

INTERNAL REVENUE SERVICE

Number: **INFO 2003-0136**
Release Date: 6/30/2003
CONEX-115389-03/CC:ITA:4
UIL: 61.00-00



Dear [REDACTED]:

This letter is in response to your inquiry dated February 7, 2003, on behalf of a constituent, [REDACTED]. We have discussed inquiry with Larry Lemon of your office and with [REDACTED].

[REDACTED] son, [REDACTED], attended the United States Air Force Academy beginning in 2001. Upon entry to the Academy, all fourthclass members are allowed to charge items such as uniforms, computers, personal services, and membership fees. The charges are covered by a loan from the federal government, and a repayment plan is established under which the amount borrowed is deducted from the cadet's base pay.

After [REDACTED] left the Academy in 2002, a Form W-2 (Wage and Tax Statement) was issued to him. The Form W-2 included in taxable income the amount of outstanding loan balance on the date of his separation from the Air Force. The Academy informed the [REDACTED] that this was done according to established Department of Defense procedures. [REDACTED] has repaid a portion of the debt and expects to repay the full amount.

Under § 61 of the Internal Revenue Code, gross income includes all income from whatever source derived, including compensation for services. Merely receiving loan proceeds does not result in gross income. However, an advance of compensation by an employer to an employee may be includible in gross income.

Whether an advance of funds from an employer to an employee is a loan or advance compensation for services to be rendered in the future depends on the specific facts and circumstances involved. We do not have sufficient facts to determine whether the Academy's treatment of this situation was correct.

Assuming, however, that an employee receives advance compensation that must be repaid to the employer, how the advance is treated depends on whether repayment occurs

in the same year as the advance or in a later year. If the repayment occurs in the same year as the advance, the advance is excluded from gross income.

If the advance is repaid in a later year, the advance is included in the employee's gross income for the year in which it was originally paid to the employee, and the employee is entitled to a miscellaneous itemized deduction for the amount repaid. In addition, if the amount of the deduction exceeds \$3,000, the benefits of § 1341 are available. The application of § 1341 is explained in the attached page from Publication 525, Taxable and Nontaxable Income.

We have contacted Ms. Linda Etter of the Defense Finance and Accounting Service (DFAS) regarding the generalities of _____ situation. If requested to do so by your office or the _____, Ms. Etter will research this issue from DFAS's perspective and furnish a response. Also, we would be pleased to assist Ms. Etter in assuring that this matter has been properly handled from the perspective of the Internal Revenue Service. Ms. Etter can be contacted at:

DFAS-DGD/DE
6760 East Irvington Place
Denver, CO 80279-8000
(303) 676-7521

I hope this information is helpful. Please call _____
_____, if you have any questions.

Sincerely,

Lewis J. Fernandez
Deputy Associate Chief Counsel
(Income Tax & Accounting)