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Department of the Treasury

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Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

CC:ITA:B04

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Date:

October 21, 2009

LEGEND

State =

Group =

Program =

Office =

Entity =

Fund =

Condition =

Industry =

Year 1 =

Year 2 =

P =

B =

C =

D =

E =

F =

G =

H =

S =

T =

U =

V =

\$w =

\$x =

\$y =

\$z =

Dear \_\_\_\_\_ :

This is in reply to Entity's request for a ruling that \$x grants it makes to or on behalf of P who purchase a B under Program are not subject to information reporting under § 6041 of the Internal Revenue Code because the payments are a purchase price reduction or are excluded from P's income under the general welfare exclusion.

#### FACTS

In Year 1, the governor of State formed Group to assess actions that could be taken quickly to address Condition. Group recommended a \$w Fund as the preferred economic stimulus for State's economy, and Industry in particular. Based on Group's recommendation, State enacted Program in Year 2 to address Condition.

Program, which is administered by Office and Entity, a public corporation of State, offers a \$x grant to P who purchase a B. P must occupy the B as a C within V days following the purchase. In addition, P must either (i) pay cash for the B or (ii) qualify for a D from a lender participating in Program and be financially able to pay for E. Entity does not work directly with P unless they pay cash for a B. P do not have to be first-time P, but they cannot already own F.

Under Program, P's adjusted gross income must not exceed \$y for single individuals or \$z for married couples. The Group and the State legislature were of the view that restricting participation in Program to lower income persons would not produce the desired result of reducing Condition. Entity represents that final statistics for Program reflect that the median income of P who received grants was U percent of the state wide median income figure published by the U.S. Department of Housing and Urban Development based on a family of four persons.

The G for transactions for the purchase by P of a B is scheduled at a H. When the G documents have been signed, the H faxes the required documents to Entity and requests Entity to wire the \$x grant to the G.

Entity's view is that the \$x grants are not gross income to P either as purchase price reductions or under the general welfare exclusion. Entity asserts that treating its contribution of a \$x grant at closing for the benefit of P as a purchase price reduction is consistent with the judicial and administrative precedents discussed below. In addition, Entity's view is that the \$x grants are excluded from income under the general welfare exclusion because Program promotes the general welfare of State residents by stimulating the Industry, a key sector in State's economy and by benefitting participants who are principally persons of low and moderate income. We do not agree.

## LAW AND ANALYSIS

### *Purchase Price Reduction*

Section 61(a) provides that, except as otherwise provided, gross income means all income from whatever source derived. Under § 61, Congress intends to tax all gains and undeniable accessions to wealth, clearly realized, over which taxpayers have complete dominion. *Commissioner v. Glenshaw Glass Co.*, 348 U.S. 426 (1955), 1955-1 C.B. 207; Rev. Rul. 2005-46, 2005-2 C.B. 120. Governmental grants are includible in gross income under § 61 unless excluded from gross income by law. See Rev. Rul. 85-39, 1985-1 C.B. 21 (dividend payments Alaska makes to all adult residents to encourage them to remain in the state and thereby reduce social, economic and political instability are gross income under § 61).

*Freedom Newspapers, Inc. v. Commissioner*, T.C. Memo. 1977-429, involves a payment by a seller's broker to a purchaser that the court found to be part of the

purchase transaction between the seller and the purchaser of newspapers. The seller insisted on the sale of a group of newspapers, one of which the purchaser did not wish to purchase. Because the seller's broker's commission depended on selling the entire group of newspapers, the broker induced the purchaser to purchase the entire group of newspapers by agreeing to pay the purchaser \$100,000 unless the broker resold one of the newspapers at purchaser's cost within one year of closing. The broker paid the purchaser \$100,000 when the broker was unable to sell the newspaper at the agreed price. The court held that the \$100,000 was not income to the purchaser, but rather a purchase price reduction that reduced the purchaser's basis in the purchased property, because the agreement with the seller's broker was intended to and succeeded in inducing the purchaser's purchase.

*Worden v. Commissioner*, 2 F.3d 359 (10<sup>th</sup> Cir. 1993), *rev'g on other grounds* T.C. Memo 1992-447, *on remand*, T.C. Memo 1994-193, involved commissions waived by an insurance agent who, pursuant to contracts with clients, paid only the net premiums to the insurance company. Because the agent contractually waived his right to a commission, the court held that the agent never had actual or constructive receipt of the commissions, and, therefore, were not gross income to him. The court analogized these facts to a situation in which a "real estate broker cuts his normal agent's commission to make a sale of real property." 2 F.3d at 362.

Rev. Rul. 76-96, 1976-1 C.B. 23, suspended on another issue by Rev. Rul. 2008-26, 2008-21 I.R.B. 985, addresses the tax treatment of rebates an automobile manufacturer paid to retail customers. The manufacturer paid rebates to its dealer's retail customers who independently negotiated at arm's length with the dealer to arrive at a purchase price for the new automobiles. The ruling holds that the rebates represent an adjustment to the purchase price of the automobiles and are not includible in a customer's gross income.

Rev. Rul. 2006-27, 2006-1 C.B. 915, addresses a situation in which a nonprofit corporation makes grants to low-income individuals and families to provide all or part of the funds they need to make a downpayment on a home. In substantially all of the cases in which the nonprofit corporation makes the grants, it receives a payment from a home seller. The amount of the home seller payment to the nonprofit corporation directly correlates to the amount of the grant that the nonprofit corporation makes to the individual or family. The ruling holds that the grants are purchase price reductions and, thus, are not includible in the grant recipients' gross income.

Rev. Rul. 2008-26, clarifying and superseding Rev. Rul. 2005-28, 2005-1 C.B. 997, involves Medicaid rebates a drug manufacturer pays to a state Medicaid agency. Federal law requires drug manufacturers to sign a "rebate agreement" with the U.S. Department of Health and Human Services to gain access the Medicaid-funded portion of the pharmaceutical market. The "rebate agreement" requires the drug manufacturer to pay to state Medicaid agencies a portion of the price that the agencies pay retailers

for certain drugs dispensed to Medicaid beneficiaries. The ruling holds that the Medicaid rebates are purchase price adjustments because the payments are made with the purpose and intent of reaching an agreed upon net selling price, and the agreements providing for such payments are negotiated and agreed to before the sale from the manufacturer to the wholesaler takes place.

In each of the situations described above, a party to the transaction took action to induce the sale of property by reducing the sales price directly (by reducing or rebating part of the sales price) or indirectly (by foregoing or rebating commissions that were dependent on the sale of the property). By contrast, Entity is not a party to the sales transactions, and the \$x grants do not affect the amount received by any seller, lender, broker, or other party to the purchase by P of a B. Each party to a sale receives the full amount that is due to them; no party receives less to induce the sale of a B to P. Thus, the \$x grants are a cash subsidy Entity makes to P, not a purchase price reduction of a B that P purchase.

#### *General Welfare Exclusion*

Although § 61 provides for broad includibility in gross income, the Service has consistently held that payments to individuals by governmental units under legislatively provided social benefit programs for the promotion of general welfare are not includible in the recipient's gross income. To qualify under the general welfare exclusion, payments must (i) be made from a governmental fund, (ii) be for the promotion of the general welfare (*i.e.*, generally based on individual or family needs), and (iii) not represent compensation for services. Rev. Rul. 2005-46. In *Bailey v. Commissioner*, 88 T.C. 1293, 1300 (1987), *acq. on another issue*, 1989-2 C.B. 1, the court noted that the general welfare exclusion has been applied when "the grant was received under a program requiring the individual recipient to establish need" and that the exclusion did not apply to "grants received under social welfare programs that did not require recipients to establish individual need...."

Thus, the general welfare exclusion does not apply to governmental payments to individuals without regard to their financial status, health, educational background, or employment status, see Rev. Rul. 85-39 (dividend payments made by a state to all adult residents regardless of need), or generally to payments to businesses (see Rev. Rul. 2005-46).

Program was created "as the preferred economic stimulus for the State economy, in general, and [Industry] in particular" and to reduce Condition. That Program is intended to benefit all State residents by stimulating the Industry in State is not itself sufficient for the \$x grants made to P to qualify under the general welfare exclusion. To qualify under the general welfare exclusion the \$x Program grants must be made to individuals based on individual need. See Rev. Rul. 2005-46 and *Bailey*.

Here, Group and the state legislature did not restrict Program grants to lower income individuals because to do so would not have produced the desired result of reducing Condition. Entity has not indicated that the purpose of Program is to help needy P purchase a B. In fact, Program participants either must pay cash for a B or be sufficiently financially solvent to obtain a D and pay for E. Thus, the \$x grants are not made to individuals based on financial need. Instead, individuals qualify for a grant only if they have financial ability to pay.

In addition, nearly S percent of married couples and over T percent of unmarried individuals meet the income limitations of Program. These income limitations, standing alone, do not establish need. Thus, Program is similar to programs under which payments are made to state residents regardless of financial status, health, educational background, or employment status. See Rev. Rul. 76-131, 1976-1 C.B. 16 (bonuses paid by state to long-time senior citizen residents not excludable as general welfare because the program is not needs based); see *also* Rev. Rul. 85-39. Therefore, the \$x grants that Entity makes to P under Program do not qualify for exclusion from income under the general welfare exclusion.

#### *Conclusions under § 61*

Because the \$x grants are not purchase price reductions or excluded from income under the general welfare exclusion, they are includible in the gross income of P under § 61.

#### *Information Reporting*

Section 6041(a) and § 1.6041-1(a)(1)(i) of the Income Tax Regulations provide, with exceptions not applicable here, that all persons engaged in a trade or business and making payment in the course of such trade or business to another person of rent, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, or other fixed or determinable gains, profits, and income, aggregating \$600 or more in the taxable year must file an information return with the Internal Revenue Service. By § 6041(d), the payor is required to furnish an information statement to the payee. For payments of \$600 or more, § 1.6041-1(d)(2) requires a payor to report on Forms 1096 and 1099.

The § 6041 information reporting requirement applies to payments made during the calendar year to another person of “fixed or determinable income.” Section 1.6041-1(a). Section 1.6041-1(c) provides that income is fixed when paid in amounts definitely predetermined. Income is determinable whenever there is a basis of calculation by which the amount to be paid may be ascertained.

Information reporting requirements may also apply to payments made by the United States or a state. Section 1.6041-1(i) provides, in part, that information returns on

Forms 1096 and 1099 of payments made by a state, or political subdivision, agency or instrumentality thereof, shall be made by the officer or employee of such state or political subdivision, agency or instrumentality thereof, having control of such payments or by the officer or employee appropriately designated to make such returns.

Each \$x grant that Entity, which is described in § 1.6041-1(i), pays to or on behalf of P is gross income to P that is fixed in amount under § 1.6041-1(c). In addition, each grant is \$600 or more.

## CONCLUSION

Because the \$x grants Entity makes to or on behalf of P under Program are includible in P's gross income, Entity is subject to the information reporting requirements of § 6041(a) and (d) for the \$x grant payments.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

The rulings contained in this letter are based upon information and representations that Entity submitted under penalties of perjury. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Entity must attach to any income tax return to which it is relevant a copy of this letter or, if it files its returns electronically, a statement providing the date and control number of this letter ruling.

In accordance with the Power of Attorney on file with this office, we are sending a copy of this letter to your authorized representative.

Sincerely,

Michael J. Montemurro  
Branch Chief  
Office of Associate Chief Counsel  
(Income Tax & Accounting)

cc: