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Department of the Treasury

Washington, DC 20224

Third Party Communication: None

Date of Communication: Not Applicable

Person To Contact:

, ID No.

Telephone Number:

Attn:

Refer Reply To:

CC:ITA:B01

PLR-107580-06

Date: September 18, 2006

Legend

X =

Year 1 =

Date a =

Dear _____ :

This letter is in response to your request for a private letter ruling with regard to the proper time for taking a deduction for pre-paid postage.

FACTS

X is the parent of an affiliated group of corporations that join in the filing of a consolidated income tax return, use an accrual method of accounting, and file returns on the basis of a 52-53 week taxable year. For Year 1, X's taxable year ends Date a. X is engaged in the direct mail advertising business. X enters contracts with clients to print and distribute advertising materials to households and businesses.

X incurs substantial expenses for postage. X maintains a permit account with the USPS. Under this arrangement X maintains a balance in an account with the USPS and the balance is reduced as items are mailed. X is not absolutely required to maintain a balance in the account, but is expected to maintain a balance sufficient to cover its mailings, and postage must be paid before mail will be delivered. Thus, an advance payment is required with respect to the postal services, but the timing and

amount of the payments are not set. X has an established business practice of contributing to its permit account on a quarterly basis. X represents that it expects to utilize the postage within 3½ months.

There are two general types of arrangements that X enters with its clients, shared mailings and solo mailings. In a shared mailing X mails a number of clients' advertising materials together and the cost of postage is included in the contract price and is not a line item on the bill to the client. Solo mailings are conducted on behalf of a single client, and postage is not included in the stated contract price. Rather, postage actually used is charged as a separate line item unless the client's own postage permit is used. X funds its postal permit based on its expected usage for the next few months for both shared and solo mailings.

RULINGS REQUESTED

- 1) The amount of the payment for USPS postage made by X prior to the end of its fiscal Year 1 for shared distribution services and reasonably to be used by X in the 3½ months following the date of payment falls within the provisions of §§ 1.263(a)-4(f)(1) and 1.461-1(a)(2)(i) and 1.461-4(d)(6)(ii) of the Income Tax Regulations and is hence deductible by X for its Year 1 fiscal year.
- 2) The amount of the payment for USPS postage made by X prior to the end of its fiscal Year 1 for solo distribution services and reasonably to be used by X in the 3½ months following the date of payment falls within the provisions of §§ 1.263(a)-4(f)(1) and 1.461-1(a)(2)(i) and 1.461-4(d)(6)(ii) and is hence deductible by X for its Year 1 fiscal year.

LAW & ANALYSIS

A deduction for ordinary and necessary business expenses is allowed in the year paid or incurred depending on the taxpayer's method of accounting. Section 162 of the Internal Revenue Code. Under an accrual method of accounting, a liability is incurred, and is generally taken into account for federal income tax purposes, in the taxable year in which (1) all the events have occurred that establish the fact of the liability, (2) the amount of the liability can be determined with reasonable accuracy, and (3) economic performance has occurred with respect to the liability. Section 461(h). See also sections 1.461-1(a)(2)(i) and 1.446-1(c)(1)(ii)(A).

Under the all events test a liability must be "fixed." A liability is fixed when payment is due or when the required performance occurs on the part of the other party. See, e.g., Rev. Rul. 80-230, 1980-2 .B. 169; Rev. Rul. 79-410, 1979-2 C.B. 213, 214, amplified by Rev. Rul 2003-90, 2003-2 C.B. 353.

Economic performance occurs with respect to a liability for services to be provided to the taxpayer, in this case postal delivery services, when the services are provided. Section 1.461-4(d)(2).

Section § 1.461-4(d)(6)(ii) provides that a taxpayer is permitted to treat services or property as provided to the taxpayer as the taxpayer makes payment to the person providing the services or property, if the taxpayer can reasonably expect the person to provide the services or property within 3½ months after the date of payment.

An amount paid or incurred is not allowed as a current deduction if it provides significant future benefits that extend substantially beyond the close of the taxable year. Such payments are instead required to be capitalized under § 263(a). See Indopco, Inc. v. Commissioner, 503 U.S. 79 (1992). However, § 1.263(a)-4(f)(1) provides that amounts paid to create any right or intangible benefit for the taxpayer that does not extend beyond the earlier of 12 months from the date the taxpayer first realizes the right or benefit, or the end of the taxpayer year following the year in which the payment is made, is not required to be capitalized.

X's liability for postage expense is fixed and the liability is incurred when X makes its periodic deposits into its postal permit account. The terms of a contract are relevant in determining the events that fix a X's obligation to pay. See, e.g., Decision, Inc. v. Commissioner, 47 T.C. 58 (1966), acq., 1967-2 C.B. 2. The USPS requires pre-payment of postage generally, and maintenance of a balance sufficient to covers its bulk mailings is part of the X's arrangement with the USPS. The amounts though not "due" on a specific date or according to a specific schedule, are due in advance of the services. We conclude that under this arrangement, the fixed prong of the all-events test is met for the postage when payment is made to the USPS. The amount is a pre-payment of postage that will be applied to a mailing that will occur within a short period of time, and pre-payment is required by the USPS. X is able to determine its postage usage for the next quarter with reasonable accuracy.

It is well established that a taxpayer may not anticipate an expense that will become fixed in a future period. Brown v. Helvering, 291 U.S. 193, 201, 1934-1 C.B. 223 (1934). In this case the reasonable accuracy test or second prong of the all-events test is clearly met by an estimate. With regard to the fixed prong, the USPS requires payment in advance of its services. Payment is due, and the fixed prong is thereby met, when the postage (stamps, charging the electronic meter, or credit to the permit) is provided, rather than when the delivery services are performed.

Economic performance for services to be provided to the taxpayer generally occurs when the services are provided. Section 1.461-4(d)(2). However, § 1.461-4(d)(6)(ii), permits X to treat the services as provided when payment is made, for purposes of determining whether economic performance has occurred, since X reasonably expects to utilize the pre-paid postage within 3½ months of the date of payment.

X's payments to its permit account create an intangible right to receive postal services in the future, but X has represented that it will exhaust this benefit within 3½ months of the date of payment and will therefore not be required to capitalize the payment under the 12-month exception contained in § 1.263(a)-4(f)(1).

Most of X's mailings are conducted on a shared basis, and X makes payments to its permit account with the USPS based on its anticipated postage usage for both shared and solo mailings. However, since X bills for solo mailings net of postage it has asked that we rule that its pre-payments for postage that are consumed by the solo mailings are also deductible, rather than advances on behalf of the client. To be deductible the expense must be the taxpayer's. If the taxpayer is entitled to reimbursement from another party, the expense is not the taxpayer's. Glendinning, McLeish & Co. v. Commissioner, 61 F.2d 950 (2d Cir.1932), aff'g 24 B.T.A. 518 (1931); Manocchio v. Commissioner, 710 F.2d 1400 (9th Cir. 1983).

X points out that it does not incur postage expenses on behalf of its solo mailing clients, but rather on its own behalf. X pre-pays postage based on its planned usage for all mailings for the next few months, pre-payments are not made with respect to specific clients' mailings. At the time that it pre-pays for its postage, X does not have a fixed right to reimbursement. See Baloian Co. v. Commissioner, 68 T.C. 620, 626 (1977) (no deduction for expense for which taxpayer has "fixed right to reimbursement"). The right to bill a solo mailing client for postage will not arise until X applies a portion of its pre-paid postage to the solo client's mailing. Also it seems evident that the portion of the pre-paid account consumed by solo mailings would be depleted within a relatively short period by shared mailings were it not consumed by the solo mailings. Therefore, because a fixed right of reimbursement does not arise when the payments are made for the postage that is consumed by solo mailings, the payments are not made with the right of reimbursement from, and not in the nature of a loan to, the solo mailing client.

RULINGS

- 1) The amount of the payment for USPS postage made by X prior to the end of its fiscal Year 1 for shared distribution services and reasonably to be used by X in the 3½ months following the date of payment falls within the provisions of §§ 1.263(a)-4(f)(1) and 1.461-1(a)(2)(i) and 1.461-4(d)(6)(ii) and is hence deductible by X for its Year 1 fiscal year.

- 2) The amount of the payment for USPS postage made by X prior to the end of its fiscal Year 1 for solo distribution services and reasonably to be used by X in the 3½ months following the date of payment falls within the provisions of §§ 1.263(a)-4(f)(1) and 1.461-1(a)(2)(i) and 1.461-4(d)(6)(ii) and is hence deductible by X for its Year 1 fiscal year.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. Corollary to the treatment of pre-paid postage applied to solo mailings described in this ruling, X must include the postage billed to its solo mailing clients in gross income. This ruling does not provide consent to make a change in method of accounting.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

A copy of this letter must be attached to any income tax return to which it is relevant. Alternatively, taxpayers filing their returns electronically may satisfy this requirement by attaching a statement to their return that provides the date and control number of the letter ruling.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Sincerely,

Thomas A. Luxner
Branch Chief, Branch 1
(Income Tax & Accounting)

cc: District Director, LM:CTM