

Internal Revenue Service

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In Re:

LEGEND:

City =

State =

Program =

Dear _____ :

This letter responds to your ruling request submitted on behalf of the City by a letter dated November 26, 2003, as supplemented on February 19, 2004. Your request relates to whether the City is required to file information returns for payments made under the Program described below. The reporting requirement for these payments depends in part upon whether the payments are taxable income to the recipients; consequently, the necessary analysis of the nature of the payments to the recipients is herein included.

BACKGROUND

The City is a municipal government incorporated under the laws of State. The City implemented the Program to preserve the architectural history and promote the quality of life in the community by providing grants to qualifying property owners of 50 percent of the cost to remove artificial siding from residences and restore the original building materials. The Program requires the property owner to (i) allow the City's rehabilitation specialists to inspect the residence, (ii) convey the right of disbursement of funds directly to the person performing improvement work, (iii) hire a licensed contractor to

perform the work unless the property owner is qualified to perform the work, and (iv) allow the City to inspect the work. There are no income restrictions to be eligible for the grants. The grants are paid with taxes that the City receives.

LAW AND ANALYSIS

Section 6041 of the Internal Revenue Code (hereinafter the "Code") requires all persons engaged in a trade or business and making payment in the course of such trade or business to another person, of rent, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, or other fixed or determinable gains, profits, and income of \$600 or more in any taxable year, to file an information return with the Internal Revenue Service (hereinafter the "Service") and to furnish an information statement to the payee.

As used in section 6041 of the Code, only fixed or determinable (i.e., taxable) income must be reported. The payments of compensation (and other amounts) required to be reported under section 6041 are those includible in gross income under section 61 of the Code. Accordingly, in order to decide whether the City is required to furnish an information return to the property owners, it is necessary to examine whether the payments are includible in gross income.

Section 61(a) of the Code and the Income Tax Regulations (hereinafter the "Regulations") thereunder define gross income, except as otherwise provided in subtitle A, to mean all income from whatever source derived. See also section 1.61-1(a) of the Regulations. Under section 61, Congress intended to tax all gains or undeniable accessions to wealth, clearly realized, over which the taxpayers have complete dominion. Commissioner v. Glenshaw Glass Co., 348 U.S. 426, 431, 75 S. Ct. 473, 99 L. Ed. 483 (1955), 1955-1 C.B. 207.

However, the Service has consistently concluded that payments to individuals by governmental units under legislated social benefit programs for the promotion of the general welfare of the public are not includible in a recipient's gross income. See, e.g., Rev. Rul. 74-205, 1974-1 C.B. 20; Rev. Rul. 98-19, 1998-1 C.B. 840. To qualify under the general welfare exclusion, payments must (i) be made from a governmental fund, (ii) be for the promotion of general welfare (i.e., generally based on individual or family needs such as housing, education, and basic sustenance expenses), and (iii) not represent compensation for services. Rev. Rul. 75-246, 1975-1 C.B. 24; Rev. Rul. 76-144, 1976-1 C.B. 17; Rev. Rul. 82-106, 1982-1 C.B. 16. Payments to businesses, generally, do not qualify under the general welfare exclusion because the payments are not based on individual or family needs. See Bailey v. Commissioner, 88 T.C. 1293, 1300-01 (1987), acq., 1989-2 C.B. 1; Notice 2003-18, 2003-1 C.B. 699.

In Rev. Rul. 76-395, 1976-2 C.B. 16, the Service ruled that payments made to low-income individuals primarily in order to subsidize home improvements necessary to correct building code violations and thereby provide safe and decent housing were excluded from the recipients' income under the general welfare exclusion.

In Rev. Rul. 76-131, 1976-1 C.B. 16, the Service ruled that payments made by the State of Alaska to long-term residents were not excluded by the general welfare exclusion because the payments were based on the recipient's age and residency requirements, regardless of financial or employment status, health, or educational background.

In Rev. Rul. 2005-46, 2005-30 I.R.B. 120, the Service concluded that a grant that a business received under a state program to reimburse losses from a natural disaster was not excluded under the general welfare doctrine.

The Program here differs materially from the home rehabilitation program described in Rev. Rul. 76-395. There are no income restrictions for eligibility, and the improvements subsidized by the Program are not intended to primarily address building code violations necessary to make housing safe and decent. In addition, the Program does not require recipients to establish individual or family needs, and owners of investment properties are not precluded from receiving the grants. Therefore, the grants are not excluded from gross income under the general welfare exclusion and are includible in gross income. See Bailey at 1300-01; Rev. Rul. 76-131; Rev. Rul. 2005-46. Accordingly, the City is required to file information returns with the Service and to furnish information statements to the property owners with respect to payments under the Program. Form 1099-MISC should be used, and the amount of the grant should be included in box 3 as "Other Income."

The City's direct payments to contractors raise an additional issue. Section 1.6041-1(e) (the "Middleman Rules") of the Regulations provides:

(e) Payment made on behalf of another person--(1) In general. A person that makes a payment in the course of its trade or business on behalf of another person is the payor that must make a return of information under this section with respect to that payment if the payment is described in paragraph (a) of this section and, under all the facts and circumstances, that person—

(i) Performs management or oversight functions in connection with the payment (this would exclude, for example, a person who performs mere administrative or ministerial functions such as writing checks at another's direction); or

(ii) Has a significant economic interest in the payment (i.e., an

economic interest that would be compromised if the payment were not made, such as by creation of a mechanic's lien on property to which the payment relates, or a loss of collateral).

Under the facts provided, it appears that the City exercises management or oversight functions with respect to payments made to contractors on behalf of the property owners. The City inspects the residence before and after the work is done and requires that the property owner use a licensed contractor unless he is himself qualified to perform the work. See section 1.6041-1(e)(5) of the Regulations.

Accordingly, if the City makes a direct payment to a contractor pursuant to the Program, the City is required to file an information return with the Service and to furnish an information statement to the contractor, in addition to meeting the obligations with respect to its grant to the property owner. Payments to contractors would be reported on Form 1099-MISC, with the amount reported in box 7 as "Nonemployee Compensation."

CONCLUSION

For these reasons, we conclude that payments under the Program will represent gross income to the property owners, that the City performs management or oversight functions in connection with payments to contractors, and that the City is subject to the resulting information reporting requirements of section 6041 with respect to the Program, unless the recipient is a corporation or other specified entity, payment to which is exempt under section 1.6041-3(p) of the Regulations.

This document may not be used or cited as precedent. See section 6110(k)(3) of the Code.

Sincerely,

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(Income Tax & Accounting)