

Installment Sale Proposal

In light of the downturn in the real estate market coupled with the President and Congress's efforts to pass a stimulus package, we would like to propose a change in the tax code that will move the economy onto more solid footing. Changing the tax code to allow builders and rehabbers (groups defined as "dealers" under the Internal Revenue Code), to use installment sale tax treatment would benefit all parties involved along with the nation as a whole.

Prior to the "Tax Reform Act of 1986,, investors, builders, dealers and rehabbers were allowed to elect Installment Sale Tax Treatment. Briefly stated, Installment Sale Tax Treatment allowed any person or entity to hold a note and receive payments over an extended period, and pay the tax owed as the money is received. The Tax Reform Act of 1986 disallowed "dealers" and builders" from enjoying this tax treatment. From that point to the present, the entire tax is due in the year of sale, without any regard as to when the profit was actually received.

For example, a property in need of repair is purchased for \$100,000. It needs \$40,000 in repairs and after fix up will be worth \$175,000. Prospective buyers love the property and would like to purchase it. They have \$15,000 to put down. The bank will lend them \$125,000 for a total of \$140,000. The rehabber/seller would be willing to receive their profit over time by taking back a second mortgage of \$35,000 in monthly installments, for instance \$275.00 over 15 years.

If the property closing takes place in January, the seller/rehabber will receive \$3,300 in payments ($\275×12). If they are in the 30% tax bracket they will owe in Federal taxes \$10,500. Since they only took in \$3,300 they will have to come up with \$7,200 in additional taxes. This punitive situation has kept many from holding notes and mortgages. Another concern is if the buyer defaults, the seller/note holder will have to amend their tax return, as they did not receive the anticipated profit that was reported.

Banks, credit card issuers, etc. are allowed to pay tax on income as it is realized. We believe this allowance should be extended to businesses in the real estate and construction industries as well.

Many builders and rehabbers would welcome the opportunity to create notes and mortgages if they were allowed to pay the tax in the year that the money is actually received. It would help them create a solid predictable cash flow to even out their business activities, thereby helping to keep the national economy on a pro-growth path.

The following are some examples of the positive benefits that allowing for Installment Sale Tax Treatment will create.

Stabilize the Balance Sheets of Financial Institutions – with private parties (rehabbers and builders) holding mortgages, many of which would be in a junior lien position, notes and mortgages issued by financial institutions would be more secure. The financial institution's notes would have a lower loan to value ratio, resulting in more safety and liquidity.

Financial Institutions Exposure to Foreclosures - with private parties holding junior liens and wishing to protect their investment, if the home owner / mortgagor gets into financial distress, these private parties would be better equipped to deal with the situation on a more personal, results oriented basis. This will have the effect of providing an extra degree of safety for the financial institutions first (superior) mortgages.

Lower Risk to Fannie Mae and Freddie Mac – As the loans insured by Fannie Mae and Freddie Mac carry a lower LTV ratio, they would be of less risk and higher quality thereby putting less strain on their portfolio. They would have more access to capital. Risk would be spread among the thousands of investors who will be holding the second mortgages, not to the government, its quasi-government agencies, and the taxpayers.

Strengthen the Financial Health of Builders and Rehabbers– By allowing Installment Sale Tax Treatment to be taken by Builders and Rehabbers, more properties could be sold quickly, creating a safe predictable cash flow and a more stable tax base.

Improvement in the Nation’s Housing Stock – By allowing rehabbers to elect installment sale tax treatment, properties in rundown neglected areas would be rehabbed, thereby creating jobs and economic growth in these communities, increasing property values and it would be done with private dollars. Taxpayer exposure would be minimized and blighted communities would spring back to life as vibrant, desirable neighborhoods.

Create Employment Opportunities in Construction and Ancillary Businesses – by allowing builders and rehabbers to use elect installment sale tax treatment, the number of new houses and renovations will rise. This will create jobs; in the construction trades, for manufacturers of building materials, building supply dealers, real estate, property managers, bookkeepers, etc.

Stabilization of Real Estate Values allowing for a Steady and More Predictable Tax Base – with financing more plentiful and risk diminished, property values throughout the nation will have a more solid foundation and can avoid precipitous ups and downs. The result? A more predictable and stable appreciation of values that will create a more stable tax base.

Help Keep Home Ownership Levels High – With the builders and rehabbers able and willing to provide some of the financing available, the number of Americans that will be able to own their own home will increase.

Increase Government Revenues – With a change in the tax code, thousands of builders, rehabbers, investors and dealers, throughout the nation would be ready, willing and able to buy, renovate and improve properties. Tax revenue will increase exponentially and flow into the government coffers. The tax rate would be based on “ordinary income” and paid as it is received.

Because of the above inequity in tax treatment over the last twenty years, many investors, dealers, builders and rehabbers have passed on many potential opportunities that could have resulted in “win-win” situations for all parties involved. By once again allowing groups to elect and take installment sale tax treatment, all parties will benefit.

Thank you for your consideration.

Yours truly,

David Corsi

Vice President, New Jersey Association of Real Estate Professionals