

Internal Revenue Service

Department of the Treasury

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Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:

CC:IT&A:3 /PLR-112611-00

Date:

August 15, 2000

LEGEND:

State X =
State Revenue Department =
State Statute A =
State Statute B =
State Statute C =
State Statute D =
State Constitution Provisions =

Year 1 =
Year 2 =
Month/Day 1 =
Month/Day 2 =
Date =
y% =
\$z =

Dear

This letter responds to your ruling request submitted on behalf of State X by a letter dated June 26, 2000, as modified by letters dated July 24, 2000, and August 8, 2000. Your request relates to whether there is an information reporting requirement under either section 6050E or section 6041 of the Code with respect to rebates to be paid pursuant to State Statute A, a tax relief provision. Before we can address those issues, it is necessary to determine the character of the rebates paid under State Statute A. In other words, we need to resolve whether the rebates are truly rebates of real property tax, rebates of income tax, or general payments (which could be either welfare payments or accessions to wealth). Also, after determining the character, we will determine whether the rebates are gross income to the recipients.

PLR-112611-00

CHARACTERIZATION OF REBATES

State Statute A provides that a rebate shall be paid by the State Revenue Department to taxpayers in the amount of the credit allowed under State Statute B with respect to the taxpayer's Year 1 State X income tax return for residential real property taxes paid on the principal residence of the taxpayer. However, the amount of the rebate shall not exceed \$z per principal residence. An individual will receive at most \$z. With respect to the situation of a married couple who file a joint Year 1 State X income tax return and who have separate residences, you have represented that State X will not issue a rebate for more than \$z to each spouse individually. In other words, State X will not issue a check for twice the amount of \$z to the couple jointly. The rebate will be paid to all eligible taxpayers who have filed a Year 1 State X income tax return on or before Month/Day 1 of Year 2. Depending on when taxpayers filed their returns before that date, the rebates are to be paid by checks issued either on or before Month/Day 1 of Year 2 or Month/Day 2 of Year 2. A check mailed on Month/Day 2 of Year 2 should be received before the end of Year 2.

State Statute B provides a state income tax credit for residential real property taxes. Every individual taxpayer is entitled to a tax credit equal to y% of real property taxes paid by such taxpayer during the taxable year on the principal residence of the taxpayer. The State Statute B credit may not exceed the state income tax liability of the taxpayer determined after applying the State Statute C credit for tax paid to other states, but before applying the State Statute B credit.

You have represented that, as used in State Statutes A and B, the phrase "real property taxes" is defined in a manner that would include only those amounts deductible under section 164(a)(1) of the Code. See State Statute D. You have also represented that the word "paid" for a taxpayer using the cash receipts and disbursements method of accounting means, with respect to amounts placed in escrow, only those amounts the third party actually paid to the taxing authority.

State Statute A and State Statute B are within the income tax statutes of State X. Real property taxes in State X are imposed under the property tax statutes. The property tax statutes impose taxes used to fund local governments, not the state government. The rebates under State Statute A will be paid from state treasury funds. The fact that the rebates will be paid from state treasury funds does not mean that the rebates cannot be refunds of real property taxes that were paid to local governments. Local governments are political subdivisions of State X, and have only the authority delegated to them by State X in its Constitution and statutes. For purposes of the rebates, local governments cannot be distinguished from the State X government. Furthermore, under the Constitution of State X, the authority of the General Assembly over "real property taxes"

PLR-112611-00

(as that term is used in State Statutes A and B) levied by local governments is absolute. See State Constitution Provisions.

As discussed in your request, the provisions of State Statute A can be illustrated by the following examples:

An individual who paid no property tax on a principal residence during Year 1 will not receive a rebate. This statement is true because the allowable rebate is equal to $y\%$ of property taxes paid by an individual on his or her principal residence during Year 1 (up to \$z).

An individual who had no state income tax liability for Year 1 after allowance of the State Statute B credit may receive a rebate. This statement is true because the credit may reduce an individual's state income tax liability to zero. In this instance, the individual will receive a rebate equal to the amount of credit allowed (up to \$z) even though that individual had no income tax liability.

There is nothing in the Constitution of State X that prohibits or expressly permits a property tax rebate limited by the amount of income tax liability. Your office has represented that it reviewed the language of State Statute A before it was enacted into law and concluded that it was constitutional.

State X generally does not publish any legislative history of public acts other than transcripts of floor debates in the General Assembly. The transcripts from the applicable legislative session are not yet available. You have represented that, to the best of your knowledge, there was no substantive statement made on the floor of either house concerning the substance of State Statute A. Accordingly, there is no legislative history available. However, the Governor of State X issued a press release dated Date, the same day the act implementing State Statute A was signed. This press release describes the rebates as property tax rebates, and it includes quotes from the Governor that refer to the rebates as property tax rebates.

Accordingly, we conclude that the rebates to be made pursuant to State Statute A are property tax rebates for property taxes paid in Year 1.

WHETHER THE PAYMENTS ARE GROSS INCOME

Section 61(a) of the Code provides that, except as otherwise provided in subtitle A, gross income means all income from whatever source derived. See also section 1.61-1(a) of the Income Tax Regulations.

PLR-112611-00

Section 111(a) of the Code provides that gross income does not include income attributable to the recovery during the taxable year of any amount deducted in any prior taxable year to the extent such amount did not reduce the amount of tax imposed by chapter 1 of subtitle A. This section constitutes the codification of the so-called “exclusionary” portion of the tax benefit rule. The balance of the tax benefit rule, the “inclusionary” portion, has been described in different ways, but it does not always require an actual recovery.

The consolidated cases of Hillsboro National Bank v. Commissioner and United States v. Bliss Dairy, Inc., 460 U.S. 370 (1983), 1983-1 C.B. 50 (discuss prior version of section 111), represent the Supreme Court’s latest analysis of the tax benefit rule. The tax benefit rule is a judicially developed principle that modifies the annual accounting doctrine under specific circumstances. The basic purpose of the tax benefit rule is to achieve rough transactional parity in tax and to protect the Government and the taxpayer from the adverse effects of reporting a transaction on the basis of assumptions that an event in a subsequent year proves to have been erroneous. Id. at 383, 1983-1 C.B. at 54. The tax benefit rule will “cancel out” an earlier deduction when the later event is fundamentally inconsistent with the premise on which the deduction was initially based. Id.

Section 164(a) of the Code provides in part the general rule that, except as otherwise provided in section 164, state and local real property taxes shall be allowed as a deduction for the taxable year within which paid or accrued.

As a general matter, a taxpayer who receives a refund of state taxes previously deducted on a prior year’s federal income tax return must include the refund in gross income in the year received to the extent of any federal income tax benefit, in accordance with section 111. A taxpayer who receives a refund of state taxes that were not previously deducted on a prior year’s federal income tax return is not required to include the refund in gross income in the year received. See Rev. Rul. 93-75, 1993-2 C.B. 63. Cf. Rev. Rul. 79-315, 1979-2 C.B. 27 (prior law); Rev. Rul. 78-194, 1978-1 C.B. 24 (prior law); Rev. Rul. 70-86, 1970-1 C.B. 23 (prior law).

Generally, the taxpayers who receive rebates pursuant to State Statute A file their State X and federal income tax returns on the cash receipts and disbursements method of accounting and on a calendar year basis. As discussed above, the rebates made pursuant to State Statute A are refunds of real property taxes paid in Year 1. The rebates will be received during Year 2 and will always be for an amount less than the real property taxes paid in Year 1 (because of the y% limitation). Depending on their particular circumstances, taxpayers may or may not have deducted the real property taxes paid on their Year 1 federal income tax return.

PLR-112611-00

Accordingly, we conclude that taxpayers who included real property taxes within their itemized deductions on Schedule A of their Year 1 Form 1040 (U.S. Individual Income Tax Return) must include the State Statute A rebate in gross income in Year 2 to the extent of any federal income tax benefit, in accordance with section 111. See Rev. Rul. 93-75. We also conclude that taxpayers who used the standard deduction in lieu of itemized deductions in the computation of their Year 1 federal income tax liability are not required to include the rebate in their Year 2 gross income.

WHETHER THERE ARE INFORMATION REPORTING REQUIREMENTS

Section 6050E

Section 6050E(a) of the Code provides that every person who, with respect to any individual, during any calendar year makes payments of refunds of State or local income taxes (or allows credits or offsets with respect to such taxes) aggregating \$10 or more shall make a return according to forms or regulations prescribed by the Secretary setting forth the aggregate amount of such payments, credits, or offsets, and the name and address of the individual with respect to whom such payment, credit, or offset was made. Section 6050E(b) provides that every person required to make a return under section 6050E(a) shall furnish certain information to each individual whose name is required to be set forth in such return.

Section 6050E applies only to refunds of income taxes. It does not apply to refunds of other types of taxes, such as the real property tax. Thus, State X has no reporting requirement under section 6050E.

Section 6041

Section 6041(a) of the Code provides in part that all persons engaged in a trade or business and making payment in the course of such trade or business to another person of rent, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, or other fixed or determinable gains, profits, and income of \$600 or more in any taxable year shall render a true and accurate return to the Secretary, under such regulations and in such form and manner and to such extent as may be prescribed by the Secretary, setting forth the amount of such gains, profits, and income, and the name and address of the recipient of such payment. Section 6041(d) provides that every person required to make a return under section 6041(a) shall furnish certain information to each person with respect to whom such a return is required.

Sections 1.6041-1(b)(1) and (g) of the Income Tax Regulations provide that payments made by a state or a political subdivision are subject to this reporting requirement.

PLR-112611-00

State X will not issue a rebate for more than \$z to any individual. Because this amount is less than the \$600 threshold amount of section 6041, State X will have no reporting requirement under section 6041 for the payment of the rebate. In addition, as used in section 6041, the phrase “gains, profits, and income” means gross income and not the gross amount paid. Under the tax benefit rule, the rebate of property tax would be includible in the gross income of the recipient only to the extent of any federal income tax benefit of a previous deduction. However, it has been represented that State X does not know which taxpayers itemized real property taxes on their federal income tax returns or the extent to which such taxpayers would have any federal income tax benefit. (State X does not allow taxpayers to itemize deductions and, consequently, does not receive information from taxpayers indicating whether they itemized deductions on their federal returns.) Therefore, the amount of income, if any, resulting from the payment of the rebate is not fixed or determinable by State X.

CONCLUSION

Based on the facts submitted and the representations made, we conclude that State X has no information reporting requirements under sections 6050E and 6041 as a result of the rebates paid pursuant to State Statute A.

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

Sincerely,

Associate Chief Counsel
(Income Tax & Accounting)

By: _____
Michael D. Finley
Chief, Branch 3

Enclosure:

Copy for section 6110 purposes

cc: District Director,
Attn: Chief, Examination Division