DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

OFFICE OF
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Mr. [redacted]

Dear [redacted]:

This responds to your inquiry to Senator [redacted] about the tax treatment of federal appropriations. [redacted] wrote to us on your behalf and asked us to respond to you directly. You asked if a business must include federal appropriations that it receives in its taxable income, or if those funds receive a different tax treatment.

The tax treatment of federal appropriations depends on all the facts and circumstances surrounding the appropriation. The law defines gross income as all income from whatever source derived [Section 61(a) of the Internal Revenue Code (Code)]. The United States Supreme Court has held that under section 61 of the Code, the Congress intended to tax all gains or undeniable accessions to wealth, clearly realized, over which taxpayers have complete dominion [*Commissioner v. Glenshaw Glass Co.*, 348 U.S. 426 (1955), 1955-1 C.B. 207]. Moreover, the Supreme Court has consistently held that taxpayers must include advance payments of income in gross income in the year they receive the advance payment [*Schlude v. Commissioner*, 372 U.S. 128 (1963); *American Automobile Association v. United States*, 367 U.S. 687 (1961); *Automobile Club of Michigan v. Commissioner*, 353 U.S. 180 (1957)].

Consequently, unless a business is tax-exempt under the Code, generally it must include federal appropriations in gross income, especially if the payments were in exchange for the purchase of goods or services by the federal or a state government. However, certain statutory or common law exclusions from gross income may apply.

One example of a common law exclusion from gross income is for an amount an individual or a business receives as a loan. Whether an amount received is a loan depends on all the facts and circumstances, including whether or not the taxpayer has an obligation to repay the amount borrowed and whether or not the lender charged interest. The Supreme Court recognized that the proceeds of a loan are not income to the borrower [*Commissioner v. Indianapolis Power & Light Co.*, 493 U.S. 203 (1990)].

An example of a statutory exception to the usual rule of inclusion in gross income is for amounts received as “gifts.” A taxpayer can exclude the value of property acquired as a gift from gross income [Section 102(a) of the Code]. The Supreme Court has held that a “gift" must result "from a 'detached and disinterested generosity,' . . . 'out of affection, respect, admiration, charity or like impulses'" [*Commissioner v. Duberstein*, 363 U.S.

278, 285 (1960), 1960-2 C.B. 428]. However, payments that result from a moral or legal duty or from an anticipated economic benefit are not gifts [*Duberstein* at 285]. Therefore, a taxpayer cannot exclude amounts received for goods or services from gross income.

In the case of a corporation, gross income does not include any contribution to the capital of the taxpayer [Section 118(a) of the Code]. The term “contribution to the capital of the taxpayer” does not include any contribution in aid of construction or a contribution as a customer or potential customer [Section 118(b) of the Code]. Special rules apply for water and sewage disposal utilities [Section 118(c) of the Code].

I hope this information is helpful. If you need further information, please contact , Identification Number [redacted], at .

Sincerely,

Robert M. Brown
Associate Chief Counsel
(Income Tax and Accounting)

cc: