Internal Revenue Service

Number: **200516011**
Release Date: 4/22/2005
Index Number: 118.00-00, 118.01-02, 118.01-03

Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:

,

Telephone Number:

Refer Reply To:
CC:PSI:5
PLR-146148-04
Date:
DEC 28 2004

LEGEND

Taxpayer =

State =

Company A =

Company B = .

Division =

City =

Department =

Lot 1 =

Lot 2 =

Year 1 =

Year 2 =

Date 1 =

Date 2 =

Date 3 =

a =

b =

c =

d =

e =

f =

g =

Dear :

This letter responds to Taxpayer's letter dated August 19, 2004, requesting a letter ruling concerning whether the transfer of a parcel of land is a nonshareholder contribution to capital excludable from Taxpayer's income under § 118(a) of the Internal Revenue Code.

Taxpayer represents that the facts are as follows:

FACTS

Taxpayer is a corporation organized under the laws of State. Taxpayer is a wholly owned subsidiary of Company A and is included in the consolidated federal tax return of Company B. Taxpayer is under the audit jurisdiction of Division.

Taxpayer is a retailer of furniture, appliances, electronics, and flooring merchandise. As part of an effort to expand into new markets, Taxpayer has opened an additional store in another location.

Taxpayer built a facility (the "Facility") including both retail and warehouse space in City. The Facility is located on approximately b acres. Construction began in Year 1 and operations commenced in Year 2. Department provided Taxpayer with the

incentives below to locate the Facility in a statutorily established redevelopment district within its jurisdiction.

On Date 1, for the sum of $a, Department sold and conveyed to Taxpayer all of its interest in Lot 1 and Lot 2 totaling approximately b acres and valued at $c and $d respectively as of Date 1. Also on Date 1, Taxpayer and Department entered into an agreement whereby Taxpayer agreed to construct, develop, complete, and operate a minimum e square foot retail facility, a minimum of f square feet of warehouse space, and certain connecting improvements located between Taxpayer's facility and those of other nearby developers.

On Date 2, Lot 1 was deeded back to Department. On Date 3, Department sold and conveyed to Taxpayer all of its interest in Lot 1 for $g.

RULING REQUESTED

Taxpayer requests the Service to rule that the transfer of Lot 1 (its value net of Taxpayer's cost) be considered a nonshareholder contribution to capital within the meaning of § 118(a) and that the basis to Taxpayer of Lot 1 is $g.

LAW AND ANALYSIS

Section 61(a) and § 1.61-1 of the Income Tax Regulations provide that gross income means all income from whatever source derived, unless excluded by law. Section 118(a) provides that in the case of a corporation, gross income does not include any contribution to the capital of the taxpayer.

Section 1.118-1 provides, in part, that § 118 also applies to contributions to capital made by persons other than shareholders. For example, the exclusion applies to the value of land or other property contributed to a corporation by a governmental unit or by a civic group for the purpose of inducing the corporation to locate its business in a particular community, or for the purpose of enabling the corporation to expand its operating facilities. However, the exclusion does not apply to any money or property transferred to the corporation in consideration for goods or services rendered, or to subsidies paid for the purpose of inducing the taxpayer to limit production.

The legislative history of § 118 provides, in part, as follows:

> This [section 118] in effect places in the Code the Court decisions on the subject. It deals with cases where a contribution is made to a corporation by a governmental unit, chamber of commerce, or other association of individuals having no proprietary interest in the corporation. In many such cases because the contributor expects to derive indirect benefits, the contribution cannot be

called a gift; yet the anticipated future benefits may also be so intangible as to not warrant treating the contribution as a payment for future services.

S. Rep. No. 1622, 83d Cong., 2d Sess. 18-19 (1954).

When § 118 was enacted in 1954, Congress also enacted § 362(c) dealing with the basis to be given to a nonshareholder's contribution to capital. Section 362(c) provides in part as follows:

(1) Property Other Than Money. Notwithstanding subsection (a)(2) [providing generally a carryover basis for contributions by shareholders], if property other than money

(A) is received by a corporation, on or after June 22, 1954, as a contribution to capital, and

(B) is not contributed by a shareholder as such, then the basis of such property shall be zero.

(2) Money. Notwithstanding subsection (a)(2), if money

(A) is received by a corporation, on or after June 22, 1954, as a contribution to capital, and

(B) is not contributed by a shareholder as such, then the basis of any property acquired with such money during the 12-month period beginning on the day the contribution is received shall be reduced by the amount of such contribution. The excess (if any) of the amount of such contribution over the amount of the reduction under the preceding sentence shall be applied to the reduction (as of the last day of the period specified in the preceding sentence) of the basis of any other property held by the taxpayer. The particular properties to which the reductions required by this paragraph shall be allocated shall be determined under regulations prescribed by the Secretary.

Section 1012 provides generally that the basis of property shall be the cost of such property.

In Detroit Edison Co. v. Commissioner, 319, U.S. 98 (1943), the Court held that payments by prospective customers to an electric utility company to cover he cost of extending the utility's facilities to their homes, were part of the price of service rather than contributions to capital. The case concerned customers' payments to a utility company for the estimated cost of constructing service facilities (primary power lines)

that the utility company otherwise was not obligated to provide. The customers intended no contribution to the company's capital.

In Brown Shoe Co. v. Commissioner, 339 U.S. 583 (1950), the Court held that money and property contributions by community groups to induce a shoe company to locate or expand its factory operations in the contributing communities were nonshareholder contributions to capital. The Court reasoned that when the motivation of the contributors is to benefit the community at large and the contributors do not anticipate any direct benefit from their contributions, the contributions are nonshareholder contributions to capital. Id. at 591.

In United States v. Chicago, Burlington & Quincy R.R. Co., 412 U.S. 401 (1973), the Court set forth five characteristics of a nonshareholder contribution. First, the payment must become a permanent part of the transferee's working capital structure. Second, it may not be compensation, such as a direct payment for a specific, quantifiable service provided for the transferor by the transferee. Third, it must be bargained for. Fourth, the asset transferred foreseeably must benefit the transferee in an amount commensurate with its value. Fifth, the asset ordinarily, if not always, will be employed in or contribute to the production of additional income and its value assured in that respect.

In Springfield St. Ry. Co. v. United States, 577 F.2d 700 (Ct. Cl. 1978), the Court of Claims found that grants by the commonwealth of Massachusetts to a taxpayer were not conditioned on the taxpayer's use of such funds for the acquisition of capital assets. As a result, such funds were not considered to be contributions to capital and were included in the taxpayer's gross income.

In the present case, Department transferred Lot 1 to Taxpayer as part of a plan to induce Taxpayer to build and operate its business in City. As in Brown Shoe Co., the transfer of Lot 1 by Department was motivated by a desire to benefit the general community.

The transfer of Lot 1 satisfies the five characteristics of a nonshareholder contribution to capital enunciated by the Court in Chicago, Burlington & Quincy R.R. Co.

Based solely on the foregoing analysis and the representations made by Taxpayer, we rule as follows:

1. The contribution of Lot 1 (its value net of Taxpayer's cost) is excludable from income as a nonshareholder contribution to capital under § 118(a).

2. The basis to Taxpayer in Lot 1 is $g.

Except as specifically set forth above, no opinion is expressed or implied concerning the federal income tax consequences of the above described facts under any other provision of the Code or regulations.

In accordance with the power of attorney filed with this request, we are sending a copy of this letter to Taxpayer's authorized representative. This 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,

/s/ Walter H. Woo

Walter H. Woo
Senior Technician Reviewer
Branch 5
Office of Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosure: 6110 copy

cc: