Internal Revenue Service

Number: **200928023**
Release Date: 7/10/2009

Index Number: 118.01-02, 118.01-03, 362.02-00, 362.02-01

Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

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, ID No.

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Refer Reply To:
CC:PSI:B05
PLR-150927-08

Date:
April 02, 2009

LEGEND:

Taxpayer =

County =

State =

Bonds =

Development =

Date =

Dear :

This letter responds to a letter dated December 4, 2008, and subsequent correspondence, submitted on behalf of Taxpayer requesting rulings under sections 118 and 362 of the Internal Revenue Code.

FACTS

Taxpayer represents the following. Taxpayer is a corporation. Taxpayer is in the business of owning and operating hotels and resorts. It constructed Development in County. In order to induce Taxpayer's construction of Development, County agreed to finance a portion of the costs.

County obtained authorization under legislative acts of both State and County to sell its special obligation Bonds and to use the proceeds to reimburse Taxpayer for a portion of the construction costs. It was the intent of County to sell the Bonds and remit the proceeds to Taxpayer to reimburse Taxpayer for the costs County had agreed to pay. The debt service on the Bonds was to be derived from the incremental property taxes on Development and the occupancy taxes imposed on the hotels located in the Development.

Taxpayer wanted the Bonds to be issued and sold to reduce the risk that a different County management might change the terms of the contribution. However, the Bonds could not be marketed until the foregoing revenues commenced. Accordingly, it was not until Taxpayer's completion of construction of, and receipt of a certificate of occupancy for, Development and Taxpayer's compliance with certain other conditions on Date that the Bonds were either released from escrow or issued to Taxpayer.

Taxpayer requests a ruling that the transfer of the Bonds to Taxpayer was, in substance, a sale of the Bonds by County to Taxpayer followed by a deemed remittance to Taxpayer of the proceeds of that sale. Taxpayer requests that this transaction be treated as a nonshareholder contribution of the sale proceeds to the capital of Taxpayer by County under section 118(a). Taxpayer also requests a ruling under section 362(c) that Taxpayer's depreciable basis in Development shall be reduced by the deemed proceeds of the sale of the Bonds.

LAW AND ANALYSIS

Section 61(a) provides that, except as otherwise provided in Subtitle A (Income Taxes), gross income means all income from whatever source derived.

Section 1.61-1(a) of the Income Tax Regulations provides that A[g]ross income means all income from whatever source derived, unless excluded by law. Gross income includes income realized in any form, whether in money, property, or services.@

The Supreme Court in Commissioner v. Glenshaw Glass Co., 348 U.S. 426, 431 (1955), held that gross income includes Ainstances of undeniable accessions to wealth, clearly realized, and over which the taxpayers have complete dominion.@

The Supreme Court in New Colonial Ice Co., Inc. v. Helvering, 292 U.S. 435, 440 (1934), held that A[w]hether and to what extent deductions shall be allowed depends on legislative grace; and only as there is clear provision therefor can any particular deduction be allowed.@ AObviously, therefore, a taxpayer seeking a deduction must be able to point to an applicable statute and show that he comes within its terms.@ Id.

Section 118(a) provides that, in the case of a corporation, gross income does not include any contribution to the capital of the taxpayer.

Section 1.118-1 provides as follows:

> In the case of a corporation, section 118 provides an exclusion from gross income with respect to any contribution of money or property to the capital of the taxpayer. Thus, if a corporation requires additional funds for conducting its business and obtains such funds through voluntary pro rata payments by its shareholders, the amounts so received being credited to its surplus account or to a special account, such amounts do not constitute income, although there is no increase in the outstanding shares of stock of the corporation. In such a case the payments are in the nature of assessments upon, and represent an additional price paid for, the shares of stock held by the individual shareholders, and will be treated as an addition to and as a part of the operating capital of the company. Section 118 also applies to contributions to capital made by persons other than shareholders. For example, the exclusion applies to the value of land or other property contributed to a corporation by a governmental unit or by a civic group for the purpose of inducing the corporation to locate its business in a particular community, or for the purpose of enabling the corporation to expand its operating facilities. However, the exclusion does not apply to any money or property transferred to the corporation in consideration for goods or services rendered, or to subsidies paid for the purpose of inducing the taxpayer to limit production. See section 362 for the basis of property acquired by a corporation through a contribution to its capital by its stockholders or by nonstockholders. (Emphasis added.)

The legislative history to section 118 indicates that the exclusion from gross income for nonshareholder contributions to capital of a corporation was intended to apply to those contributions that are neither gifts, because the contributor expects to derive indirect benefits, nor payments for future services, because the anticipated future benefits are too intangible. The legislative history also indicates that the provision was intended to codify the existing law that had developed through administrative and court decisions on the subject. H.R. Rep. No. 1337, 83d Cong., 2d Sess. 17 (1954); S. Rep. No. 1622, 83d Cong., 2d Sess. 18-19 (1954).

The legislative history of section 118 provides, in part, the following:

> This [section 118] in effect places in the Code the court decisions on this subject. It deals with cases where a contribution is made to a corporation by a governmental unit, chamber of commerce, or other association of individuals having no proprietary interest in the corporation. In many such cases because the contributor expects to derive indirect benefits, the contribution cannot be called a gift; yet the anticipated future benefits may also be so intangible as to not warrant treating the contribution as a payment for future services. (Emphasis added.)

S. Rep. No. 1622, 83d Cong., 2d Sess. 18-19 (1954).

One of the court decisions on this subject referred to in the committee reports is Detroit Edison Co. v. Commissioner, 319 U.S. 98 (1943). The facts involved the payment of cash to the taxpayer by prospective customers to cover the estimated cost of construction of the extension of the taxpayer=s electric utility service facilities to the prospective customers. The taxpayer contended that the payments were gifts or contributions to capital. The Court disagreed, holding that A[t]he payments were to the customers the price of the service.@ Id. at 103. The Court reasoned that Ait overtaxes imagination to regard the farmers and other customers who furnished these funds as makers either of donations or contributions to the Company. The transaction neither in form nor in substance bore such a semblance.@ Id. at 102.

Another court decision on this subject is Brown Shoe Co., Inc. v. Commissioner, 339 U.S. 583 (1950). The facts involved the payment of cash and the transfer of other property to the taxpayer by certain community groups as an inducement to the location or expansion of the taxpayer=s factory operations in the communities. The taxpayer contended that the properties so acquired were gifts or contributions to capital. The Court held that A the assets transferred to petitioner by the community groups represented >contributions to capital.=@ Id. at 589. The Court reasoned that A[t]he contributions to petitioner were provided by citizens of the respective communities who neither sought nor could have anticipated any direct service or recompense whatever, their only expectation being that such contributions might prove advantageous to the community at large.@ Id. at 591.

In United States v. Chicago, Burlington & Quincy Railroad Co., 412 U.S. 401 (1973), the Court, in determining whether a taxpayer was entitled to depreciate the cost of certain facilities that had been funded by the federal government, held that the governmental subsidies were not contributions to the taxpayer's capital. The court recognized that the holding in Detroit Edison Co. had been qualified by its decision in Brown Shoe Co. The Court in Chicago, Burlington & Quincy Railroad Co. found that the

distinguishing characteristic between those two cases was the differing purpose motivating the respective transfers. The Court stated that:

> It seems fair to say that neither in Detroit Edison nor in Brown Shoe did the Court focus upon the use to which the assets transferred were applied, or upon the economic and business consequences for the transferee corporation. Instead, the Court stressed the intent or motive of the transferor and determined the tax character of the transaction by that intent or motive. Thus, the decisional distinction between Detroit Edison and Brown Shoe rested upon the nature of the benefit to the transferor, rather than to the transferee, and upon whether that benefit was direct or indirect, specific or general, certain or speculative. These factors, of course, are simply indicia of the transferor's intent of motive.

Id. at 411.

The Court reconciles Detroit Edison and Brown Shoe on the ground that in the former the transferor intended no contribution to the transferee's capital, whereas in the latter the transferors did have that intent. See Id. at 412.

In addition, the Court stated that other characteristics of a contribution to capital are implicit in the two cases that do focus upon the use to which the assets transferred were applied or upon the economic and business consequences for the transferee corporation. The Court listed the following characteristics of a nonshareholder contribution to capital:

> [1] It certainly must become a permanent part of the transferee=s working capital structure. [2] It may not be compensation, such as a direct payment for a specific, quantifiable service provided for the transferor by the transferee. [3] It must be bargained for. [4] The asset transferred foreseeably must result in benefit to the transferee in an amount commensurate with its value. [5] And the asset ordinarily, if not always, will be employed in or contribute to the production of additional income and its value assured in that respect.

Id. at 413.

In the present case, all the requirements of Chicago, Burlington, & Quincy Railroad Co. have been met.

Section 362(c)(1) provides that if property other than money is acquired by a corporation as a contribution to capital and is not contributed by a shareholder as such, then the basis of such property shall be zero.

County's transfers of the Bonds to Taxpayer were nonshareholder contributions of property other than money to Taxpayer.

CONCLUSIONS

Accordingly, we conclude as follows:

(1) The Bonds are a nonshareholder contribution to the capital of Taxpayer under section 118(a); and

(2) Taxpayer's basis in each of the Bonds is zero under section 362(c)(1).

No opinion is expressed or implied regarding the application of any other provisions of the Code or regulations.

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

In accordance with the power of attorney on file, a copy of this letter is being sent to Taxpayer=s authorized representatives.

Sincerely yours,

Paul F. Handleman
Chief, Branch 5
Office of Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosures (2):
Copy of this letter
Copy for section 6110 purposes