

Internal Revenue Service

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Department of the Treasury
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Person To Contact:
, ID No.

Telephone Number:

Refer Reply To:
CC:ITA:B05
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Date:
August 23, 2021

Legend

Taxpayer =
Parent =
State =
Facility =
Services =
Agency =

Permit =

Regulations =
Plan =
Activities =
Other =
Activities =
Fees =

Other Fees =

Account =

Other =
Accounts

Agreement =

Other =
Agreements

Agent =

Fund =

Dear :

This letter supersedes our letter dated July 01, 2021, to correct an obvious error.

This letter responds to your letter, dated December 30, 2020, and subsequent correspondence, submitted on behalf of Taxpayer, requesting a private letter ruling that Fees and Other Fees charged to fund Activities and Other Activities and held in Account and Other Accounts are excludible from gross income under § 61 of the Internal Revenue Code (Code).

FACTS

Taxpayer is an S Corporation that operates Facility in State. Taxpayer is wholly owned by Parent. State regulates operation of Facility for which Taxpayer maintains Permit issued by Agency. Taxpayer's business operations model consists of two stages. During the first stage, Taxpayer provides Services to its clients. During the second stage, Taxpayer performs its statutorily mandated obligations of Activities and Other Activities for which Regulations require Taxpayer to establish a Plan. Taxpayer charges its clients a standard rate for Services and also collects Fees from its clients to fund Taxpayer's obligation to perform Activities and Other Activities. Taxpayer deposits Fees into Account pursuant to Agreement with State. Agency monitors the balances of, approves withdrawals from, and conducts periodic audits of Account. Further, funds in Account must be readily available in the event of an emergency.

Taxpayer enters into Other Agreements with Agency. Other Agreements authorize Taxpayer to collect Other Fees from clients to cover Activities and Other Activities. Taxpayer is permitted to increase rate of Other Fees charged to customers. Taxpayer deposits Other Fees into Other Accounts. Agency does not directly approve withdrawals from Other Accounts, and the funds held in Other Accounts do not have to be readily available in the event of an emergency. Agency requires Taxpayer to submit invoices for funds drawn from Other Accounts, and expenditures must be deemed reasonable and within the scope of Plan.

Taxpayer deposits Fees and Other Fees with Agent who places funds in an interest-bearing account. All interest and other earned income is deposited into the respective Account and Other Accounts. The funds held in Account and Other Accounts are not considered to be an asset of Taxpayer and will not be available to potential creditors. After Agency determines that Taxpayer has completed all Activities and Other Activities, Agent transfers the balances remaining in Account and Other Accounts into Fund.

Taxpayer's relationship with its clients ends when Taxpayer starts Activities and Other Activities per Plan. At that time, Taxpayer may withdraw funds from Accounts and Other Accounts. These funds are used to pay vendors hired by Taxpayer. Taxpayer does not receive a commission or a mark-up over the invoiced amounts submitted by vendors. A significant portion of the construction of Facility and work on Activities and Other Activities is performed by parties related to Taxpayer at rates typically charged by similar vendors in the local market.

Taxpayer also makes withdrawals from Accounts and Other Accounts to purchase certain equipment. Taxpayer owns the equipment purchased with the funds from Accounts and Other Accounts.

Presently, Taxpayer does not recognize income in the year it collects Fees and/or Other Fees and does not claim a deduction for amounts withdrawn from Account and/or Other Accounts. Further, Taxpayer presently does not take basis and claim depreciation or amortization for the equipment purchased with funds withdrawn from Account and/or Other Accounts.

LAW

Section 61(a) of the Code provides that except as otherwise provided in subtitle A, gross income means all income from whatever source derived. Specifically, § 61(a)(2) includes income derived from business in gross income. Gross income is an undeniable accession to wealth, clearly realized, over which a taxpayer has complete dominion. *Commissioner v. Glenshaw Glass Co.*, 348 U.S. 426 (1955). As stated by the Supreme Court in discussing an earlier version of the Section, “[t]he income taxed is described in sweeping terms and should be broadly construed in accordance with an obvious purpose to tax income comprehensively.” *Commissioner v. Jacobson*, 336 U.S. 28, 49 (1949).

If taxpayer receives funds that must be spent in a way regulated by another entity, such as a government regulator, the taxpayer must recognize amounts received as gross income under Section 61(a)(2). The determinative factors are the degree of control over the funds the taxpayer enjoys and the degree to which Taxpayer benefits from the expenditures of the funds. *Mutual Telephone Co. v. United States*, 204 F.2d 160, 161-62 (9th Cir.1953) (increased charges collected by public utility to decrease demand are income when placed in retirement fund, as directed by regulating Commission); *United*

States v. Maryland Jockey Club of Baltimore City, 210 F.2d 367, 371-72 (4th Cir.), cert. denied, 347 U.S. 1014 (1954); *Iowa Southern Utilities Co. v. United States*, 841 F.2d 1108 (Fed.Cir.1988), aff'g 11 Cl.Ct. 868 (1987); Rev. Rul. 63-182, 1963-2 C.B. 194.

Under the *Seven-Up* line of cases, when a taxpayer is controlled by another and acts as an agent, fiduciary, or a conduit, funds that taxpayer received and spent for the benefit of others are not includible in taxpayer's gross income under Section 61. *Seven-Up Co. v. Commissioner*, 14 T.C. 965 (1950), acq. in result, 1974-2 C.B. 4; Rev. Rul. 74-319, 1974-2 C.B. 15. Cf. Rev. Rul. 74-318, 1974-2 C.B. 14. See also *Broadcast Measurement Bureau, Inc. v. Commissioner*, 16 T.C. 988 (1951) (relying on *Seven-Up*, the court held that amounts the taxpayer collected from its radio subscribers to conduct surveys were not includible in the taxpayer's gross income). However, the tax court has held that for proceeds held in trust to be excluded from gross income under the trust fund doctrine, no profit, gain or other benefit must accrue to the taxpayer on account for their receipt. See *Ford Dealers Advertising Fund, Inc. v. Commissioner*, 55 T.C. 761 (1971), aff'd, 456 F.2d 255 (5th Cir. 1972), nonacq., 1974-2 C.B. 5; *Affiliated Foods, Inc. v. Commissioner*, 154 F.3d 527 (5th Cir. 1998), aff'g and rev'g on other grounds, T.C. Memo 1996-505 (1996).

In the cemetery perpetual care line of cases, if a taxpayer receives funds and is bound either by agreements or by statute to pay certain sums into a trust fund, and the principal and interest do not inure to the benefit of the taxpayer, those funds are not considered part of the taxpayer's gross income. See *Commissioner v. Cedar Park Cemetery Ass'n*, 183 F.2d 553 (7th Cir. 1950); *Los Angeles Cemetery Asso. V. Commissioner*, 2 B.T.A 495 (1925), acq. 1926-1 C.B. 4; *American Cemetery Co. v. United States*, 28 F.2d 918 (D. Kan. 1928); *Portland Cremation Ass'n v. Commissioner*, 31 F.2d 843 (9th Cir. 1929), rev'g, 10 B.T.A 65 (1928). However, where the taxpayer has control and receives benefits from proceeds placed in trust courts have treated the proceeds as gross income under § 61. See *Gracelawn Memorial Park, Inc. v. United States*, 260 F.2d 328 (3rd Cir. 1958), aff'g, 157 F.Supp. 516 (1957); *Crystal Lake Cemetery Asso. v. United States*, 413 F.2d 617 (8th Cir. 1969), aff'g, 1968 U.S. Dist. LEXIS 11621 (1968)

ANALYSIS

We are adverse to Taxpayer's request for two reasons. First, Taxpayer asserts that, under the *Seven-Up* line of cases and under the cemetery perpetual care line of cases, Fees and Other Fees collected for Activities and Other Activities and placed in Account and Other Accounts should not be included in Taxpayer's gross income because it is merely a conduit and has no control over the Fees and Other Fees as it is required to deposit the funds into Account and Other Accounts and to use those funds for a specific purpose.

We disagree with Taxpayer's position. The fact that Taxpayer is required to keep certain amounts in Accounts and Other Accounts to ensure its obligations will be

satisfied during the second stage of its business operations does not mean that these amounts are not included in gross income. Unlike the cemetery plot owners who are concerned not only with the upkeep of their lots, but also with the overall maintenance of the cemetery grounds, Taxpayer's clients have no interest in, nor participate in the Activities and Other Activities' phase of Taxpayer's operations. *Commissioner v. Cedar Park Cemetery Ass'n*, 183 F.2d 553, 555 (7th Cir. 1950) Further, Taxpayer has a statutory obligation to perform Activities and Other Activities. Taxpayer's obligations are owed to Agency and State, and the clients have no interest in Taxpayer's Activities or Other Activities. Further, Taxpayer is under no obligation to repay the funds to its clients, and all of the Activities and Other Activities obligations are imposed on the Taxpayer. Therefore, Taxpayer does not act as a mere conduit.

Second, Taxpayer asserts that, similar to the *Seven-Up* line of cases and the cemetery perpetual care line of cases, it does not derive a benefit from Fees or Other Fees.

We disagree with Taxpayer's position. Unlike the bottlers in *Seven-Up* and the taxpayers in the cemetery perpetual care line of cases, Taxpayer has a statutory obligation to perform Activities and Other Activities. Thus, funding Activities and Other Activities is Taxpayer's liability. Using the funds in Account and Other Accounts to satisfy its liabilities is a benefit to Taxpayer. Moreover, Taxpayer may use the funds in Account and Other Accounts to purchase equipment for which Taxpayer takes ownership, thus directly benefiting from the Fees and Other Fees.

CONCLUSION

Therefore, to comply with the requirements of § 61, Taxpayer must include Fees and Other Fees in gross income.

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 representatives.

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,

Christina M. Glendening
Senior Counsel, Branch 5
Office of Associate Chief Counsel
(Income Tax & Accounting)

cc: