

INTERNAL REVENUE SERVICE

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INTERNAL REVENUE SERVICE NATIONAL OFFICE FIELD SERVICE ADVICE

MEMORANDUM FOR DISTRICT COUNSEL, SOUTHERN CALIFORNIA
ATTN FRANK N. PANZA CC:WR:SCA:LN

FROM: Heather C. Maloy
Associate Chief Counsel CC:IT&A

SUBJECT: Accrual of Management Fee Income

This Field Service Advice responds to your memorandum dated June 9, 2000. Field Service Advice is not binding on Examination or Appeals and is not a final case determination. This document is not to be cited as precedent.

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LEGEND:

A =
B's =
X % =

ISSUE:

When must A accrue management fee income from B's.

CONCLUSION:

A's right to receive management fee income is fixed upon the performance of services, and at the end of its taxable year the amount of its income can be estimated with reasonable accuracy. Its management agreements provide that its income is X% of patient fees paid to the B's, and because A is responsible for collecting the fees on behalf of the B's, at year end, it should accrue X% of patient fees paid to date.

FACTS:

A has management agreements with B's and states that it owns, develops and manages women's health centers for obstetrical and gynecological conditions. According to the agreements, the B's were formed to provide home uterine activity monitoring (HUAM) services and infusion (INFUSION) therapy for obstetrical and gynecological conditions. The B's employ A to provide management services for their businesses as follows:

1. obtaining licences and permits for management and operation of B's businesses;
2. setting up and administering accounting and administrative services, including billing and collection of accounts, and obtaining necessary codes and licenses to receive collections from such billings;
3. hiring and training all clinical and office personnel required to perform the relevant services;
4. providing management and professional services, including consulting and legal services for the establishment and incorporation of the B's businesses including advice on non-medical matters and drafts of documentation and related operations;
5. providing office space and equipment; and,
6. establishing and operating centers.

A provides the B's with office space, equipment and utilities, orders and purchases all supplies, equipment and other materials, furnishes all necessary equipment, supplies and services to provide HUAM to B's patients, furnishes all pharmacy and nursing services required for INFUSION therapies, furnishes all clinical and office personnel required for both HUAM and INFUSION therapies, furnishes accounting services and prepares various monthly reports.

A does not perform the role of a licensed physician; rather, the HUAM and INFUSION services must be performed by physicians. The services are provided by means of monitoring devices worn by patients. The physicians fit the devices to the patients. Monitoring services are

ongoing, and the devices send a signal to a device at A's facilities where the devices are monitored by nurses employed by A. The nurses then contact the physicians regarding any problems that require their attention.

Pursuant to the approved collection policies of the B's, A supervises and directs the collection of all accounts due to the B's, and as necessary employs collection agencies and attorneys for the collection of bad debts. The agreements provide that the management fee compensation to A for the facilities and services provided, shall be X % of the revenues collected each month by the B's. The management fee is payable on the 15th day of the month following the month in which the revenues are collected.

LAW:

Under an accrual method of accounting, income is includable in gross income when all the events have occurred which fix the right to receive such income and the amount thereof can be determined with reasonable accuracy. Treas. Reg. § 1.451-1(a). Where an amount of income is properly accrued on the basis of a reasonable estimate and the exact amount is subsequently determined, the difference, if any, shall be taken into account for the taxable year in which such determination is made. *Id.*

The Service has ruled that under an accrual method of accounting, all of the events that fix the right to receive income occur when (1) the required performance occurs, (2) payment therefor is due, or (3) payment therefor is made, whichever happens first. Rev. Rul. 79-266, 1979-2 C.B. 203; Rev. Rul. 84-31, 1984-1 C.B. 127.

ANALYSIS:

Under an accrual method of accounting, it is the right to receive income and not the actual receipt that determines the inclusion of the amount in income. When the right to receive an amount is fixed, the right accrues. Spring City Foundry Co. v. Commissioner, 292u.S. 182, 184 (1934).

In determining whether the right to receive has become fixed, consideration must be given to a number of factors. These include the substance of the transaction, the agreement of the parties, the time when services are rendered or property delivered, the existence of contingencies or conditions precedent or subsequent and whether the liability is acknowledged or disputed. Stephen F. Gertman, Federal Tax Accounting, ¶4.02[1][a] (1993).

The facts of this case establish that A provides management services to the B's, for which it is entitled to receive payment in the amount of X% of the revenues collected by the B's for each month. Each month's payment is due to A on the 15th of the following month.

At the end of A's taxable year, management services have been provided to the B's. A has earned its compensation for the services provided to the B's, and its right to receive this income is fixed. Rev. Rul. 79-266, supra (income accrues upon the earliest of performance

occurring, payment due or payment made). A acts as the collection agent for the B's, so A is clearly able to accurately estimate its own management fee which is X% of what it has collected each month for the B's. Thus, at year end, A should accrue as income X% of patient fees collected by the B's.. As additional patient payments are made and additional management fee income is due to A, the appropriate income adjustment may be made Treas. Reg. § 1.451-1(a).

In summary, at the end of the taxable year, A has the right to receive management fees for services performed and is able to reasonably estimate the amount of its income based on patient fees received through year end.

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS:

We recommend requiring income accrual as discussed herein.

With respect to your concern about a court viewing the contractual arrangement here as one between A and the patients rather than between A and the B's, there are no facts in your field service advice request which would lead us to believe that A should be considered a direct service provider to patients. We agree with your assessment that the time of accrual should be governed by the management agreement. The right to payment is clearly set forth in the contract between A and the B's and the most reasonable contract interpretation is that the B's provide patient services, not A. Furthermore, the payment terms between A and B's were apparently negotiated contingent upon the actual patient payments because the B's were unwilling to pay A for services unless patients paid them.

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