

Installment Sales

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Zack sold his investment property to Nicholas for \$150,000. Zack's investment property had a mortgage on it of \$50,000 that Nicholas assumed. Nicholas will pay the remaining \$100,000 in 10 equal annual installments of \$10,000, plus interest. Zack's basis in his investment property was \$75,000 and he had no selling expenses.

Zack's gross profit is \$75,000 (\$150,000 less his basis of \$75,000). The selling price of \$150,000 is reduced by the mortgage assumed by Nicholas of \$50,000 to arrive at a contract price of \$100,000. Zack's gross profit percentage is 75% (profit of \$75,000 divided by contract price of \$100,000).

When Zack receives his annual payment of \$10,000 plus interest he will report the interest received as interest income, \$7,500 (75% of each \$10,000 annual payment) as gain attributable to the sale and \$2,500 (\$10,000 - \$7,500) as recovery of basis.

Installment sales are rarely this cut and dry. In reality, they are usually much more complex, which is why you should always seek the advice of a qualified tax professional when you are involved in an installment sale.

For example, if interest was not paid in addition to the \$10,000 annual payment then interest must be imputed prior to computing the portion attributable to gain and basis.

If the mortgage was greater than Zack's basis in the property than Zack's gross profit would be 100%.

Gina L. Gwozdz is a CPA who has chosen to specialize in taxes. Visit her website at <http://GLGcpa.com> to view more Tax Tip Articles.