

Internal Revenue Service

Number: **200519002**

Release Date: 5/13/2005

Index Number: 61.00-00, 61.13-07, 61.13-00,
61.44-00, 61.44-01, 111.00-
00, 111.06-00, 6041.00-00

Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

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Refer Reply To:
CC:ITA:B05
PLR-101064-04

Date:
January 19, 2005

LEGEND:

City =
State =
City Code =

Dear _____ :

This letter responds to your ruling request submitted on behalf of City by a letter dated November 26, 2003, as supplemented on January 30, 2004. Your request relates to whether City is required to file information returns for property, sales, and food and beverage tax rebate payments made as development incentives. The reporting requirement for these payments depends in part upon whether the rebates in issue are taxable income to the recipients; consequently, the necessary analysis of the taxable nature of the payments to the recipients is herein included.

BACKGROUND

City is a municipal government incorporated under the laws of State. As a development incentive, City rebates property, sales, and food and beverage taxes to businesses that agree to locate within the City's corporate limits. The property taxes to be rebated are those imposed by the City and collected through a levy process administered by the overlapping county. The sales taxes to be rebated are imposed by the State and shared between the State and various local government entities. State distributes monthly a portion of the sales tax to the various local government entities including City. The food and beverage taxes to be rebated are taxes imposed by the City "upon the privilege of purchasing food items or alcoholic liquor served or prepared at either a restaurant or liquor establishment in the city, and upon the privilege of purchasing alcoholic liquor at any liquor

establishment[.]” City Code. The food and beverage tax is collected by the business at the point of sale and is remitted monthly to the City.

LAW AND ANALYSIS

Section 61(a) of the Internal Revenue Code provides that, except as otherwise provided in subtitle A, gross income means all income from whatever source derived. See also section 1.61-1(a) of the Income Tax Regulations.

Section 111(a) of the Code provides that gross income does not include income attributable to the recovery during the taxable year of any amount deducted in any prior taxable year to the extent such amount did not reduce the amount of tax imposed by chapter 1 of subtitle A. This section constitutes the codification of the so-called "exclusionary" portion of the tax benefit rule. The balance of the tax benefit rule, the "inclusionary" portion, has been described in different ways, but it does not always require an actual recovery. The consolidated cases of Hillsboro National Bank v. Commissioner and United States v. Bliss Dairy, Inc., 460 U.S. 370 (1983), represent the Supreme Court's latest analysis of the tax benefit rule. The tax benefit rule is a judicially developed principle that modifies the annual accounting doctrine under specific circumstances. The basic purpose of the tax benefit rule is to achieve rough transactional parity in tax and to protect the Government and the taxpayer from the adverse effects of reporting a transaction on the basis of assumptions that an event in a subsequent year proves to have been erroneous. *Id.* at 383, 1983-1 C.B. at 54. The tax benefit rule will "cancel out" an earlier deduction when the later event is fundamentally inconsistent with the premise on which the deduction was initially based. *Id.*

Section 164 provides in part the general rule that state and local taxes that are paid or accrued in carrying on a trade or business shall be allowed as a deduction.

Section 6041 of the Code requires all persons engaged in a trade or business and making payment in the course of the trade or business to another person of fixed or determinable gains, profits, and income of \$600 or more in a tax year to make an information return. Sections 1.6041-1(b)(1) and (i) of the Income Tax Regulations provide that payments made by a state or a political subdivision are subject to this reporting requirement.

Section 1.6041-1(c) of the regulations provides that income is "fixed" when it is to be paid in amounts definitely predetermined. Income is "determinable" when there is a basis of calculation by which the amount to be paid may be ascertained.

As used in section 6041, the term "gains, profits, and income" means gross income and not the gross amount paid. A payor generally is not required to make a return under section 6041 for payments that are not includible in the recipient's income, nor is a payor required to make a return if the payor does not have a basis to determine the amount of a payment that is required to be included in the recipient's gross income.

If a taxpayer in the City deducts property, sales, or food and beverage taxes on a federal income tax return and receives reimbursement of the tax in a later year, the taxpayer generally will be required pursuant to the tax benefit rule to include the reimbursement in gross income for the later year. However, if the City does not possess the information necessary to determine whether or how much of a reimbursement will be includible as tax benefit income, the reimbursements paid by the City will not constitute fixed or determinable income for the purpose of information reporting. Cf., Rev. Rul. 80-22, 1980-1 C.B. 286

Property Taxes

City cannot determine with certainty that the recipient of a property tax rebate received a tax benefit from deduction of the tax. For example, a net operating loss, since expired unused, could have been available to reduce taxable income so that the deduction for property taxes resulted in no additional tax benefit. This tax benefit uncertainty as to the recipients' tax consequences relieves the payor, here City, from any reporting requirement as to the rebate of property taxes. In addition, notwithstanding the above considerations, any payment made to a corporation generally would also be exempt from reporting under section 1.6041-3(p)(1) of the Income Tax Regulations.

Sales Taxes

The considerations discussed above with regard to property taxes would also come into play for rebate of sales taxes. Insofar as the tax appears to be imposed upon sellers under the laws of State, sellers would account for collected sales tax in gross sales and take an offsetting deduction. Nevertheless, as with property taxes, given the uncertainty as to whether sellers received a tax benefit, City would have no reporting requirement. The regulations' section 1.6041-3 exception for payments to corporations would also apply here.

Food and Beverage Taxes

On the basis of the information you have supplied, under the City Code, the food and beverage tax is imposed directly upon the purchaser for the privilege of purchasing food items or alcoholic liquor served or prepared at either a restaurant or liquor establishment in the City and/or for the privilege of purchasing alcoholic liquor at any liquor establishment. The food and beverage tax is collected by the business, specifically as the collecting agent for the City, at the point of sale. This revenue is remitted monthly to the City. Because the food and beverage tax is imposed on the consumer and not the business, when this tax or a portion thereof is rebated (or more

precisely, simply paid out) to the business entity which collected it, that entity would have clearly determinable income. See Rev. Rul. 73-465, 1973-2 C.B. 49 (where retailer acts as collection agent, tax is neither gross income nor deduction). Hence, City is required to file an information return on the food and beverage tax payment amounts. As with the sales and property tax refunds, however, in the case of those payments made to corporations (as well as certain other entities specifically provided for in the regulations), the exemption from reporting under section 1.6041-3(p) of the Income Tax Regulations applies.

CONCLUSION

Based on the facts submitted, we conclude that City has no information reporting requirements under section 6041 as a result of the property and sales tax rebates paid by City; however, we conclude that the food and beverage tax “rebates” are not actually rebates and, therefore, are income irrespective of the tax benefit doctrine (i.e., the payments are includible in the businesses’ gross income). Consequently, a Form 1099 would be required for such payments by City, unless the recipient is a corporation or other specified entity payment to which is exempted under section 1.6041-3(p) of the Income Tax Regulations.

This document may not be used or cited as precedent. Section 6110(k)(3) of the Internal Revenue Code.

Sincerely,

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(Income Tax and Accounting)