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TY:

Legend:

Taxpayer =
Parent =
Trust =
Insurer =
State A =
State B =
Date 1 =
$aa =
$bb =
Year 1 =
Year 2 =
Year 3 =
Year 4 =
Year 5 =
Year 6 =
Year 7 =
X% =

Dear :

This letter is in response to a ruling request dated submitted on behalf of Taxpayer by its authorized representative, requesting a ruling as to the proper year of inclusion in income of an amount of a time-value credit attributable to an erroneous collection of a State A insurance premium tax and whether the time-value credit is includable in Taxpayer's income under the anticipatory assignment of income doctrine.

FACTS

Taxpayer is a multiple-employer voluntary employee beneficiary association (VEBA) formed by Parent in Year 1 for the purpose of providing benefits to the employees of member employers in . Trust is a simple trust operating as a welfare benefit fund and was formed by Parent in Year 2 for the purpose of providing benefits to the employees of member employers in . Parent is a § 501(c)(6) member organization for employers located in . Parent has always been the sponsor of both Taxpayer and Trust, and all employers participating in both Taxpayer and Trust are members of Parent. Taxpayer, Trust and Parent each employ an overall accrual method of accounting and file Federal income tax returns on a calendar-year basis.

As of Date 1, Year 3, Taxpayer ceased offering benefits coverage to its participating employers and transitioned those participating employers to Trust. The wind-down of and termination of insurance coverage through Taxpayer was specifically planned.

Former participants in Taxpayer who continue to participate in Trust are entitled to receive rate concessions from Year 4 through at least Year 7. The rate concessions are a result of a refund of a State A insurance premium tax Insurer erroneously charged to Taxpayer in prior years. Taxpayer was not liable for the State A premium tax because Taxpayer was not domiciled in State A and the insurance contracts were delivered in State B. In addition to the refund of the State A premium taxes, Insurer added an X% time-value credit for the delay in correcting its error. The total amount of premium credit to which Taxpayer was entitled was $aa, and the total time-value credit was $bb.

Taxpayer represents that Trust may receive the rate concession, which includes the time-value credit, only if Trust and its participating employers continue to purchase insurance through Insurer. Trust has no obligation to negotiate with Insurer, but if Trust were to switch carriers, the unused credit would be lost. During Year 5, Trust seriously considered whether to continue its relationship with Insurer during Year 6 and will review that relationship prior to renewing with Insurer for Year 7, knowing that any unused credit would be lost and not refunded if it terminates its relationship with Insurer.

Additionally, Taxpayer represents that participating employers are under no obligation to continue to purchase insurance from Insurer through Trust; some employers have ceased purchasing insurance through Trust, thus forgoing any credit to which they might have been entitled. Participating employers may also opt out of purchasing insurance through Trust any year after Year 4, also forgoing any unused credit.

Trust would like to exhaust the credit by Year 7 and administrative burdens have made switching insurance carriers before full use of the credit improbable. However, determining the exact amount of the rate concession received is uncertain and each year's negotiation for the rate concession represents a mutually agreed upon estimate of value received and value remaining. Taxpayer does not have any role in whether Trust will continue insuring with Insurer, any negotiations with Insurer, or future use or nonuse of the credit.

RULINGS REQUESTED

(1) Taxpayer requests a ruling that the time-value credit of $bb paid as a rate concession is not income to the taxpayer in Year 3; and

(2) Taxpayer requests a ruling that the time-value credit of $bb is not includible in its income under the anticipatory assignment of income doctrine.

LAW AND ANALYSIS

Section 61 of the Internal Revenue Code provides that, except as otherwise provided by law, gross income means all income from whatever source derived.

Section 451(a) provides that items of gross income shall be included in gross income for the taxable year in which received by the taxpayer, unless, under the method of accounting used in computing taxable income, such amount is to be properly accounted for as of a different period.

Section 1.451-1(a) of the Income Tax Regulations provides that under an accrual method of accounting, income is includible in gross income when all the events have occurred which fix the right to receive such income and the amount thereof can be determined with reasonable accuracy (the "all-events test"). All events that fix the right to receive income occur when (1) the required performance takes place, (2) payment is due, or (3) payment is made, whichever happens first. See Schlude v. Commissioner, 372 U.S. 128 (1963).

Year of Accrual

In John Graf Co. v. Commissioner, 39 B.T.A. 379, 384-85 (1939), an accrual method taxpayer entered into a settlement agreement under which it would receive discounts on purchases made in the future. The Board of Tax Appeals held that the taxpayer did not have to accrue the maximum amount that it might be entitled to receive under the settlement agreement in the year of the settlement. The Board reasoned that the right to receive the future discounts was not fixed at the time of the settlement agreement was entered into because the discounts depended on the taxpayer's future

purchases, and because the taxpayer could not compel the other party to pay the amount in cash.

In Snyder v. Commissioner, T.C. Memo. 1988-320, a partnership in which the taxpayer was a partner qualified for a fixed amount of future state tax reductions by making certain capital improvements to its facilities. The Tax Court held that the taxpayer must include the future tax reductions in income under the accrual method of accounting in the year in which the state certified the capital improvements. On appeal, however, the Commissioner conceded, and the Sixth Circuit agreed, that the future state tax reductions should not be included in income in the year in which the capital improvements were certified by the state; instead, the future tax reductions should be accounted for through smaller state tax deductions in the year in which the tax reductions were used to reduce the taxpayer's state taxes. Snyder v. Commissioner, No. 89-1276, 1990 WL 6953, at *4 (6th Cir. Feb. 1, 1990), vacating and remanding without published opinion T.C. Memo. 1988-320.

Revenue Ruling 79-247, 1979-2 C.B. 24, holds that amounts computed at the prevailing rate of interest deposited with a stockbroker by an investor, that are credited on the broker's books, and may be used only to offset commissions payable to the broker on subsequent stock transactions are includable in the gross income of the investor only when so used. Rev. Rul. 79-247 relies on John Graf Co. and reasons that the use of the credits is totally contingent on the investor entering into future stock transactions to which the credits could be applied. Rev. Rul. 79-247 specifically states that this treatment applies to accrual as well as cash basis taxpayers.

Like the taxpayers in John Graf Co., Snyder, and Rev. Rul. 79-247, Taxpayer does not have a fixed right to receive the time-value credit in Year 3 because the right to receive the time-value credit is contingent on future activities by Trust. To be entitled to rate concessions, former participants in Taxpayer must transition from Taxpayer to Trust and Trust must continue to purchase insurance through Insurer. If Trust were to no longer insure through Insurer, any unused credit would be lost; Taxpayer has represented that Trust has seriously considered ceasing to purchase insurance through Trust, even though Trust would lose any unused credit. Further, Taxpayer has represented that some former participants in Taxpayer decided against transitioning over to Trust and thus have foregone any rate concession from the credit. Accordingly, the Taxpayer does not have a fixed right to receive the time-value credit in Year 3 because the right to receive the time-value credit is contingent on Trust continuing to insure through Insurer for Years 4 and later.

Assignment of Income

In general, under the anticipatory assignment of income doctrine, a taxpayer who earns or otherwise creates a right to receive income will be taxed on any gain realized from it, if the taxpayer has the right to receive the income or if, based on the realities

and substance of the events, the receipt of the income is practically certain to occur (i.e., whether the right basically has become a fixed right), even if the taxpayer transfers the right before receiving the income. Ferguson v. Commissioner, 174 F.3d 997 (9th Cir. 1999); Jones v. United States, 531 F.2d 1343, 1346 (6th Cir. 1976); Kinsey v. Commissioner, 477 F.2d 1058, 1063 (2d Cir. 1973); Hudspeth v. United States, 471 F.2d 275, 280 (8th Cir. 1972); Estate of Applestein v. Commissioner, 80 T.C. 331 (1983); Lucas v. Earl, 281 U.S. 111 (1930).

By contrast, the mere anticipation or expectation of the receipt of income is insufficient to conclude that a fixed right to income exists. S.C. Johnson & Son, Inc. v. Commissioner, 63 T.C. 778, 787-88 (1975). In Greene v. United States, 13 F.3d 577 (2d. Cir. 1994), the taxpayers contributed appreciated futures contracts to a charity in 1982. The charity had the right to determine when, or if, to sell the contracts. The charity, however, had issued a standing order to its broker, to sell contracts that the taxpayer contributed to the charity the same day or shortly after the taxpayer donated each contract. Upon the sale of each contract, the charity retained the long-term capital gain and paid to the taxpayer the short-term capital gain. Under these facts, the court found that the taxpayer neither had a fixed right to the income from the contracts at the time they contributed them to the charity nor had maintained any control over the charity's sale of the contracts. Thus, the court held that the taxpayers were not required to include the long-term capital gain in their income under the anticipatory assignment of income doctrine.

In Thompson v. Commissioner, T.C. Memo. 1964-198, the taxpayer sold stock in a corporation under an installment contract with a collateral agreement that the purchaser could withhold a portion of the interest payments due the taxpayer to pay part of any deficiency in the corporation's income taxes. The court held that the taxpayer had a contingent right to the interest payments rather than a vested right because the taxpayer's right to a payment of interest was contingent upon the nonexistence of any taxes being due or owed. Therefore, the taxpayer did not realize the income due to the withheld interest, and the purchaser's payment of the corporation's taxes out of the withheld interest was not an anticipatory assignment of income.

In this case, Taxpayer's right to receive the time-value credit was not earned under anticipatory assignment of income doctrine principles at the end of Year 3. Taxpayer's participants must transition over to Trust; employers who participate in Trust are not obligated to continue coverage through Trust and may pursue other insurance options, thereby foregoing any credit for the rate concessions. Taxpayer does not any control over whether Trust will use or not use the remaining rate concession. Accordingly, the rate concessions are subject to conditions beyond the control of Taxpayer and, therefore, are contingent and uncertain.

CONCLUSION

Based on the information submitted and the representations made, we conclude that:

(1) Taxpayer does not have a fixed right to receive the time-value credit of $bb in Year 3 because receipt of the time-value credit is contingent on Trust and its participants continuing to insure through Insurer for Years 4 and later.

(2) Taxpayer does not include in its income the time-value credit of $bb paid as rate concessions under the anticipatory assignment of income doctrine.

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.

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 D. Moffitt
Branch Chief, Branch 2
(Income Tax & Accounting)

cc: