

(Continued from Page D8)

annual installments of \$4,000 plus interest. The buyer assumes no mortgage, so the contract price is the same as the selling price. The adjusted basis of the machinery is \$8,400. The difference between the adjusted basis and the cost is due to cost recovery (depreciation) deductions of \$11,600.

Gain on the sale is \$3,600; this is a section 1245 gain and is taxed as ordinary income. The entire gain must be reported and is taxed in year one of the installment period.

The basis (undepreciated cost of the machinery), is adjusted in the amount of \$3,600. Therefore, the adjusted basis is \$8,400 plus \$3,600 or \$12,000. This amount equals the sale price, so profit received after the basis adjustment is zero. There is no taxable gain as additional annual installments are received in years two and three.

When there is no section 1245 gain to report (as would be the case

if the asset were not depreciated), the approach is somewhat different. For example, assume that land is sold for \$12,000 and payment includes three installment payments of \$4,000 plus interest. The contract price equals the sale price and the buyer assumes no mortgage. The adjusted basis of the land is \$8,400. The gross profit percentage (the ratio of gross profit to the contract price) is \$3,600 divided by \$12,000, or 30 percent. The share of each \$4,000 payment to be reported as gain is \$4,000 times 0.30 or \$1,200.

In the absence of an installment sale, the transaction described above would have produced gain of \$3,600 in one year. The installment method spreads the gain over three years, permitting maximum use of the standard deduction and personal exemption to offset income and reduce the resulting tax obligation.

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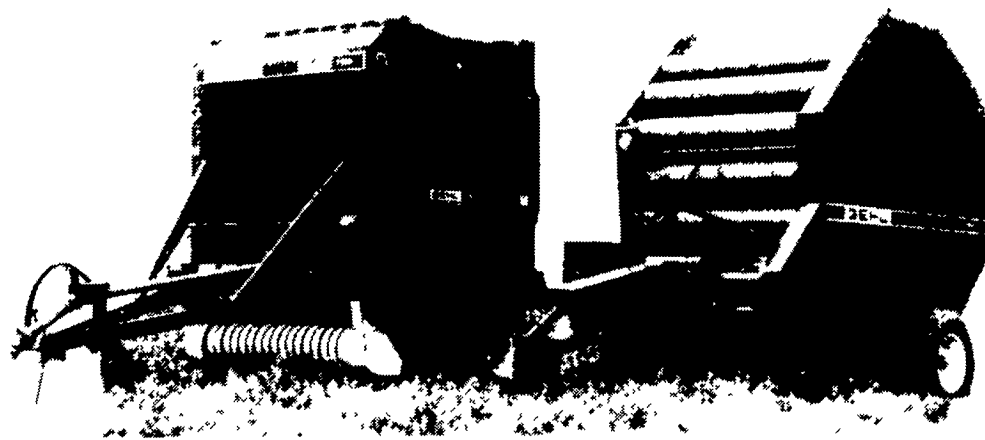
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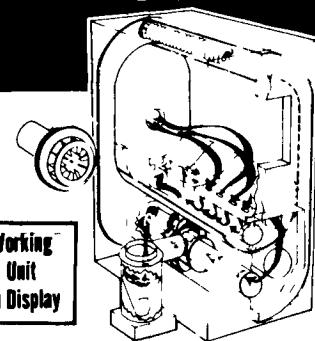
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