

ID: CCA\_2013050609123627

Office:

UILC: 451.00-00, 451.14-00, 451.14-03,  
451.19-00

Number: **201321023**

Release Date: 5/24/2013

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**From:**

**Sent:** Monday, May 06, 2013 9:12:45 AM

**To:**

**Cc:**

**Subject:** CAPCO question - draft of our response

Below, please find our response to your inquiry:

1) Does a CAPCO need to recognize income when it applies tax credit offsets as payments of interest and principal on notes issued to its investors? Tax credit offsets is the term taxpayers use for insurance premium tax credits used to pay back their investors in lieu of cash.

Yes, the taxpayer must recognize income from the use of tax credit offsets as payments of interest and principal on notes issued to its investors. Section 61 generally provides that gross income means all income from whatever source derived. The term "income" is broadly defined as "instances of undeniable accessions to wealth, clearly realized, and over which the taxpayers have complete dominion." Commissioner v. Glenshaw Glass Co., 348 U.S. 426, 431 (1955). The payment of the expenses of a taxpayer by another is includible in the taxpayer's gross income. Old Colony Trust v. Commissioner, 279 U.S. 716 (1929) (payment of employee's income taxes by the employer made in consideration of employee's services constituted additional taxable income of employee). Moreover, the payments are includible in the taxpayer's gross income regardless of whether they are made directly to the taxpayer or to a third party on the taxpayer's behalf. See Old Colony at 729, which held it "immaterial that the taxes were paid over directly to the government. The discharge by a third person of an obligation [of the taxpayer] is equivalent to receipt by the [taxpayer]." Vasquez v. Commissioner, T.C.M. 1997-78 (repayment of student loans by employer includable in student's gross income).

2) When should the CAPCO recognize income from the application of tax credit offsets?

The CAPCO must annually recognize income in the amount of loan payments made, or deemed paid, through the use of the tax credit offsets (a.k.a. premium tax credits) during

that taxable year. In responding to your question we assume that the CAPCO is an accrual basis taxpayer.

Section 451 provides the general rule that the amount of any gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless such amount is to be properly accounted for in a different period. Section 1.451-1(a) of the Income Tax Regulations provides that gains, profits, and income are to be included in gross income for the taxable year in which they are actually or constructively received by the taxpayer, unless includible for a different year in accordance with the taxpayer's method of accounting. 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"). Section 1.446-1(c)(1)(ii)(A). All the events that fix the right to receive income occur when (1) the required performance takes place, (2) payment is due, or (3) payment is received, whichever happens earliest. See Schlude v. Commissioner, 372 U.S. 128, 133 (1963); Rev. Rul. 84-31, 1984-1 C.B. 127; Rev. Rul. 80-308, 1980-2 C.B. 162. Under these facts, payment has been received.