

Internal Revenue Service

Department of the Treasury
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LEGEND

- Taxpayer 1 =
- Taxpayer 2 =
- Global Brand =
- Industry =
- Licensees =
- Brand Fund =
- Licensee Association =
- Year X =
- Year Y =
- Payment Source A =
- Company A =
- \$z =
- Payment Source B =

Dear :

This letter responds to your request for a private letter ruling dated December 2, 2020, as supplemented by letters dated August 12, 2021; November 18, 2021; and April 21, 2022, and as modified by the letters dated August 9, 2022 and October 4, 2022. The request was submitted by Taxpayer 1 on behalf of its subsidiary, Taxpayer 2, and relates to whether specific payments must be included in Taxpayer 2's gross income under § 61 of the Internal Revenue Code ("Code"). This letter ruling is being issued electronically in accordance with Rev. Proc. 2020-29, 2020-21 I.R.B. 859. A paper copy will not be mailed to the taxpayers.

FACTS

Background

Taxpayer 1 is the parent of a U.S. consolidated group engaged in the Industry as part of Global Brand. Taxpayer 2 is a wholly-owned indirect subsidiary of Taxpayer 1. Global Brand's main activity is to license its brand to Licensees and manage Licensees' facilities pursuant to license and/or management agreements ("Licensing Agreements").

Under the Licensing Agreements, Licensees must make certain payments into the Brand Fund, a pooled fund that is used for the collective benefit of the Licensees. Taxpayer 2 receives the Licensees' payments and manages the Brand Fund; however, the use of the money in the Brand Fund, as well as the identification of other funding sources for the Brand Fund, is governed by contractual arrangements and agreed-upon business practices (collectively, Brand Fund Agreements) between Taxpayer 2 and Licensee Association, an independent organization run by and representing the interests of the Licensees. Under the Brand Fund Agreements, amounts placed in the Brand Fund can only be used to pay expenses related to promotional activities that benefit licensees such as marketing, distribution, and reward reimbursements. To ensure that the Brand Fund is being used in accordance with the Brand Fund Agreements, the Licensees monitor the Brand Fund's budget and the Brand Fund is subject to an independent audit every year.

Consent Agreement

In Year X, a Consent Agreement granting a change in accounting method was executed by Taxpayer 1 on behalf of Taxpayer 2. Under the terms of the Consent Agreement, Taxpayer 2 was given permission to exclude from gross income the Licensing Payments it received from the Licensees that it placed in the Brand Fund. The Consent Agreement was based, in part, on representations supporting the position that Taxpayer 2 was acting as a conduit for the Licensees with regard to the Licensing Payments.

Payment Sources

As of Year Y, Taxpayer 2 had agreements with various third-parties which have resulted in Taxpayer 2 receiving funds from non-licensees that are placed into the Brand Fund. These third-party payments were not previously contemplated in the Consent Agreement.

Payment Source A consists of payments received from Company A pursuant to a contract entered into between Company A and Taxpayer 2 in Year X (Company A Agreement). Taxpayer 2 received Payment Source A in the form of a single \$z payment in Year X and has been recognizing the payment ratably over the life of the Company A Agreement for financial accounting purposes.

From Year X until Year Y, as Payment Source A amounts have been recognized for financial accounting purposes, those amounts have been contributed to the Brand Fund pursuant to the Brand Fund Agreements active at the time. Taxpayer 1 represents that Taxpayer 2 and the Licensee Association have since agreed that Revenue Stream A amounts treated as received beginning in Year Y will not be considered part of the Brand Fund. Taxpayer 2 also intends to change how it accounts for the Payment Source A amounts by including them in Taxpayer 2's income as those amounts are recognized.

Payment Source B also consists of payments received from Company A pursuant to the Company A agreement and represent a portion of the revenue generated from the Licensees' customers who purchase Company A's products. Taxpayer 2 receives Revenue Stream B payments on an ongoing basis.

As with Payment Source A, Payment Source B payments have been treated as part of the Brand Fund under the Brand Fund Agreements and excluded from income. Taxpayer 1 represents that Taxpayer 2 and the Licensee Association have agreed that Payment Source B payments received beginning in Year Y will not be considered part of the Brand Fund. Taxpayer 2 also intends to change how it accounts for the Payment Source B payments by including them in Taxpayer 2's income as those amounts are recognized.

REQUESTED RULING

Whether the change in treatment of Payment Source A and Payment Source B payments is a change of Taxpayer 2's facts, rather than a change in its method of accounting, which does not adversely impact the validity of the Consent Agreement.

LAW AND ANALYSIS

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 a taxpayer's receipt of a payment is conditioned on a binding legal obligation to remit the payment to another, or the taxpayer receives a payment as an agent receiving amounts on behalf of a principal, the taxpayer is generally deemed to be a mere conduit of those funds and is not required to include the payment in income. See Rev. Rul. 76-479, 1976-2 C.B. 20; Rev. Rul. 69-274, 1969-1 C.B. 36; Rev. Rul. 65-282, 1965-2 C.B.

21 and Rev. Rul. 58-220, 1958-1 C.B. 26, for instances in which the Service has held that a taxpayer does not have gross income upon receipt of a payment because the taxpayer receives the payment as a conduit for the ultimate recipient. See also Seven-Up Co. v. Commissioner, 14 T.C. 965 (1950), acq. in result, 1974-2 C.B. 1 (concluding that a manufacturer's receipt of funds from participating bottlers for a national advertising campaign was not includible in gross income because the funds benefitted the payors, not the manufacturer).

The Consent Agreement concerns the income tax treatment of the Licensing Payments—in other words, payments made by the Licensees to Taxpayer 2, as mandated by the Licensing Agreements, which Taxpayer 2 must place in the Brand Fund, pursuant to the Licensing Agreements and/or the Brand Fund Agreements.

Payments received from Payment Sources A and B do not fall within the ambit of the Consent Agreement, under either the older or newer Brand Fund Agreements. Although, prior to Year Y, Taxpayer 2's use of Payment Source A and B payments were subject to restrictions under the Brand Fund Agreements, such restrictions were not a condition of Taxpayer 2's receipt of the payments from Company A. The subsequent changes in treatment of Payment Source A and B payments under the Brand Fund Agreements do not alter this analysis. Consequently, the changes in treatment have no impact on the Consent Agreement.

CAVEATS

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,

Ronald J. Goldstein
Senior Technician Reviewer, Branch 2
(Income Tax & Accounting)

cc: