

**§ 1.453-11 Installment obligations received from a liquidating corporation.**

(a) *In general*—(1) *Overview*. Except as provided in section 453(h)(1)(C) (relating to installment sales of depreciable property to certain closely related persons), a qualifying shareholder (as defined in paragraph (b) of this section) who receives a qualifying installment obligation (as defined in paragraph (c) of this section) in a liquidation that satisfies section 453(h)(1)(A) treats the receipt of payments in respect of the obligation, rather than the receipt of the obligation itself, as a receipt of payment for the shareholder's stock. The shareholder reports the payments received on the installment method unless the shareholder elects otherwise in accordance with § 15a.453-1(d) of this chapter.

(2) *Coordination with other provisions*—(i) *Deemed sale of stock for installment obligation*. Except as specifically provided in section 453(h)(1)(C), a qualifying shareholder treats a qualifying installment obligation, for all purposes of the Internal Revenue Code, as if the obligation is received by the shareholder from the person issuing the obligation in exchange for the shareholder's stock in the liquidating corporation. For example, if the stock of a corporation that is liquidating is traded on an established securities market, an installment obligation distributed to a shareholder of the corporation in exchange for the shareholder's stock does not qualify for installment reporting pursuant to section 453(k)(2).

(ii) *Special rules to account for the qualifying installment obligation*—(A) *Issue price*. A qualifying installment obligation is treated by a qualifying shareholder as newly issued on the date of the distribution. The issue price of the qualifying installment obligation on that date is equal to the sum of the adjusted issue price of the obligation on the date of the distribution (as determined under § 1.1275-1(b)) and the amount of any qualified stated interest (as defined in § 1.1273-1(c)) that has accrued prior to the distribution but that is not payable until after the distribution. For purposes of the preceding sentence, if the qualifying installment obligation is subject to § 1.446-2 (e.g., a

debt instrument that has unstated interest under section 483), the adjusted issue price of the obligation is determined under § 1.446-2(c) and (d).

(B) *Variable rate debt instrument*. If the qualifying installment obligation is a variable rate debt instrument (as defined in § 1.1275-5), the shareholder uses the equivalent fixed rate debt instrument (within the meaning of § 1.1275-5(e)(3)(ii)) constructed for the qualifying installment obligation as of the date the obligation was issued to the liquidating corporation to determine the accruals of original issue discount, if any, and interest on the obligation.

(3) *Liquidating distributions treated as selling price*. All amounts distributed or treated as distributed to a qualifying shareholder incident to the liquidation, including cash, the issue price of qualifying installment obligations as determined under paragraph (a)(2)(ii)(A) of this section, and the fair market value of other property (including obligations that are not qualifying installment obligations) are considered as having been received by the shareholder as the selling price (as defined in § 15a.453-1(b)(2)(ii) of this chapter) for the shareholder's stock in the liquidating corporation. For the proper method of reporting liquidating distributions received in more than one taxable year of a shareholder, see paragraph (d) of this section. An election not to report on the installment method an installment obligation received in the liquidation applies to all distributions received in the liquidation.

(4) *Assumption of corporate liability by shareholders*. For purposes of this section, if in the course of a liquidation a shareholder assumes secured or unsecured liabilities of the liquidating corporation, or receives property from the corporation subject to such liabilities (including any tax liabilities incurred by the corporation on the distribution), the amount of the liabilities is added to the shareholder's basis in the stock of the liquidating corporation. These additions to basis do not affect the shareholder's holding period for the stock. These liabilities do not reduce the amounts received in computing the selling price.

(5) *Examples.* The provisions of this paragraph (a) are illustrated by the following examples. Except as otherwise provided, assume in each example that A, an individual who is a calendar-year taxpayer, owns all of the stock of T corporation. A's adjusted tax basis in that stock is \$100,000. On February 1, 1998, T, an accrual method taxpayer, adopts a plan of complete liquidation that satisfies section 453(h)(1)(A) and immediately sells all of its assets to unrelated B corporation in a single transaction. The examples are as follows:

*Example 1.* (i) The stated purchase price for T's assets is \$3,500,000. In consideration for the sale, B makes a down payment of \$500,000 and issues a 10-year installment obligation with a stated principal amount of \$3,000,000. The obligation provides for interest payments of \$150,000 on January 31 of each year, with the total principal amount due at maturity.

(ii) Assume that for purposes of section 1274, the test rate on February 1, 1998, is 8 percent, compounded semi-annually. Also assume that a semi-annual accrual period is used. Under § 1.1274-2, the issue price of the obligation on February 1, 1998, is \$2,368,450. Accordingly, the obligation has \$631,550 of original issue discount (\$3,000,000-\$2,368,450). Between February 1 and July 31, \$19,738 of original issue discount and \$75,000 of qualified stated interest accrue with respect to the obligation and are taken into account by T.

(iii) On July 31, 1998, T distributes the installment obligation to A in exchange for A's stock. No other property is ever distributed to A. On January 31, 1999, A receives the first annual payment of \$150,000 from B.

(iv) When the obligation is distributed to A on July 31, 1998, it is treated as if the obligation is received by A in an installment sale of shares directly to B on that date. Under § 1.1275-1(b), the adjusted issue price of the obligation on that date is \$2,388,188 (original issue price of \$2,368,450 plus accrued original issue discount of \$19,738). Accordingly, the issue price of the obligation under paragraph (a)(2)(ii)(A) of this section is \$2,463,188, the sum of the adjusted issue price of the obligation on that date (\$2,388,188) and the amount of accrued but unpaid qualified stated interest (\$75,000).

(v) The selling price and contract price of A's stock in T is \$2,463,188, and the gross profit is \$2,363,188 (\$2,463,188 selling price less A's adjusted tax basis of \$100,000). A's gross profit ratio is thus 96 percent (gross profit of \$2,363,188 divided by total contract price of \$2,463,188).

(vi) Under §§ 1.446-2(e)(1) and 1.1275-2(a), \$98,527 of the \$150,000 payment is treated as a payment of the interest and original issue discount that accrued on the obligation from July 31, 1998, to January 31, 1999 (\$75,000 of qualified stated interest and \$23,527 of original issue discount). The balance of the payment (\$51,473) is treated as a payment of principal. A's gain recognized in 1999 is \$49,414 (96 percent of \$51,473).

*Example 2.* (i) T owns Blackacre, unimproved real property, with an adjusted tax basis of \$700,000. Blackacre is subject to a mortgage (underlying mortgage) of \$1,100,000. A is not personally liable on the underlying mortgage and the T shares held by A are not encumbered by the underlying mortgage. The other assets of T consist of \$400,000 of cash and \$600,000 of accounts receivable attributable to sales of inventory in the ordinary course of business. The unsecured liabilities of T total \$900,000.

(ii) On February 1, 1998, T adopts a plan of complete liquidation complying with section 453(h)(1)(A), and promptly sells Blackacre to B for a 4-year mortgage note (bearing adequate stated interest and otherwise meeting all of the requirements of section 453) in the face amount of \$4 million. Under the agreement between T and B, T (or its successor) is to continue to make principal and interest payments on the underlying mortgage. Immediately thereafter, T completes its liquidation by distributing to A its remaining cash of \$400,000 (after payment of T's tax liabilities), accounts receivable of \$600,000, and the \$4 million B note. A assumes T's \$900,000 of unsecured liabilities and receives the distributed property subject to the obligation to make payments on the \$1,100,000 underlying mortgage. A receives no payments from B on the B note during 1998.

(iii) Unless A elects otherwise, the transaction is reported by A on the installment method. The selling price is \$5 million (cash of \$400,000, accounts receivable of \$600,000, and the B note of \$4 million). The total contract price also is \$5 million. A's adjusted tax basis in the T shares, initially \$100,000, is increased by the \$900,000 of unsecured T liabilities assumed by A and by the obligation (subject to which A takes the distributed property) to make payments on the \$1,100,000 underlying mortgage on Blackacre, for an aggregate adjusted tax basis of \$2,100,000. Accordingly, the gross profit is \$2,900,000 (selling price of \$5 million less aggregate adjusted tax basis of \$2,100,000). The gross profit ratio is 58 percent (gross profit of \$2,900,000 divided by the total contract price of \$5 million). The 1998 payments to A are \$1 million (\$400,000 cash plus \$600,000 receivables) and A recognizes gain in 1998 of \$580,000 (58 percent of \$1 million).

(iv) In 1999, A receives payment from B on the B note of \$1 million (exclusive of interest). A's gain recognized in 1999 is \$580,000 (58 percent of \$1 million).

(b) *Qualifying shareholder.* For purposes of this section, *qualifying shareholder* means a shareholder to which, with respect to the liquidating distribution, section 331 applies. For example, a creditor that receives a distribution from a liquidating corporation, in exchange for the creditor's claim, is not a qualifying shareholder as a result of that distribution regardless of whether the liquidation satisfies section 453(h)(1)(A).

(c) *Qualifying installment obligation—*  
 (1) *In general.* For purposes of this section, *qualifying installment obligation* means an installment obligation (other than an evidence of indebtedness described in §15a.453-1(e) of this chapter, relating to obligations that are payable on demand or are readily tradable) acquired in a sale or exchange of corporate assets by a liquidating corporation during the 12-month period beginning on the date the plan of liquidation is adopted. See paragraph (c)(4) of this section for an exception for installment obligations acquired in respect of certain sales of inventory. Also see paragraph (c)(5) of this section for an exception for installment obligations attributable to sales of certain property that do not generally qualify for installment method treatment.

(2) *Corporate assets.* Except as provided in section 453(h)(1)(C), in paragraph (c)(4) of this section (relating to certain sales of inventory), and in paragraph (c)(5) of this section (relating to certain tax avoidance transactions), the nature of the assets sold by, and the tax consequences to, the selling corporation do not affect whether an installment obligation is a qualifying installment obligation. Thus, for example, the fact that the fair market value of an asset is less than the adjusted basis of that asset in the hands of the corporation; or that the sale of an asset will subject the corporation to depreciation recapture (e.g., under section 1245 or section 1250); or that the assets of a trade or business sold by the corporation for an installment obligation include depreciable property, certain marketable securities, accounts

receivable, installment obligations, or cash; or that the distribution of assets to the shareholder is or is not taxable to the corporation under sections 336 and 453B, does not affect whether installment obligations received in exchange for those assets are treated as qualifying installment obligations by the shareholder. However, an obligation received by the corporation in exchange for cash, in a transaction unrelated to a sale or exchange of noncash assets by the corporation, is not treated as a qualifying installment obligation.

(3) *Installment obligations distributed in liquidations described in section 453(h)(1)(E)—*(i) *In general.* In the case of a liquidation to which section 453(h)(1)(E) (relating to certain liquidating subsidiary corporations) applies, a qualifying installment obligation acquired in respect of a sale or exchange by the liquidating subsidiary corporation will be treated as a qualifying installment obligation if distributed by a controlling corporate shareholder (within the meaning of section 368(c)) to a qualifying shareholder. The preceding sentence is applied successively to each controlling corporate shareholder, if any, above the first controlling corporate shareholder.

(ii) *Examples.* The provisions of this paragraph (c)(3) are illustrated by the following examples:

*Example 1.* (i) A, an individual, owns all of the stock of T corporation, a C corporation. T has an operating division and three wholly-owned subsidiaries, X, Y, and Z. On February 1, 1998, T, Y, and Z all adopt plans of complete liquidation.

(ii) On March 1, 1998, the following sales are made to unrelated purchasers: T sells the assets of its operating division to B for cash and an installment obligation. T sells the stock of X to C for an installment obligation. Y sells all of its assets to D for an installment obligation. Z sells all of its assets to E for cash. The B, C, and D installment obligations bear adequate stated interest and meet the requirements of section 453.

(iii) In June 1998, Y and Z completely liquidate, distributing their respective assets (the D installment obligation and cash) to T. In July 1998, T completely liquidates, distributing to A cash and the installment obligations respectively issued by B, C, and D. The liquidation of T is a liquidation to which section 453(h) applies and the liquidations of Y and Z into T are liquidations to which section 332 applies.

(iv) Because T is in control of Y (within the meaning of section 368(c)), the D obligation acquired by Y is treated as acquired by T pursuant to section 453(h)(1)(E). A is a qualifying shareholder and the installment obligations issued by B, C, and D are qualifying installment obligations. Unless A elects otherwise, A reports the transaction on the installment method as if the cash and installment obligations had been received in an installment sale of the stock of T corporation. Under section 453B(d), no gain or loss is recognized by Y on the distribution of the D installment obligation to T. Under sections 453B(a) and 336, T recognizes gain or loss on the distribution of the B, C, and D installment obligations to A in exchange for A's stock.

*Example 2.* (i) A, a cash-method individual taxpayer, owns all of the stock of P corporation, a C corporation. P owns 30 percent of the stock of Q corporation. The balance of the Q stock is owned by unrelated individuals. On February 1, 1998, P adopts a plan of complete liquidation and sells all of its property, other than its Q stock, to B, an unrelated purchaser for cash and an installment obligation bearing adequate stated interest. On March 1, 1998, Q adopts a plan of complete liquidation and sells all of its property to an unrelated purchaser, C, for cash and installment obligations. Q immediately distributes the cash and installment obligations to its shareholders in completion of its liquidation. Promptly thereafter, P liquidates, distributing to A cash, the B installment obligation, and a C installment obligation that P received in the liquidation of Q.

(ii) In the hands of A, the B installment obligation is a qualifying installment obligation. In the hands of P, the C installment obligation was a qualifying installment obligation. However, in the hands of A, the C installment obligation is not treated as a qualifying installment obligation because P owned only 30 percent of the stock of Q. Because P did not own the requisite 80 percent stock interest in Q, P was not a controlling corporate shareholder of Q (within the meaning of section 368(c)) immediately before the liquidation. Therefore, section 453(h)(1)(E) does not apply. Thus, in the hands of A, the C obligation is considered to be a third-party note (not a purchaser's evidence of indebtedness) and is treated as a payment to A in the year of distribution. Accordingly, for 1998, A reports as payment the cash and the fair market value of the C obligation distributed to A in the liquidation of P.

(iii) Because P held 30 percent of the stock of Q, section 453B(d) is inapplicable to P. Under sections 453B(a) and 336, accordingly, Q recognizes gain or loss on the distribution of the C obligation. P also recognizes gain or loss on the distribution of the B and C installment obligations to A in exchange for A's stock. See sections 453B and 336.

(4) *Installment obligations attributable to certain sales of inventory*—(i) *In general.* An installment obligation acquired by a corporation in a liquidation that satisfies section 453(h)(1)(A) in respect of a broken lot of inventory is not a qualifying installment obligation. If an installment obligation is acquired in respect of a broken lot of inventory and other assets, only the portion of the installment obligation acquired in respect of the broken lot of inventory is not a qualifying installment obligation. The portion of the installment obligation attributable to other assets is a qualifying installment obligation. For purposes of this section, the term *broken lot of inventory* means inventory property that is sold or exchanged other than in bulk to one person in one transaction involving substantially all of the inventory property attributable to a trade or business of the corporation. See paragraph (c)(4)(ii) of this section for rules for determining what portion of an installment obligation is not a qualifying installment obligation and paragraph (c)(4)(iii) of this section for rules determining the application of payments on an installment obligation only a portion of which is a qualifying installment obligation.

(ii) *Rules for determining nonqualifying portion of an installment obligation.* If a broken lot of inventory is sold to a purchaser together with other corporate assets for consideration consisting of an installment obligation and either cash, other property, the assumption of (or taking property subject to) corporate liabilities by the purchaser, or some combination thereof, the installment obligation is treated as having been acquired in respect of a broken lot of inventory only to the extent that the fair market value of the broken lot of inventory exceeds the sum of unsecured liabilities assumed by the purchaser, secured liabilities which encumber the broken lot of inventory and are assumed by the purchaser or to which the broken lot of inventory is subject, and the sum of the cash and fair market value of other property received. This rule applies solely for the purpose of determining the portion of the installment obligation (if any) that

is attributable to the broken lot of inventory.

(iii) *Application of payments.* If, by reason of the application of paragraph (c)(4)(ii) of this section, a portion of an installment obligation is not a qualifying installment obligation, then for purposes of determining the amount of gain to be reported by the shareholder under section 453, payments on the obligation (other than payments of qualified stated interest) shall be applied first to the portion of the obligation that is not a qualifying installment obligation.

(iv) *Example.* The following example illustrates the provisions of this paragraph (c)(4). In this example, assume that all obligations bear adequate stated interest within the meaning of section 1274(c)(2) and that the fair market value of each nonqualifying installment obligation equals its face amount. The example is as follows:

*Example.* (i) P corporation has three operating divisions, X, Y, and Z, each engaged in a separate trade or business, and a minor amount of investment assets. On July 1, 1998, P adopts a plan of complete liquidation that meets the criteria of section 453(h)(1)(A). The following sales are promptly made to purchasers unrelated to P: P sells all of the assets of the X division (including all of the inventory property) to B for \$30,000 cash and installment obligations totalling \$200,000. P sells substantially all of the inventory property of the Y division to C for a \$100,000 installment obligation, and sells all of the other assets of the Y division (excluding cash but including installment receivables previously acquired in the ordinary course of the business of the Y division) to D for a \$170,000 installment obligation. P sells 1/3 of the inventory property of the Z division to E for \$100,000 cash, 1/3 of the inventory property of the Z division to F for a \$100,000 installment obligation, and all of the other assets of the Z division (including the remaining 1/3 of the inventory property worth \$100,000) to G for \$60,000 cash, a \$240,000 installment obligation, and the assumption by G of the liabilities of the Z division. The liabilities assumed by G, which are unsecured liabilities and liabilities encumbering the inventory property acquired by G, aggregate \$30,000. Thus, the total purchase price G pays is \$330,000.

(ii) P immediately completes its liquidation, distributing the cash and installment obligations, which otherwise meet the requirements of section 453, to A, an individual cash-method taxpayer who is its sole shareholder. In 1999, G makes a payment to A of

\$100,000 (exclusive of interest) on the \$240,000 installment obligation.

(iii) In the hands of A, the installment obligations issued by B, C, and D are qualifying installment obligations because they were timely acquired by P in a sale or exchange of its assets. In addition, the installment obligation issued by C is a qualifying installment obligation because it arose from a sale to one person in one transaction of substantially all of the inventory property of the trade or business engaged in by the Y division.

(iv) The installment obligation issued by F is not a qualifying installment obligation because it is in respect of a broken lot of inventory. A portion of the installment obligation issued by G is a qualifying installment obligation and a portion is not a qualifying installment obligation, determined as follows: G purchased part of the inventory property (with a fair market value of \$100,000) and all of the other assets of the Z division by paying cash (\$60,000), issuing an installment obligation (\$240,000), and assuming liabilities of the Z division (\$30,000). The assumed liabilities (\$30,000) and cash (\$60,000) are attributed first to the inventory property. Therefore, only \$10,000 of the \$240,000 installment obligation is attributed to inventory property. Accordingly, in the hands of A, the G installment obligation is a qualifying installment obligation to the extent of \$230,000, but is not a qualifying installment obligation to the extent of the \$10,000 attributable to the inventory property.

(v) In the 1998 liquidation of P, A receives a liquidating distribution as follows:

Item	Qualifying installment obligations	Cash and other property
Cash .....	.....	\$190,000
B note .....	\$200,000	.....
C note .....	\$100,000	.....
D note .....	\$170,000	.....
F note .....	.....	\$100,000
G note <sup>1</sup> .....	\$230,000	\$ 10,000
<b>Total .....</b>	<b>\$700,000</b>	<b>\$300,000</b>

<sup>1</sup>Face amount \$240,000.

(vi) Assume that A's adjusted tax basis in the stock of P is \$100,000. Under the installment method, A's selling price and the contract price are both \$1 million, the gross profit is \$900,000 (selling price of \$1 million less adjusted tax basis of \$100,000), and the gross profit ratio is 90 percent (gross profit of \$900,000 divided by the contract price of \$1 million). Accordingly, in 1998, A reports gain of \$270,000 (90 percent of \$300,000 payment in cash and other property). A's adjusted tax basis in each of the qualifying installment obligations is an amount equal to 10 percent of the obligation's respective face amount.

A's adjusted tax basis in the F note, a non-qualifying installment obligation, is \$100,000, i.e., the fair market value of the note when received by A. A's adjusted tax basis in the G note, a mixed obligation, is \$33,000 (10 percent of the \$230,000 qualifying installment obligation portion of the note, plus the \$10,000 nonqualifying portion of the note).

(vii) With respect to the \$100,000 payment received from G in 1999, \$10,000 is treated as the recovery of the adjusted tax basis of the nonqualifying portion of the G installment obligation and \$9,000 (10 percent of \$90,000) is treated as the recovery of the adjusted tax basis of the portion of the note that is a qualifying installment obligation. The remaining \$81,000 (90 percent of \$90,000) is reported as gain from the sale of A's stock. See paragraph (c)(4)(iii) of this section.

(5) *Installment obligations attributable to sales of certain property*—(i) *In general.* An installment obligation acquired by a liquidating corporation, to the extent attributable to the sale of property described in paragraph (c)(5)(ii) of this section, is not a qualifying obligation if the corporation is formed or availed of for a principal purpose of avoiding section 453(b)(2) (relating to dealer dispositions and certain other dispositions of personal property), section 453(i) (relating to sales of property subject to recapture), or section 453(k) (relating to dispositions under a revolving credit plan and sales of stock or securities traded on an established securities market) through the use of a party bearing a relationship, either directly or indirectly, described in section 267(b) to any shareholder of the corporation.

(ii) *Covered property.* Property is described in this paragraph (c)(5)(ii) if, within 12 months before or after the adoption of the plan of liquidation, the property was owned by any shareholder and—

(A) The shareholder regularly sold or otherwise disposed of personal property of the same type on the installment plan or the property is real property that the shareholder held for sale to customers in the ordinary course of a trade or business (provided the property is not described in section 453(l)(2) (relating to certain exceptions to the definition of dealer dispositions));

(B) The sale of the property by the shareholder would result in recapture income (within the meaning of section 453(i)(2)), but only if the amount of the

recapture income is equal to or greater than 50 percent of the property's fair market value on the date of the sale by the corporation;

(C) The property is stock or securities that are traded on an established securities market; or

(D) The sale of the property by the shareholder would have been under a revolving credit plan.

(iii) *Safe harbor.* Paragraph (c)(5)(i) of this section will not apply to the liquidation of a corporation if, on the date the plan of complete liquidation is adopted and thereafter, less than 15 percent of the fair market value of the corporation's assets is attributable to property described in paragraph (c)(5)(ii) of this section.

(iv) *Example.* The provisions of this paragraph (c)(5) are illustrated by the following example:

*Example.* Ten percent of the fair market value of the assets of T is attributable to stock and securities traded on an established securities market. T owns no other assets described in paragraph (c)(5)(ii) of this section. T, after adopting a plan of complete liquidation, sells all of its stock and securities holdings to C corporation in exchange for an installment obligation bearing adequate stated interest, sells all of its other assets to B corporation for cash, and distributes the cash and installment obligation to its sole shareholder, A, in a complete liquidation that satisfies section 453(h)(1)(A). Because the C installment obligation arose from a sale of publicly traded stock and securities, T cannot report the gain on the sale under the installment method pursuant to section 453(k)(2). In the hands of A, however, the C installment obligation is treated as having arisen out of a sale of the stock of T corporation. In addition, the general rule of paragraph (c)(5)(i) of this section does not apply, even if a principal purpose of the liquidation was the avoidance of section 453(k)(2), because the fair market value of the publicly traded stock and securities is less than 15 percent of the total fair market value of T's assets. Accordingly, section 453(k)(2) does not apply to A, and A may use the installment method to report the gain recognized on the payments it receives in respect of the obligation.

(d) *Liquidating distributions received in more than one taxable year.* If a qualifying shareholder receives liquidating distributions to which this section applies in more than one taxable year,

the shareholder must reasonably estimate the gain attributable to distributions received in each taxable year. In allocating basis to calculate the gain for a taxable year, the shareholder must reasonably estimate the anticipated aggregate distributions. For this purpose, the shareholder must take into account distributions and other relevant events or information that the shareholder knows or reasonably could know up to the date on which the federal income tax return for that year is filed. If the gain for a taxable year is properly taken into account on the basis of a reasonable estimate and the exact amount is subsequently determined the difference, if any, must be taken into account for the taxable year in which the subsequent determination is made. However, the shareholder may file an amended return for the earlier year in lieu of taking the difference into account for the subsequent taxable year.

(e) *Effective date.* This section is applicable to distributions of qualifying installment obligations made on or after January 28, 1998.

[T.D. 8762, 63 FR 4170, Jan. 28, 1998]

**§ 1.453-12 Allocation of unrecaptured section 1250 gain reported on the installment method.**

(a) *General rule.* Unrecaptured section 1250 gain, as defined in section 1(h)(7), is reported on the installment method if that method otherwise applies under section 453 or 453A and the corresponding regulations. If gain from an installment sale includes unrecaptured section 1250 gain and adjusted net capital gain (as defined in section 1(h)(4)), the unrecaptured section 1250 gain is taken into account before the adjusted net capital gain.

(b) *Installment payments from sales before May 7, 1997.* The amount of unrecaptured section 1250 gain in an installment payment that is properly taken into account after May 6, 1997, from a sale before May 7, 1997, is determined as if, for all payments properly taken into account after the date of sale but before May 7, 1997,

unrecaptured section 1250 gain had been taken into account before adjusted net capital gain.

(c) *Installment payments received after May 6, 1997, and on or before August 23, 1999.* If the amount of unrecaptured section 1250 gain in an installment payment that is properly taken into account after May 6, 1997, and on or before August 23, 1999, is less than the amount that would have been taken into account under this section, the lesser amount is used to determine the amount of unrecaptured section 1250 gain that remains to be taken into account.

(d) *Examples.* In each example, the taxpayer, an individual whose taxable year is the calendar year, does not elect out of the installment method. The installment obligation bears adequate stated interest, and the property sold is real property held in a trade or business that qualifies as both section 1231 property and section 1250 property. In all taxable years, the taxpayer's marginal tax rate on ordinary income is 28 percent. The following examples illustrate the rules of this section:

*Example 1.* General rule. This example illustrates the rule of paragraph (a) of this section as follows:

(i) In 1999, A sells property for \$10,000, to be paid in ten equal annual installments beginning on December 1, 1999. A originally purchased the property for \$5000, held the property for several years, and took straight-line depreciation deductions in the amount of \$3000. In each of the years 1999-2008, A has no other capital or section 1231 gains or losses.

(ii) A's adjusted basis at the time of the sale is \$2000. Of A's \$8000 of section 1231 gain on the sale of the property, \$3000 is attributable to prior straight-line depreciation deductions and is unrecaptured section 1250 gain. The gain on each installment payment is \$800.

(iii) As illustrated in the table in this paragraph (iii) of this *Example 1.*, A takes into account the unrecaptured section 1250 gain first. Therefore, the gain on A's first three payments, received in 1999, 2000, and 2001, is taxed at 25 percent. Of the \$800 of gain on the fourth payment, received in 2002, \$600 is taxed at 25 percent and the remaining \$200 is taxed at 20 percent. The gain on A's remaining six installment payments is taxed at 20 percent. The table is as follows: