



CHIEF COUNSEL

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

MAR - 4 2010

Cameron F. Kerry
General Counsel
United States Department of Commerce
1401 Constitution Avenue, NW, Room 5870
Washington, DC 20230

Dear Cam:

This letter responds to your e-mail dated February 3, 2010, regarding whether recipients of grant payments awarded by the Department of Commerce's National Telecommunications and Information Administration under the Broadband Technology Opportunities Program (BTOP) must include those payments in income. BTOP was created by the American Recovery and Reinvestment Act of 2009 (the Act). Based on our review of the legislation, we think that grant payments under BTOP will qualify for exclusion from income under section 118 of the Internal Revenue Code (the Code) in some circumstances, but not in others.

Generally, gross income includes all income from whatever source derived. Thus, taxpayers other than nonprofit or governmental entities must include governmental grants in gross income absent a specific exclusion. BTOP grant payments do not qualify for the general welfare exclusion because that exclusion is generally limited to individuals who receive governmental payments to help them with their individual needs (e.g., housing, education, and basic sustenance expenses). The Act which authorizes the BTOP grants does not expressly exclude them from gross income, so we must look for any exclusion within the Code. The Code does have several specific exclusions from gross income, but the only exclusion that applies, in some circumstances, to the BTOP grants is section 118 of the Code.

Section 118(a) of the Internal Revenue Code provides that, in the case of a corporation, gross income does not include any contribution to the capital of the corporation. Section 1.118-1 of the Income Tax Regulations provides that section 118(a) applies to contributions to capital made by a person other than a shareholder, for example, property contributed to a corporation by a governmental unit for the purpose of enabling the corporation to expand its operating facilities.

In United States v. Chicago, Burlington & Quincy Railroad Co., 412 U.S. 401 (1973), the Supreme Court adopted a two-part inquiry to identify a nonshareholder contribution to capital: (1) the intent or motive of the transferor; and (2) the economic effect on the transferee corporation. The transferor's intent must be to enlarge the transferee corporation's capital to expand its trade or business for the benefit of the community at

large and not to receive a direct or specific benefit for the transferor. For the requisite economic effect on the transferee corporation, the following five factors must be present: (1) the contribution certainly must become a permanent part of the transferee's working capital structure; (2) the contribution may not be compensation, such as a direct payment for a specific, quantifiable service provided for the transferor by the transferee; (3) the contribution must be bargained for; (4) the contributed asset foreseeably must result in benefit to the transferee in an amount commensurate with its value; and (5) the contributed asset ordinarily, if not always, will be employed in or contribute to the production of additional income and its value assured in that respect.

Thus, a BTOP grant payment that is made to a corporation restricted solely to the acquisition of capital assets to be used to expand the corporate grant recipient's trade or business and that satisfies the five factors is excluded from the corporation's gross income as a nonshareholder contribution to capital under section 118(a). A BTOP grant payment made to a corporation that may be used for operating expenses, however, will not qualify as a section 118(a) contribution to capital and so must be included in the corporation's gross income.

Another limitation on section 118(a) is that it applies only to corporations, including Limited Liability Companies (LLCs) treated as a corporation for federal income tax purposes. Section 118(a) does not apply to noncorporate entities such as partnerships, including LLCs treated as a partnership for federal income tax purposes. In the case of an LLC treated as a "disregarded entity" for federal income tax purposes, we would look to the owner of the disregarded entity, i.e., a corporate owner could qualify for the exclusion while a disregarded LLC owned by a partnership would not.

If a grant recipient must include a BTOP grant payment in gross income, the grant recipient is allowed to deduct against the grant proceeds and other gross income all deductible business expenses, net operating losses, and other allowable deductions for that year.

I hope this information is helpful. If you would like to discuss this matter, please call me at (202) 622-3300.

Sincerely,

A handwritten signature in black ink, appearing to read "William J. Wilkins". The signature is fluid and cursive, with a large initial "W" and "J".

William J. Wilkins
Chief Counsel