Office of Chief Counsel
Internal Revenue Service

memorandum

CC:NER:NED:BOS:TL-N-1799-00
MJGormley

date: MAR 24 2000

to: Chief, Appeals Division, New England District
Attn: Appeals Officer Philip T. MacNeil

from: District Counsel, New England District, Boston

subject: [redacted]

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You have requested our advice as to whether your taxpayer, [redacted] is required to report advance rental payments and deposits in the year received under Treasury Regulation § 1.61-8(b) or whether such payments may be subject to deferral under Revenue Procedure 71-21, 1971-2 C.B. 549, until the year the services are completed.

I.R.C. § 451 provides that generally the amount of any item of gross income shall be included in income for the taxable year in which received by the taxpayer, unless, under the method of accounting used in computing taxable income, such amount is

properly accounted for as of a different period.

Treasury Regulation § 1.446-1(c)(1)(ii) provides that generally, under an accrual method, income is to be included for the taxable year when all the events have occurred that fix the right to receive the income and the amount of the income can be determined with reasonable accuracy. The Service has ruled that all the events that fix the right to receive income occur on the earliest of when (1) the required performance takes place, (2) payment is due, or (3) payment is made. Rev. Rul. 84-31, 1984-1 C.B. 127. Advance rentals must be included in income in the year received, regardless of the period covered or the taxpayer's method of accounting. Treas. Reg. § 1.61-8(b).

Absent a specific provision authorizing deferral, prepaid income must be included in income upon receipt. Automobile Club of Michigan v. Commissioner, 353 U.S. 180 (1957); American Automobile Association v. United States, 367 U.S. 687 (1961); Schlude v. Commissioner, 372 U.S. 128 (1963). Revenue Procedure 71-21, 1971-2 C.B. 549, provides specific rules for deferring prepaid income in some circumstances. It provides that a taxpayer on the accrual method of accounting who receives payments in advance for services to be provided before the end of the next succeeding tax year may defer the inclusion of income over the time in which the services are provided, rather than including the entire amount in income upon receipt.

Revenue Procedure 71-21 implements an administrative decision made under section 446 to allow accrual method taxpayers to defer income in certain specified and limited circumstances. Tax accounting generally requires that payments for services to be performed in future years be included in gross income in the taxable year of receipt. In many cases financial accounting requires the deferral of such income until the year in which the services are performed. The purpose of the revenue procedure is to reconcile tax and financial accounting treatment for such payments, in many cases without permitting extended deferral for including such payments in gross income. As Revenue Procedure 71-21 is an application of section 446, a taxpayer that properly applies Revenue Procedure 71-21 is computing its income in a manner that clearly reflects income.

While income from services in some circumstances may be deferred under Revenue Procedure 71-21, other types of income are not eligible for deferral. In particular, prepaid rental income is not permitted to be deferred. Section 3.08, Revenue Procedure 71-21. However, Section 3.08 further provides that for purposes of the revenue procedure, the term rent does not include payments for the use or occupancy of rooms or other space where

significant services are also rendered to the occupant, such as for the use or occupancy of rooms or other quarters in hotels, boarding houses, or apartment houses furnishing hotel services. Rev. Proc. 71-21, § 3.08, citing Treasury Regulation § 1.1372-4(b)(5)(vi)(services are considered rendered to the occupant if they are primarily for their convenience and are other than those usually or customarily rendered in connection with the rental of space.)

If you need additional assistance, please contact the undersigned at 617/ 565-7858.

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