

**Internal Revenue Service, Treasury**

**§ 1.453-3**

see section 1033(e) and the regulations thereunder.

[T.D. 7526, 42 FR 64624, Dec. 27, 1977]

**§§ 1.453-1—1.453-2 [Reserved]**

**§ 1.453-3 Purchaser evidences of indebtedness payable on demand or readily tradable.**

(a) *In general.* A bond or other evidence of indebtedness (hereinafter in this section referred to as an obligation) issued by any person and payable on demand shall not be treated as an evidence of indebtedness of the purchaser in applying section 453(b) to a sale or other disposition of real property or to a casual sale or other casual disposition of personal property. In addition, an obligation issued by a corporation or a government or political subdivision thereof—

(1) With interest coupons attached (whether or not the obligation is readily tradable in an established securities market),

(2) In registered form (other than an obligation issued in registered form which the taxpayer establishes will not be readily tradable in an established securities market), or

(3) In any other form designed to render such obligation readily tradable in an established securities market shall not be treated as an evidence of indebtedness of the purchaser in applying section 453(b) to a sale or other disposition of real property or to a casual sale or other casual disposition of personal property. For purposes of this section, an obligation is to be considered in registered form if it is registered as to principal, interest, or both and if its transfer must be effected by the surrender of the old instrument and either the reissuance by the corporation of the old instrument to the new holder or the issuance by the corporation of a new instrument to the new holder.

(b) *Treatment as payment.* If under section 453(b)(3) an obligation is not treated as an evidence of indebtedness of the purchaser, then—

(1) For purposes of determining whether the payments received in the taxable year of the sale or disposition exceed 30 percent of the selling price, and

(2) For purposes of returning income on the installment method during the taxable year of the sale or disposition or in a subsequent taxable year, the receipt by the seller of such obligation shall be treated as a payment. The rules stated in this paragraph may be illustrated by the following examples:

\$250,000 payment (i.e., 250 of corporation Y's registered bonds each with a principal amount and fair market value of \$1,000)	=	25 per cent
\$1 million selling price (i.e., \$250,000 of corporation Y's registered bonds plus promissory note of \$750,000)		

*Example (1).* On July 1, 1970, A, an individual on the cash method of accounting reporting on a calendar year basis, transferred all of his stock in corporation X (traded on an established securities market and having a fair market value of \$1 million) to corporation Y in exchange for 250 of corporation Y's registered bonds (which are traded in an over-the-counter bond market) each with a principal amount and fair market value of \$1,000 (with interest payable at the rate of 8 percent per year), and Y's unsecured promissory note, with a principal amount of \$750,000. At the time of such exchange A's basis in the corporation X stock is \$900,000. The promissory note is payable at the rate of \$75,000 annually, due on July 1, of each year following 1970, until the principal balance is paid. The note provides for the payment of interest at the rate of 10 percent per year also payable on July 1 of each year. Under the rule stated in subparagraph (1) of this paragraph, the 250 registered bonds of corporation Y are treated as a payment for purposes of the 30 percent test described in section 453(b)(2)(A)(ii). The payment on account of the bonds equals 25 percent of the selling price determined as follows:

Since the payments received in the taxable year of the sale do not exceed 30 percent of the selling price and the sales price exceeds \$1,000, A may report the income received on the sale of his corporation X stock on the installment method. A elects to report the income on the installment method. The gross profit to be realized when the corporation X stock is fully paid for is 10 percent of the total contract price, computed as follows: \$100,000 gross profit (i.e., \$1 million contract price less \$900,000 basis in corporation X stock) over \$1 million contract price. However, since subparagraph (2) of this paragraph also treats the 250 corporation Y registered bonds as a payment for purposes of reporting income, A must include \$25,000

(i.e., 10 percent times \$250,000) in his gross income for calendar year 1970, the taxable year of sale.

*Example (2).* Assume the same facts as in example (1). Assume further that on July 1, 1971, corporation Y makes its first installment payment to A under the terms of the unsecured promissory note with 75 more of its \$1,000 registered bonds. A must include \$7,500 (i.e., 10 percent gross profit percentage times \$75,000) in his gross income for calendar year 1971. In addition, A includes the interest payment made by corporation Y on July 1, in his gross income for 1971.

(c) *Payable on demand.* Under section 453(b)(3), an obligation shall be treated as payable on demand only if the obligation is treated as payable on demand under applicable state or local law.

(d) *Designed to be readily tradable in an established securities market*—(1) *In general.* Obligations issued by a corporation or government or political subdivision thereof will be deemed to be in a form designed to render such obligations readily tradable in an established securities market if—

(i) Steps necessary to create a market for them are taken at the time of issuance (or later, if taken pursuant to an expressed or implied agreement or understanding which existed at the time of issuance),

(ii) If they are treated as readily tradable in an established securities market under subparagraph (2) of this paragraph, or

(iii) If they are convertible obligations to which paragraph (e) of this section applies.

(2) *Readily tradable in an established securities market.* An obligation will be treated as readily tradable in an established securities market if—

(i) The obligation is part of an issue or series of issues which are readily tradable in an established securities market, or

(ii) The corporation issuing the obligation has other obligations of a comparable character which are described in subdivision (i) of this subparagraph. For purposes of subdivision (ii) of this subparagraph, the determination as to whether there exist obligations of a comparable character depends upon the particular facts and circumstances. Factors to be considered in making such determination include, but are not limited to, substantial similarity

with respect to the presence and nature of security for the obligation, the number of obligations issued (or to be issued), the number of holders of such obligation, the principal amount of the obligation, and other relevant factors.

(3) *Readily tradable.* For purposes of subparagraph (2)(i) of this paragraph, an obligation shall be treated as readily tradable if it is regularly quoted by brokers or dealers making a market in such obligation or is part of an issue a portion of which is in fact traded in an established securities market.

(4) *Established securities market.* For purposes of this paragraph, the term established securities market includes (i) a national securities exchange which is registered under section 6 of the Securities and Exchange Act of 1934 (15 U.S.C. 78f), (ii) an exchange which is exempted from registration under section 5 of the Securities Exchange Act of 1935 (15 U.S.C. 78e) because of its limited volume of transactions, and (iii) any over-the-counter market. For purposes of this subparagraph, an over-the-counter market is reflected by the existence of an interdealer quotation system. An interdealer quotation system is any system of general circulation to brokers and dealers which regularly disseminates quotations of obligations by identified brokers or dealers, other than a quotation sheet prepared and distributed by a broker or dealer in the regular course of his business and containing only quotations of such broker or dealer.

(5) *Examples.* The rules stated in this paragraph may be illustrated by the following examples:

*Example (1).* On June 1, 1971, 25 individuals owning equal interests in a tract of land with a fair market value of \$1 million sell the land to corporation Y. The \$1 million sales price is represented by 25 bonds issued by corporation Y each having a face value of \$40,000. The bonds are not in registered form and do not have interest coupons attached, and, in addition, are payable in 120 equal installments each due on the first business day of each month. In addition, the bonds are negotiable and may be assigned by the holder to any other person. However, the bonds are not quoted by any brokers or dealers who deal in corporate bonds, and, furthermore, there are no comparable obligations of corporation Y (determined with reference to the characteristics set forth in subparagraph (2) of this paragraph) which are so quoted.

Therefore, the bonds are not treated as readily tradable in an established securities market. In addition, under the particular facts and circumstances stated, the bonds will not be considered to be in a form designed to render them readily tradeable in an established securities market. Since the bonds are not in registered form, do not have coupons attached, are not in a form designed to render them readily tradable in an established securities market, the receipt of such bonds by the holder is not treated as a payment for purposes of section 453(b), notwithstanding that they are freely assignable.

*Example (2).* On April 1, 1972, corporation M purchases in a casual sale of personal property a fleet of trucks from corporation N in exchange for corporation M's negotiable notes, not in registered form and without coupons attached. The corporation M notes are comparable to earlier notes issued by corporation M, which notes are quoted in the Eastern Bond section of the National daily quotation sheet, which is an interdealer quotation system. Both issues of notes are unsecured, held by more than 100 holders, have a maturity date of more than 5 years, and were issued for a comparable principal amount. On the basis of these similar characteristics it appears that the latest notes will also be readily tradable. Since an interdealer system reflects an over-the-counter market, the earlier notes are treated as readily tradable in an established securities market. Since the later notes are obligations comparable to the earlier ones, which are treated as readily tradable in an established securities market, the later notes are also treated as readily tradable in an established securities market (whether or not such notes are actually traded).

(e) *Special rule for convertible securities*—(1) *General rule.* For purposes of paragraph (d)(1) of this section, if an obligation contains a right whereby the holder of such obligation may convert it directly or indirectly into another obligation which would be treated as a payment under paragraph (b) of this section or may convert it directly or indirectly into stock which would be treated as readily tradable or designed to be readily tradable in an established securities market under paragraph (d) of this section, the convertible obligation shall be considered to be in a form designed to render such obligation readily tradable in an established securities market unless such obligation is convertible only at a substantial discount. In determining whether the stock or obligation, into which an obligation is convertible, is readily

tradable or designed to be readily tradable in an established securities market, the rules stated in paragraph (d) of this section shall apply, and for purposes of such paragraph (d) if such obligation is convertible into stock then the term "stock" shall be substituted for the term "obligation" whenever it appears in such paragraph (d).

(2) *Substantial discount rule.* Whether an obligation is convertible at a substantial discount depends upon the particular facts and circumstances. A substantial discount shall be considered to exist if at the time the convertible obligation is issued, the fair market value of the stock or obligation into which the obligation is convertible is less than 80 percent of the fair market value of the obligation (determined by taking into account all relevant factors, including proper discount to reflect the fact that the convertible obligation is not readily tradable in an established securities market and any additional consideration required to be paid by the taxpayer). Also, if a privilege to convert an obligation into stock or an obligation which is readily tradable in an established securities market may not be exercised within a period of 1 year from the date the obligation is issued, a substantial discount shall be considered to exist.

(f) *Effective date.* The provisions of this section shall apply to sales or other dispositions occurring after May 27, 1969, which are not made pursuant to a binding written contract entered into on or before such date. No inference shall be drawn from this section as to any question of law concerning the application of section 453 to sales or other dispositions occurring on or before May 27, 1969.

[T.D. 7197, 37 FR 13532, July 11, 1972]

#### § 1.453-4 Sale of real property involving deferred periodic payments.

(a) *In general.* Sales of real property involving deferred payments include (1) agreements of purchase and sale which contemplate that a conveyance is not to be made at the outset, but only after all or a substantial portion of the selling price has been paid, and (2) sales in which there is an immediate transfer of title, the vendor being protected by a