(f) or who serve as fiduciaries of estates or trusts that are related persons as defined under section 453(f).

4. Bona Fide Loans from Trusts and Estates. Exclude from the definition of "substantially similar" under Prop. Reg. § 1.6011-13(c) and specifically exempt from the elements described in Prop. Reg. § 1.6011-13(b)(5) or (6) bona fide loans made by the fiduciaries of trusts and estates even if such loans happen to be proximate to an installment purchase.

DISCUSSION

ACTEC wholly supports the principle that taxpayers should pay tax when they recognize income unless such recognition specifically is exempted or deferred by Congress through the Code. Accordingly, in these comments, ACTEC does not oppose the Service's fundamental effort to disregard Monetized Installment Sale Transactions.

However, ACTEC is concerned that the Proposed Regulations describe Monetized Installment Sale Transactions and substantially similar transactions in a manner that is far too broad. As a result, the IRS will receive excessive reporting on legitimate installment sale transactions that are not of interest. In addition, because of the overbreadth of the Proposed Regulations, taxpayers engaging in legitimate installment sales and their advisors inappropriately would be subject to reporting obligations, penalties, and extended statutes of limitations. Accordingly, the Service should narrow and better define Monetized Installment Sale Transactions in the final regulations.

ACTEC is concerned that the Proposed Regulations are far too broad because:

1. They capture installment arrangements that do not include an element of "monetization;"
2. They fail to specify that only the income tax deferral of Monetized Installment Sale Transactions should prompt reporting, not an incidental impact of installment arrangements on other types of tax, such as transfer taxes;
3. They are redundant with respect to related persons because of section 453(f), so related persons—particularly related person trusts—should be excluded from the definition of "Intermediaries;"[25] and
4. They capture bona fide loans from trusts or estates that are commonly entered into for legitimate fiduciary purposes.

[25] Note that the Proposed Regulations at § 6011-13(d) state that "[b]uyers of gain property described in paragraph (b) … are not treated as participants." This type of carveout is what ACTEC is seeking in these comments related to other areas of concern in determining what may be considered "substantially similar."

1. INSTALLMENT ARRANGEMENTS THAT DO NOT INCLUDE AN ELEMENT OF "MONETIZATION"

In designating Monetized Installment Sale Transactions as listed transactions, the Service seems understandably concerned about a transaction with elements that purportedly permit a taxpayer to realize income (i.e., through receipt of loan proceeds secured by sales proceeds) without currently recognizing that income and paying income tax. The final regulations should be narrowed to address situations where the taxpayer-seller, in fact, monetizes the sold asset, through a loan or otherwise.

"Substantially similar" is defined in § 1.6011-4(c)(4) to include "any transaction that is expected to obtain the same or similar types of tax consequences and that is either factually similar or based on the same or similar tax strategy." Paragraph I. of the *Explanation of Provisions* section of the Notice details seven enumerated elements of Monetized Installment Sale Transactions, tracking the elements of Proposed Regulation § 1.6011-13(b). However, the Notice then immediately goes on to specify that "A transaction may be 'substantially similar' to the transaction described above ***even if such transaction does not include all of the elements described above.***" (Emphasis added.) This "substantially similar" language of the Notice tracks, almost perfectly, the text of Proposed Regulation § 1.6011-13(c).

Here we make two important observations:

A. Monetized Installment Sale Transactions purportedly are designed to be subject to the installment method of reporting under section 453. Accordingly, <u>every</u> *legitimate* installment sale will be a "transaction that is expected to obtain the same or similar types of tax consequences" as a Monetized Installment Sale Transaction.

B. Because a transaction may be 'substantially similar' to the Monetized Installment Sale Transaction described in § 1.6011-13(b) even if such transaction does not include all seven of the elements enumerated therein, then *legitimate* installment sales that do not include elements (5) or (6)—i.e., the "monetization" of the installment sale, or the loan back to the seller—nonetheless may be treated as substantially similar under the Proposed Regulations.

It is neither reasonable nor advisable for "substantially similar" transactions under the terms of the Proposed Regulations to include legitimate installment sales transactions that include no element of monetization. Including the types of transactions ACTEC requests be specifically excluded from the term "substantially similar" risks a chilling effect on legitimate transactions, additional costs to taxpayers, additional compliance risks for taxpayers, and over-disclosure to the IRS of normal, legitimate installment transactions which are not of concern to the IRS. It is to be expected that cautious or conservative taxpayers, their advisors, and other related third parties such as trustees, will file as Participants or Material Advisors—even for transactions about which the

IRS has no concern—merely as a prophylactic against the consequences of failing to report "substantially similar" transactions.

As currently drafted, the sentence in Proposed Regulation § 1.6011-13(c) specifying that "A transaction may be 'substantially similar' to the transaction described in paragraph (b) of this section ***if the transaction does not include all of the elements described in that paragraph***" runs a significant risk of being successfully challenged as subject to the vagueness doctrine.

> [T]he [vagueness] doctrine is concerned with providing officials with explicit guidelines in order to avoid arbitrary and discriminatory enforcement. Hynes, 425 U.S. at 622, 96 S.Ct. at 1761; Goguen, 415 U.S. at 572-73, 94 S.Ct. at 1246-47; Papachristou v. City of Jacksonville, 405 U.S. 156, 170, 92 S.Ct. 839, 847, 31 L.Ed.2d 110 (1972). To that end, laws are invalidated if they are "wholly lacking in 'terms susceptible of objective measurement.'" Keyishian v. Board of Regents, 385 U.S. 589, 604, 87 S.Ct. 675, 684, 17 L.Ed.2d 629 (1967) (quoting Cramp v. Board of Public Instruction, 368 U.S. 278, 286, 82 S.Ct. 275, 280, 7 L.Ed.2d 285 (1961)). See also NAACP v. Button, 371 U.S. 415, 466, 83 S.Ct. 328, 355, 9 L.Ed.2d 405 (1963) (Harlan, J., dissenting) ("Laws that have failed to meet this (vagueness) standard are, almost without exception, those which turn on language calling for the exercise of subjective judgment, unaided by objective norms.") Big Mama Rag, Inc. v. U.S., 631 F. 2d 1030, 1035 (D.C. Cir. 1980) (definition of "educational" contained in treasury regulation governing the tax exemption afforded educational or charitable organizations violated vagueness doctrine).
>
> We are sympathetic with the IRS's attempt to safeguard the public fisc by closing revenue loopholes…. Applications for tax exemption must be evaluated, however, on the basis of criteria capable of neutral application. The standards may not be so imprecise that they afford latitude to individual IRS officials …. *Id*., at 1040.

Similarly, it is neither reasonable nor fundamentally fair to characterize sellers engaged in legitimate installment sales or their professional advisors as Participants under Treas. Reg. § 1.6011-4 or Material Advisors under sections 6111 and 6112, respectively, or to put them at risk of misinterpreting "substantially similar" without clear guidance as to what elements should be present before a transaction will be considered to fall under that definition. Conservative taxpayers, such as the trustees ACTEC Fellows regularly represent, who legitimately may sell an asset on the installment method or who could be characterized as an intermediary, will be inclined to disclose *every* installment sale transaction under the overbroad Proposed Regulations.

Treasury readily could narrow the scope of "substantially similar" to capture transactions Treasury intends to target. In the final regulations, ACTEC respectfully submits that the Service should specify that "A transaction may be 'substantially similar' to the transaction described above even if such transaction does not include all of the elements described above, **so long as the transaction includes a monetization of the installment sale, such as a loan back to the seller, or a lender's loan to the seller secured by the intermediary's sales proceeds such as described**

in elements (5) and (6), above." In a Monetized Installment Sale Transaction, recognition of the income (i.e., loan proceeds) by the seller is a key element that must be present to implicate a listed transaction. In addition, ACTEC suggests that Treasury narrow the final regulations by specifically identifying legitimate transactions that will not be considered "substantially similar."

2. ONLY THE INCOME TAX DEFERRAL WHICH CONCERNS THE IRS SHOULD PROMPT REPORTING; BY CONTRAST, AN INCIDENTAL IMPACT OF INSTALLMENT ARRANGEMENTS ON OTHER TYPES OF TAX, SUCH AS TRANSFER TAXES, SHOULD NOT PROMPT REPORTING

In designating Monetized Installment Sale Transactions as listed transactions, the Service is concerned about a transaction with elements that purportedly permit a taxpayer to realize income (i.e., through receipt of loan proceeds secured by sales proceeds) without recognizing that income currently and paying ***income tax***. The final regulations should be narrowed to address situations where the taxpayer-seller defers ***income tax*** while, in substance, otherwise recognizing the income through a secondary loan secured by the proceeds of the ultimate sale.

The Proposed Regulations neglect to specify a concern solely with the *income tax* consequences of Monetized Installment Sales Transactions. Where "[t]he term substantially similar includes any transaction that is expected to obtain the same or similar types of *tax consequences* and that is either factually similar or based on the same or similar tax strategy,"[26] (emphasis added) and where all installment sales could have similar *transfer tax* consequences to Monetized Installment Sales Transactions, the failure to limit the scope of the Proposed Regulations to *income taxes* will result in substantial over-disclosure. A legitimate installment sale for full consideration that attracts no gift or Generation Skipping Transfer ("GST") tax should not trigger disclosure and reporting requirements under sections 6011 and 6012. Similarly, the normal financial impact (i.e. fixing the value) of a legitimate installment sale for full consideration in a taxpayer's taxable estate for *estate tax* purposes should not trigger disclosure and reporting requirements under sections 6011 and 6012.

Instead, in the final regulations, ACTEC respectfully submits that the Service should clarify that Monetized Installment Sales Transactions are listed transactions because of their purported *income tax* deferral, not because of any incidentally similar tax consequence under the estate, gift or GST taxes. For purposes of disclosure by participants and material advisors, "substantially similar" transactions should be those expected to obtain the same or similar types of *income tax* consequences as Monetized Installment Sales Transactions.

[26] § 1.6011-4(c)(4).

3. RELATED PERSONS—PARTICULARLY RELATED PERSON TRUSTS—SHOULD BE EXCLUDED FROM THE DEFINITION OF "INTERMEDIARIES"

For purposes of clarity and consistency with the statutory framework of the installment method, ACTEC respectfully submits that the final regulations should expressly exclude "Related Persons" as intermediaries.

Code section 453(f)(1) defines a related person:

> (1) Related person Except for purposes of subsections (g) and (h), the term "related person" means—
>
> (A) a person whose stock would be attributed under section 318(a) (other than paragraph (4) thereof) to the person first disposing of the property, or
>
> (B) a person who bears a relationship described in section 267(b) to the person first disposing of the property.

Of particular interest to ACTEC, estates and trusts broadly are described as related persons in sections 318(a)(2)(A) & (B); 318(a)(3)(A) & (B); 318(a)(5)(C); 267(b)(4), (5), (6), (7) & (8); and 267(c)(1).

Importantly, an existing, effective, decades-old statutory framework under section 453(e) sufficiently prescribes the income tax treatment of an installment sale to a related person intermediary, such as a trust or an estate. Specifically, if any taxpayer-seller disposes of property to a related person intermediary (i.e., the first disposition), and before the taxpayer-seller receives all installment payments the related person intermediary disposes of the property within two years (i.e., the second disposition), then the amount recognized in the second disposition is treated as received and recognized by the taxpayer-seller at that time. Because section 453(e) already details the income tax treatment of installment sales to related persons when followed by subsequent dispositions, to avoid significant confusion and conflict among the tax laws, installment sales to related persons subject to section 453(e) should not also constitute elements of a Monetized Installment Sale Transaction.[27]

Under the Monetized Installment Sale Transaction, the intermediary "transfers the gain property to the buyer in a sale of the gain property in exchange for the buyer cash."[28] However, if the intermediary is a related person, then on the date the intermediary disposes of the property to a third-party buyer, the taxpayer-seller must recognize gain under section 453(e)(1) based upon the proceeds received by the intermediary. On the date of the second disposition, there is no further risk of improper income tax deferral, as the gain has been recognized by the original taxpayer-seller. For instance, it should no longer matter whether the intermediary loans proceeds back to

[27] A regulation [such as Prop. Treas. Reg. 1.6011-13] is reasonably related to the purposes of the legislation to which it relates if the regulation serves to prevent circumvention of the statute and ***is not inconsistent with the statutory provisions*** [such as sections 453(e) & (f)]. See Carpenter, Chartered v. Secretary of Veterans Affairs, 343 F.3d 1347 (Fed. Cir. 2003)(emphasis added).

[28] Element (4), Paragraph I., Explanation of Provisions section of the Notice.

the taxpayer or similarly pledges the sales proceeds as collateral for a loan. The deferred tax already will be recognized by the original taxpayer-seller under section 453(e)(1).

Accordingly, in the final regulations, ACTEC respectfully submits that the Service should exclude from Monetized Installment Sales Transactions installment sales to a related person intermediary as defined under section 453(f)(1). The final regulations could adopt an exclusion for related person intermediaries similar to the proposed reporting limitation on buyers.

4. BONA FIDE LOANS FROM TRUSTS OR ESTATES TO CONSTITUENTS

ACTEC is concerned that the Proposed Regulations seem overbroad when applied to bona fide loans commonly issued by trusts or estates in the ordinary course of fiduciary administration. Specifically, such loans should not constitute monetization if they happen to be proximate to an installment sale.

Trusts regularly receive assets by gift or sale, including installment sales. Frequently, such installment purchases of assets by trusts are required by contracts, such as buy-sell agreements. Trusts have many non-income tax-motivated estate planning and business reasons for purchasing assets under the installment method.

Independently, trusts also regularly enter into bona fide loans on adequate terms,[29] lending funds to constituents including estates, beneficiaries, settlors, and others. As one common example, a trustee might lend money to a beneficiary to purchase a home or a business interest. Compelling fiduciary reasons often make loans more attractive than an outright distribution to a beneficiary. For instance, a loan can preserve the corpus of a trust, permitting the trustee to keep shares of the trust equal among beneficiaries. Also, rather than a large outright distribution to a young beneficiary, a loan can help teach good stewardship to a beneficiary, requiring them to repay the amount borrowed to the family trust.

ACTEC's concern is that bona fide loans made from existing, unrelated trust assets may happen to be proximate in time to a trust's unrelated installment purchase or asset sale (or both). However, ACTEC respectfully submits that bona fide loans from trusts for substantial non-tax purposes should not be treated as the monetization of an installment sale and should be excluded from the final regulations.

Example

The following example illustrates ACTEC's four main concerns highlighted in the discussion, above, under a factual scenario akin to many commonly encountered by Fellows:

[29] Loan terms are adequate under IRC § 7872.

Years ago, D formed Farm, LLC, to own and operate Greenacre. Soon thereafter, D formed a non-grantor Trust benefiting D's family—D's children from D's first marriage—and made a gift of 10% of D's membership interest in Farm LLC to such Trust. Farm, LLC is a partnership for income tax purposes. The operating agreement of Farm, LLC contains terms comparable to similar arrangements entered into by persons in arms' length transactions obligating remaining members to purchase a deceased member's interest from such member's estate within 90 days of the member's death. Most or all of the purchase price can be paid with an installment note.

D dies. The beneficiaries of D's Estate may vary from the beneficiaries of D's Trust (e.g., D's second spouse).

1. INSTALLMENT SALE. The executor of D's Estate sells the Estate's membership interest in Farm, LLC to the Trust on the installment method pursuant to the requirements of Farm, LLC's operating agreement. (Note: The Estate's cost basis in its LLC membership interest likely was stepped up at death under section 1014, and the underlying assets of Farm, LLC likely received a proportionate cost basis adjustment under section 743(b). Accordingly, there may be very little post death appreciation—i.e., a very low gross profit percentage—under section 453.)

2. SALE TO THIRD PARTY. The trustee of the Trust determines that 100% of Farm, LLC is not a prudent investment for it to continue to hold and operate under applicable state law, and no family member is capable of or willing to operate the company or Greenacre. So, shortly, the trustee identifies an unrelated third-party buyer and then sells Farm, LLC to such buyer in exchange for cash. (Note: Code section 453(e)(1) causes the Estate to recognize capital gain, if any, upon the subsequent disposition of the property by the related person Trust in less than two years even though the Trust's continuing payment obligations under the installment loan are not terminated under state law.)

3. BONA FIDE LOAN BACK OR PLEDGE. Consider the following variations on bona fide loans:

    a. Following the trustee's sale of Farm, LLC, prior to the 9-month anniversary of D's death, D's Estate borrows money from a third-party bank to pay its estate taxes. The terms of the Estate's loan payable to the bank are not dissimilar to the terms of the commercially reasonable loan receivable made by the Trust.

    b. Shortly after the trustee's sale of Farm, LLC, prior to the 9-month anniversary of D's death, the trustee of the Trust agrees to loan the Estate money, directly, to pay the estate taxes owed by D's Estate.

    c. Shortly after the trustee's sale of Farm, LLC, the trustee of the Trust makes a loan (from the sales proceeds), secured by a mortgage and for adequate interest, to one

beneficiary of the Trust to enable the beneficiary to buy the family homestead from the Estate in a manner that is fair to all Trust beneficiaries.

The example, above, is not far-fetched or conjectural, but rather is representative of typical transactions our Fellows regularly encounter in professional practice. ACTEC respectfully submits that final regulations should clarify that *none* of the foregoing variations involving related persons should be considered "substantially similar" to a Monetized Installment Sales Transaction, triggering disclosure and reporting requirements under sections 6011 and 6012.

On its face, this sample transaction—including its variations—appears to be "substantially similar" to the description of a Monetized Installment Sales Transaction under the Proposed Regulations. The example transaction could be described as follows in a manner that seems to reflect most or all of the enumerated elements of a Monetized Installment Sales Transaction:

(1) Following D's death and aware that the Trust will purchase Farm, LLC, the trustee of the Trust, in the exercise of its fiduciary duties, may seek a third-party buyer for Farm, LLC (which may enjoy modest post-death appreciation) who is willing to purchase Farm, LLC for cash or other property (buyer cash);
(2) Whether under a buy-sell obligation or not, the executor of the Estate would enter into an agreement to sell the gain property to the Trust--a person other than the buyer--in exchange for an installment obligation;
(3) The executor would transfer Farm, LLC to the trustee, and it is possible that the trustee takes title only briefly before transferring it to an unrelated third-party buyer;
(4) The trustee of the Trust would transfer Farm, LLC to the unrelated third-party buyer in a sale of the gain property in exchange for buyer cash;
(5) The Estate obtains a loan to pay estate taxes, the commercially reasonable terms of which are such that the amount of the trustee's interest payments on the installment obligation correspond to the amount of the Estate's purported interest payments on the loan during the period;
(6) It is possible (but less likely) that the sales proceeds from the unrelated third-party buyer previously received by the trustee could be provided in escrow to the estate's lender as security; and
(7) On the estate's Federal income tax return for the year of the installment sale of Farm, LLC, the estate treats the installment sale as an installment sale under section 453.

Despite the Service's concerns with some taxpayers' income tax deferral using Monetized Installment Sale Transactions, the parties to the typical transaction, above, defer little to no gain or income tax due to the operation of section 453(e)(1) (related party recognition), section 1014 (basis step up at death) and section 743(b) (adjustment to inside basis at death of a partner). The bona fide loans to the Estate or beneficiaries are not part of a scheme and should not trigger disclosure or reporting requirements under sections 6011 and 6012.

However, to avoid the consequences of sections 6011 and 6012, conservative fiduciaries representing the Estate and Trust would be obligated to disclose such typical transactions as "substantially similar" to the listed transaction under the Proposed Regulations.

By contrast, ACTEC asserts that the final regulations for Monetized Installment Sale Transactions should specify that (1) only arrangements where an installment note is monetized are "substantially similar;" (2) only arrangements involving non-de minimis[30] income tax deferral are "substantially similar" (without reference to any similar transfer tax consequence); (3) only arrangements involving intermediaries who are not related persons are "substantially similar" (as transactions with related persons already are addressed by Congress under sections 453(e)(1) and –(f)); and (4) even if proximate to an installment purchase, bona fide loans extended by trustees who are governed by fiduciary standards do not constitute "substantially similar" monetization of the installment purchase.

OTHER COMMENTS

ACTEC also offers the following abbreviated comments.

1. GRANTOR TRUSTS. Trusts that are grantor trusts to the original seller should not be characterized as an intermediary in Monetized Installment Sale Transactions. Where the income tax consequences of an installment sale to a grantor trust are disregarded pursuant to Rev. Rul. 85-13, there is no opportunity for income tax deferral or avoidance. Indeed, thwarting income tax mitigation is a principal reason Congress created the grantor trust rules. Because such transfers to grantor trusts necessarily involve no abusive income tax deferral, they should be excluded from the scope of the Proposed Regulations.

2. TRUSTEE SALES AS PRUDENT INVESTMENT ACTIVITY. In the normal course of estate planning, taxpayers regularly transfer assets to trustees of trusts. Acting independently and subject to fiduciary standards, trustees frequently decide to diversify trust assets by subsequently selling them consistent with the principles of the Prudent Investor Act. This transfer-and-sell pattern is so common that the Proposed Regulations should take care not to characterize that pattern as a listed transaction.

3. UNRELATED BUYERS. If the Service chooses to include buyers (as suggested on page 16 of Notice), ACTEC observes that buyers often are bona fide third-party purchasers in estate and trust transactions. ACTEC affirms the Service's leanings that the definition of buyers should not be overbroad.

4. DEFERRED SALES TRUSTS. This comment memorandum is specifically not intended to address the transaction commonly referred to as a "Deferred Sales Trust," but rather trusts established for legitimate planning purposes. "Deferred Sales Trusts" probably do not share

[30] Consider the $150,000 limit in section 453A(b)(1).

most of the elements of Monetized Installment Sale Transactions, but merely because they are dissimilar does not mean ACTEC believes Deferred Sales Trusts are legitimate installment sales.

5. POLICY AND SCOPE. ACTEC Fellows harbor real concerns that the Proposed Regulations, as currently drafted, will operate to "kill a fly with a shotgun." Admittedly, ACTEC does not have data concerning how many taxpayers attempt to use Monetized Installment Sale Transactions or the impact on the government fisc. We understand that Monetized Installment Sale Transactions could be meaningful only for taxpayers seeking to defer no more than $5 million of long term capital gain and the related income taxes.[31] The "benefit" of Participants' tax deferral would be further attenuated by their ordinary income tax on interest income, and the capital gains tax they pay at the end of their installment arrangements. Similarly, such Participants can be expected to substitute deferral techniques approved by statute or regulation if a Monetized Installment Sale Transaction is unavailable (e.g., section 1031 exchanges, charitable remainder trusts). *Again, ACTEC wholly supports the principle that taxpayers should pay tax when they recognize income, and ACTEC does not oppose the Service's fundamental effort to disregard Monetized Installment Sale Transactions*. Moreover, as a policy matter, the Proposed Regulations should identify the listed transaction in a sufficiently narrow manner so that the Treasury's costs to administer the new listed transaction and innocent taxpayers' costs to comply with the Proposed Regulations should be minimized.

Again, ACTEC commends Treasury and the IRS for their efforts in drafting such a well-organized package of Proposed Regulations, and we appreciate the opportunity to submit these comments on the Proposed Regulations.

[31] See section 453A(b)(2).