Internal Revenue Service

Number: **201016043**
Release Date: 4/23/2010

Index Number: 3121.01-00, 3306.02-00, 3401.02-00

Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable
Person To Contact:

Telephone Number:

Refer Reply To:
CC:TEGE:EOEG:ET2
PLR-143722-09
Date:
January 07, 2010

Legend:

Taxpayer =
Programs =
Program 1 =
Program 2 =
State X =
Date A =

Dear :

This is in response to your letter of September 30, 2009, requesting a ruling concerning whether the amount of indebtedness that the Taxpayer forgives under its Programs is includable in the incomes of the Program participants under section 108(f) of the Internal Revenue Code (the Code) and whether such amount constitutes wages subject to income tax withholding under section 3401(a).

Issues:

Whether amounts of indebtedness discharged under the Taxpayer's Programs, as further described below, are excludable from the gross incomes of the Program participants under Code section 108(f).

Whether the amounts of indebtedness discharged under the Taxpayer's Programs are wages subject to income tax withholding pursuant to Code section 3401(a).

Conclusions:

Assuming the Taxpayer's Programs are operated substantially as described, we conclude that loans under the programs are "student loans" within the meaning of Code section 108(f)(2), that the terms of such loans satisfy the requirements of section 108(f)(1), and that amounts of indebtedness discharged under the Programs are excludable from the gross incomes of the program participants under section 108(f) of the Code. Further, we conclude that the amounts discharged do not represent compensation for services within the contemplation of Code section 61(a).

For federal income tax withholding purposes the amounts of indebtedness discharged under the Taxpayer's Programs are not includible in Program participant wages pursuant to Code section 3401.

Facts:

The Taxpayer is a non-profit, statewide association representing and serving the needs of State M's community health centers. The Taxpayer has been recognized as exempt from federal income tax under Code section 501(c)(3), and is a public charity described in section 170(b)(1)(A)(vi). A letter from the IRS issued on Date A, verifies the exempt status of the Taxpayer as a section 501(c)(3) organization. The Taxpayer furthers its charitable purpose of promoting health by providing a wide range of activities, including the providing of assistance to community health centers and serving as an information source on community-based health care to policymakers, opinion leaders, and the media, and works to strengthen the state's community health center network through comprehensive technical assistance, training and education, workforce development, information dissemination, community development and advocacy.

State M community health centers provide primary, preventive, and dental care, as well as mental health, substance abuse, and other community-based services, to persons in need regardless of their insurance status or ability to pay. In addition to providing comprehensive health services to underserved individuals, community health centers facilitate access to health insurance coverage for low-income residents and attempt to eliminate health disparities between racial and ethnic populations.

In furtherance of its charitable endeavors, the Taxpayer has established Programs, currently consisting of Program 1 and Program 2. These programs were established by the Taxpayer in order to increase the capacity of State M community health centers to provide primary care by enhancing the availability of primary care physicians, nurse practitioners, and certified nurse-midwives (primary care clinicians). It is anticipated that by easing educational debt burdens, more primary care clinicians will choose primary care practice, and commit to working at community health centers providing primary health care services to medically underserved and uninsured patients of State M.

The Programs are open to primary care clinicians who have completed their training and are not currently working at a State M community health center but have a hire date within one year of their application date, and medical students, interns, and residents still in training. An eligible applicant must commit to working full time at an eligible State M community health center for at least two years, and must have one or more eligible educational loans. Primary care clinicians, medical students, interns, and residents selected for participation in the programs must demonstrate a commitment to a career in primary care practice and work in communities of need, volunteerism, and service to underserved communities or special populations.

For purposes of the program, eligible educational loans consist of governmental and commercial loans obtained by the participant for reasonable and related undergraduate and graduate student educational and living expenses, including tuition, fees, books and supplies, educational equipment and materials, room, board, and transportation and commuting expenses, etc. If an eligible educational loan is consolidated or refinanced with other non-education related debt, the loan will not be eligible for the Programs.

If accepted into a Program, a participant enters into a loan repayment program contract, in which the participant agrees to repay the loan advanced by the Taxpayer, or fulfill the required service to qualify for loan forgiveness. Under the contact, the participant agrees to provide primary health care services to approved community health centers with a mission to serve underserved populations and communities, all of which centers are organizations exempt from federal income tax under Code section 501(c)(3) or are licensed under and part of a section 501(c)(3) organization, for a period of obligated service. The period of obligated service is either two or three years. In return for the participant's agreement to perform the obligated service, the Taxpayer agrees to make a forgivable loan to the participant to be used to repay the participant's original qualifying educational loan, in an amount up to $25,000 per year of obligated service, i.e., to a maximum of $75,000 for a three-year service obligation. The Taxpayer repays the original educational loan(s), as an upfront payment. In no event will the amount repaid exceed the participant's outstanding educational loan indebtedness. Although the Taxpayer administers the Programs, participants do not perform services for the Taxpayer, nor are they employed by the Taxpayer, but rather by a selected community health center.

If, for any reason, a participant fails to complete the period of obligated service, he or she will be liable to the Taxpayer for the total amount paid by the Taxpayer to or on behalf of the participant under the contract, plus interest retroactive to the date Taxpayer made the payment, at a specified (penalty) rate, payable within one year of Taxpayer's determination of the participant's breach of his or her contract obligations.

Law and Analysis:

Code section 61(a) provides that, except as otherwise provided by law, gross income means all income from whatever source derived, including income from compensation for services, and income from the discharge of indebtedness. Under section 61, Congress intends to tax all gains or 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.

Code section 108(f)(1) provides that, in the case of an individual, gross income does not include any amount which, (but for section 108(f)) would be includible in gross income by reason of the discharge (in whole or in part) of any student loan if such discharge was pursuant to a provision of such loan under which all or a part of the indebtedness of the individual would be discharged if the individual worked for a certain period of time, in certain professions (including, specifically, medicine and nursing), for any of a broad class of employers.

Code section 108(f)(2) defines a "student loan" for purposes of section 108(f) to include any loan to an individual to assist the individual in attending an educational organization described in section 170(b)(1)(A)(ii) (describing, generally, a "school") made by certain governmental entities or public benefit corporations. The definition of a "student loan" in section 108(f) was substantially expanded by The Taxpayer Relief Act of 1997, P.L. 105-34 (Act), which added section 108(f)(2)(D), providing that the term includes loans made by educational organizations themselves, if, in relevant part, the loans were made pursuant to a program of such educational organization which is designed to encourage its students to serve in occupations with unmet needs or in areas with unmet needs and under which the services provided by the students (or former students) are for or under the direction of a governmental unit or an organization described in section 501(c)(3) and exempt from tax under section 501(a) [section 108(f)(2)(D)(ii)]. The Act further provided that the term "student loan" includes any loan made by an organization exempt from tax under section 501(a) to refinance a loan [including any existing student loan] to an individual to assist the individual in attending any such educational organization but only if the refinancing loan is pursuant to a program of the refinancing organization which is described in section 108(f)(2)(D)(ii). The legislative history to the Act indicates that, in the case of loans made or refinanced by those tax-exempt organizations, the student's work must fulfill a "public service requirement."

Revenue Ruling 2008-34, 2008-28 I.R.B. 76, illustrates an example of a qualifying (law school) loan repayment assistance program operated by an organization described in Code section 170(b)(1)(A)(ii). The loan repayment assistance program in the instant case is substantially similar to that considered in Rev. Rul. 2008-34. The Taxpayer's programs fall squarely within the parameters of Code sections 108(f)(1) and 108(f)(2)(D)(ii). Our analysis and review of the Taxpayer's Programs indicates that loans under the Programs are "student loans" within the meaning of section 108(f)(2), that the terms of such loans satisfy the requirements of section 108(f)(1), and that the

amounts of indebtedness discharged under the Programs are excludable from the gross incomes of the program participants under section 108(f).

Amounts of discharged indebtedness excluded from gross income under Code section 108(f)(1) do not represent "compensation for services" within the contemplation of section 61(a): the discharges addressed under section 108(f)(1) are not made by reason of the performance of services for a particular employer or employers, but by reason of the public service commitment attendant on the repayment agreement.

The legislative history to the section [section 1076 of the Deficit Reduction Act of 1984, Pub. L. 98-369] states that: "... to minimize any elements of compensation in loan cancellation arrangements, Congress believed that the requirements for the exclusion should … provide that the loan cancellation could only be conditioned on the performance of services for a specified, broad class of employers (i.e., could not be conditioned on the performance of services for a specified employer or for one of a limited number of employers." And further, that "[t]he reference to broad classes of employers is designed to require that the loan agreement encourage the performance of services in areas of need without serving as indirect compensation from a specified employer or employers." *Contrast* the student loan discharges described in Code section 108(f)(1) with the loan repayments described in section 108(f)(4).

Code section 3402(a) imposes on every employer a requirement to withhold federal income tax equal to a percentage of wages paid with respect to employment. For purposes of income tax withholding, the term "employer" means the person for whom an individual performs services as an employee. However, section 3401(d)(1) provides that, if the person for whom services are performed does not have control of the payment of wages, the term "employer" means the person having control of the payment of such wages.

Code section 3401(a) provides with certain exceptions that for federal income tax withholding purposes the term "wages" means all remuneration for employment, including the cash value of all remuneration (including benefits) paid in any medium other than cash.

As discussed in detail above, amounts of indebtedness discharged under the Taxpayer's Programs are excludable from the gross income of the Program participant's under Code section 108(f). Income tax withholding is imposed on remuneration paid by an employer only to the extent that an employee recognizes income.[1] Accordingly, compensation excludable from income is not considered wages under section 3401(a). See, for example, Rev. Rul. 56-632, 1956-2 C.B. 101. This is consistent with the legislative history of sections 3401-3404, which indicates that a purpose of income tax

[1] Requiring federal income tax withholding on amounts not includible in income could result in over-withholding and, in certain cases, would require the filing of a Form 1040, U.S. Individual Tax Return, in order to obtain a refund when filing is not otherwise required.

withholding is to enable individual to pay income tax in the year in which the income is earned. H.R. Cong. Rep. No. 510, 78th Cong., 1st Sess. at 1 (1943); H.R. Rep. No. 401, 78th Cong, 1st Sess. At 1 (1943); and S. Rep. No. 221 78th Cong., 1st Sess. at 1 (1943). Therefore, because the amounts of indebtedness discharged under the Taxpayer's Programs are excludable from income, such amounts are not considered wages under section 3401(a) and are not subject to income tax withholding.

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

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representatives.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. 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.

Sincerely,

Lynne Camillo
Branch Chief, Employment Tax Branch 2 (Exempt Organizations/Employment Tax/Government Entities)
(Tax Exempt & Government Entities)

cc: