

INTERNAL REVENUE SERVICE

April 15, 2002

Number: **INFO 2002-0112**
Release Date: 9/30/3002
UIL: 102.06-00
265.00-00

GENIN-106537-02
CC:ITA:B5



Dear [REDACTED]:

This responds to your letter dated October 16, 2001, enclosing comments of members of the Committee on Exempt Organizations and the 9/11 Task Force. Your letter and enclosure request confirmation from the IRS that certain grants made by charities described in section 501(c)(3) of the Internal Revenue Code (hereinafter "the Code") to for-profit business entities affected by the September 11th terrorist attacks are excludible from income as gifts within the meaning of section 102 of the Code. Your letter was supplemented by a letter dated November 19, 2001, enclosing examples of small to medium-sized businesses in lower Manhattan that may receive these grants. These examples were prepared by [REDACTED] and [REDACTED].

The supplemental letter presents three common scenarios.

- (1) A grant made to replace destroyed property that was used in a trade or business. For example, a pushcart vendor may receive a grant to provide the funds necessary to replace the pushcart destroyed in the terrorist attacks.
- (2) A grant made to assist relocation and reconstruction of a business. For example, a company may receive a grant to assist in relocating to new office space and in reconstructing its business records in order to continue in business.
- (3) A grant made to assist a business in meeting payroll and other operating expenses. For example, a company experiencing a significant loss of business since the terrorist attacks may receive a grant to assist it in temporarily meeting its payroll, rent, and other ongoing operational expenses.

The supplemental letter states that, in providing aid to businesses located in lower Manhattan, in close proximity to the World Trade Center site, charities seek to provide relief to the poor and distressed, and to combat community deterioration. Your letter

does not ask, however, and this letter does not address, in what circumstances a grant to a for-profit business would be consistent with the grantor's charitable purposes under section 501(c)(3) of the Code.

The letter additionally states that it is expected that charities will adopt and follow certain procedures in selecting business recipients to ensure that the grants will further charitable purposes and satisfy the requirements of section 501(c)(3) of the Code. For example, charities are expected to require businesses seeking grants to provide detailed information describing operations and losses. It is also expected that charities will require businesses to use grant funds solely in accordance with the intended uses and allow charities access to financial records to evaluate whether the grant funds are being used as intended.

CONCLUSION

An examination of the facts and circumstances surrounding a section 501(c)(3) charity's transfer to a for-profit business will govern whether the business can exclude the amount transferred from gross income under section 102 of the Code. An important factor is whether the charity makes the transfer with donative intent. We believe that transfers by section 501(c)(3) charities to businesses in the examples described in the November 19th letter and similar scenarios will qualify as gifts under section 102 of the Code assuming the transfers are primarily motivated by charitable or similar impulses and not by moral or legal obligations or anticipation of economic benefit, and are not in return for services. In these examples, we believe that the expenses incurred for business purposes consistent with the charity's grant are allocable to funds excluded from the business' gross income under section 102 of the Code. Accordingly, under section 265(a)(1) of the Code, deductions of expenses for those business purposes are not allowed to the extent of the excluded amounts.

ANALYSIS

A. Section 102

Section 61 of the Code provides that, except as otherwise provided, gross income means all income from whatever source derived. This definition encompasses any item representing "undeniable accessions to wealth, clearly realized, and over which the taxpayers have complete dominion." Commissioner v. Glenshaw Glass Co., 348 U.S. 426, 431, reh'g denied, 349 U.S. 925 (1955).

Section 102(a) of the Code provides that gross income does not include the value of property acquired by gift. Neither the Code nor legislative history accompanying section 102 defines the term gift. A leading interpretive authority on the meaning of the term gift for section 102 purposes is Duberstein v. Commissioner, 363 U.S. 278 (1960). In Duberstein, the Supreme Court considered two cases involving payments "made in a

context with business overtones.” Id. at 285. The Court noted that a gift proceeds from a "detached and disinterested generosity," and is made "out of affection, respect, admiration, charity or like impulses." If the payment proceeds primarily from “any moral or legal duty” or from "the incentive of anticipated benefit" of an economic nature, it is not a gift. Further, "where the payment is in return for services rendered, it is irrelevant that the donor derives no economic benefit from it." Id. (citations omitted). Thus, under Duberstein, a factual analysis of the circumstances surrounding the transfer in each particular case is necessary to determine the dominant reason for the transfer and whether the circumstances support a finding of donative intent. Insight into a transferor’s intention can be gained by examining the factors (such as the economic need of the recipient) that the transferor considered in deciding whether to make the transfer and the form of assistance. See United States v. Kaiser, 363 U.S. 299 (1960).

Since Duberstein, the courts have consistently applied its test to determine whether a transfer is a nontaxable gift. However, there have been very few reported cases in which gift treatment has been claimed for a transfer to a for-profit business, and in each of those cases the courts concluded that the transfers were not excludible gifts. For example, in Publishers New Press, Inc. v. Commissioner, 42 T.C. 396 (1964), a for-profit publisher solicited contributions to continue publishing its newspaper. The court applied the Duberstein intent test to transfers to the corporation and determined the contributions in issue were not gifts under section 102 because the funds were not furnished with detached and disinterested generosity but “were furnished by the contributors to obtain something the contributors desired ... namely, the continued publication of the newspaper.” Id. at 400. See also Webber v. Commissioner, 21 T.C. 742 (1954), aff’d, 219 F.2d 834 (10th Cir. 1955) (minister who solicited funds on a radio program had to report the contributions as income because the contributions were not gifts but given in order to continue the radio program; the opinion is prior to Duberstein but consistent with its test); Teleservice Co. of Wyoming Valley v. Commissioner, 27 T.C. 722, aff’d, 254 F.2d 105 (3d Cir. 1958) (contributions provided by residents to a business in order for the residents to receive television signal transmission services were not gifts or contributions to capital but part of the price for services).

We have found no reported case in which it has been asserted that an outright transfer from a charity to a for-profit business was a nontaxable gift under section 102. The absence of authority relating to the tax treatment by the recipient of such transfers is consistent with our understanding that it is highly unusual for charities to make outright transfers to for-profit businesses. Cf. Rev. Rul. 74-587, 1974-2 C.B. 162 (charitable purposes may be served by providing low-cost or long-term loans to, or purchasing equity interests in, businesses in economically depressed areas). We nonetheless believe that such a transfer is properly excluded from the recipient's gross income under section 102 if it constitutes a gift under the Duberstein standard. Thus, such a transfer may be an excludible gift to the recipient under section 102 if it (1) proceeds from a "detached and disinterested generosity," (2) is made "out of affection, respect, admiration, charity or like impulses," (3) is not made from "any moral or legal duty" nor

"the incentive of anticipated benefit" of an economic nature, and (4) is not in return for services rendered.

Accordingly, assuming the transfers by charities to businesses in the examples described in the November 19th letter and similar scenarios primarily proceed from charitable or similar impulses motivated by the needs of the recipient, and not from moral or legal obligations or anticipation of economic benefit, and are not in return for services, the transfers will qualify as gifts under section 102 of the Code. Cf. Rev. Rul. 99-44, 1999-2 C.B. 549 (payment made by charity to individual that responds to individual's needs, and does not proceed from any moral or legal duty, is motivated by detached and disinterested generosity). Similarly, if a recoverable grant (under which repayment is only required under certain circumstances) constitutes a gift from the charity to the business, the business realizes no income under section 102 of the Code.

B. Section 265(a)(1)

If a recipient for-profit business properly excludes a section 501(c)(3) charity's transfer from gross income under section 102(a) of the Code, then the rules preventing double tax benefits apply.

For example, section 265(a)(1) of the Code disallows any deductions which are allocable to one or more classes of income wholly exempt from federal income taxes. The purpose of section 265(a)(1) is to prevent a double tax benefit. Section 265(a)(1) applies where tax exempt income is earmarked for a specific purpose and deductions are incurred in carrying out that purpose. In that event, it is proper to conclude that some or all of the deductions are allocable to the tax exempt income. Rev. Rul. 83-3, 1983-1 C.B. 72, mod. in part, Rev. Rul. 85-96, 1985-2 C.B. 87 (expenses allocable to allowances excluded under section 107), mod. in part, Rev. Rul. 87-32, 87-1 C.B. 131 (to reflect section 265(a)(6) of the Code regarding certain housing allowances). A number of reported cases have concluded that deductions are disallowed under section 265(a)(1) because they were allocable to tax-exempt income. See, e.g., Christian v. United States, 201 F. Supp. 155 (E.D. La. 1962) (English teacher denied deduction for expenses incurred for literary research trip to England because the expenses were allocable to a tax-exempt gift and fellowship grant). Accord Rickard v. Commissioner, 88 T.C. 188 (1987) (section 265(a)(1) barred Indian tribe member from deducting his farm losses and an investment tax credit for farm equipment from unrelated taxable income because his farm income was exempt from tax); Manocchio v. Commissioner, 78 T.C. 989 (1982) (section 265(a)(1) barred a veteran pilot from deducting the cost of flight-training classes to the extent they were paid with tax-exempt reimbursement from the Veterans' Administration), aff'd on other grounds, 710 F.2d 1400 (9th Cir. 1983) (based on definition of an expense under section 162, court denied pilot's expense deductions that were later reimbursed by the Veterans' Administration).

In the scenarios presented, we believe that the expenses incurred for business purposes consistent with the charity's grant are allocable to funds excluded from the business' gross income under section 102 of the Code. As a consequence, under section 265(a)(1) of the Code, deductions of expenses for those business purposes are not allowed to the extent of the excluded amount. For example, if a company receives a grant from a section 501(c)(3) charity to help pay the company's payroll expenses and the grant is excludible from gross income under section 102(a) of the Code, section 265(a)(1) disallows the company's current deductions allocable to those payroll expenses.

We hope you will find our discussion of the law helpful. Please do not hesitate to call me at (202) 622-4810 if you have any questions.

Sincerely,
Lewis J. Fernandez
Deputy Associate Chief Counsel
(Income Tax and Accounting)

cc: