

**REQUEST FOR CONFIRMATION FROM THE INTERNAL REVENUE SERVICE
THAT CHARITABLE LOANS AND GRANTS PROVIDED TO FOR-PROFIT
BUSINESS ENTITIES AFFECTED BY THE SEPTEMBER 11, 2001 TERRORIST
ATTACKS ARE EXCLUDABLE FROM INCOME**

The following Request represents the individual views of the members of the Section of Taxation who prepared them and does not represent the position of the American Bar Association or of the Section of Taxation.

This Request was prepared by individual members of the Committee on Exempt Organizations and the 9/11 Tax Task Force of the Section of Taxation, and colleagues of such members who are currently working on disaster-relief efforts. Principal responsibility was exercised by Victoria B. Bjorklund and Catherine E. Livingston on behalf of the 9/11 Tax Task Force of the Section of Taxation chaired by Michael Hirschfeld. Substantive contributions were made by Dickson G. Brown, Jennifer L. Franklin, Jennifer I. Goldberg, Kim Maxfield, and Michelle Wandler. This Request was reviewed by Richard Lipton, Section Chair, William Wilkins, Vice Chair, Government Relations and Michael Hirschfeld, Chair, 9/11 Tax Task Force.

Although many members of the Section of Taxation who participated in preparing this Request have clients who would be affected or have advised clients on the application of such principles, no such member (or the firm or organization to which such member belongs) has been engaged by a client to make a government submission with respect to, or otherwise to influence the development or outcome of, the specific subject matter of this Request.

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We are seeking confirmation from the Internal Revenue Service (the “Service”) that charitable loans and grants to for-profit business entities affected by the September 11th terrorist attacks are excludable from income as gifts within the meaning of Section 102 of the Internal Revenue Code of 1986, as amended (the “Code”).

The Service has taken a clear and definitive position that relief payments awarded to individuals on the basis of need are excludable from income. Where the relief payment is made as part of a governmentally-authorized program, the Service has ruled that the payment is excluded from the recipient’s income under the general welfare doctrine (See, e.g., Rev. Rul. 76-144, 1976-1 C.B. 17 (grant received under the Disaster Relief Act of 1974 is in the interest of the general welfare and not includible in an individual's gross income)). Where the payment is made by a nongovernmental Code section 501(c)(3) charity, the Service has ruled that “a payment made by a charity to an individual that responds to the individual’s needs, and does not proceed from any moral or legal duty, is motivated by detached and disinterested generosity,” and therefore is excludable from the individual’s income as a gift (See Rev. Rul. 99-44, 1999-43 I.R.B.).

The treatment of charitable relief payments to business entities, however, is not clear. In addition, it is not clear whether the application of Code sections 7872 or 108 would cause relief, provided in the form of a below-market loan or forgiveness of all or part of a loan, to create income for the beneficiary. We believe there is a sound basis in the law that is reflected in published Service rulings to exclude these relief payments to business entities from income. Accordingly, we request from the Service prompt confirmation of the exclusion from income of charitable relief payments, including grants, the below-market interest portion of loans, and the cancellation of all or part of loans, made by Code section 501(c)(3) charities to for-profit business entities affected by the September 11th terrorist attacks.

Relief Efforts.

In addition to government agencies, hundreds of charities have undertaken disaster-relief programs. A number of those charities are assisting small and medium-sized for-profit business entities affected by the September 11th terrorist attacks on the World Trade Center. Such charitable relief efforts include grants to the business entities and below-market or interest-free loans, all or some of which may be forgiven over time. These business entities include individual proprietorships, partnerships, LLCs and corporations.

Below-Market Loans.

The proceeds from a loan are not includable in a borrower’s income (See, e.g., E.C. Gatlin v. Commissioner, 34 B.T.A. 50 (1936); Rev. Rul. 70-266, 1970-1 C.B. 116). The Service, however, has the authority under Code section 7872 to impute income to parties who borrow funds at a below-market rate of interest. Below-market loans undertaken as part of a government relief effort do not create this type of imputed income to the recipient business

entities (See, e.g., Priv. Ltr. Rul. 1999-43-037 (Oct. 29, 1999) (the Service found that Code section 7872 does not apply to government-financed loan programs created to provide financial assistance to companies affected by severe flood and fire damage, as these loans were not established with the principal purpose of tax avoidance)). This ruling applies only to a governmentally-authorized loan program. Nevertheless, we believe that the same policy and rationale should apply to below-market or interest-free loans made by nongovernmental Code section 501(c)(3) charities responding to the September 11th terrorist attacks. Therefore, we request that the Service confirm that the bargain element of below-market charitable relief loans made to for-profit business entities in connection with the September 11th terrorist attacks does not create income for the borrower.

In addition to the potential imputed income from the bargain element discussed above, amounts forgiven on government disaster-relief loans can create cancellation of indebtedness income for the borrower under Code section 108 (See, e.g., Priv. Ltr. Rul. 1999-43-037 (Oct. 29, 1999)). For the reasons discussed below, we believe that the cancellation of loans made by governmental entities and Code section 501(c)(3) charities should be properly viewed as gifts to the borrower. Therefore, we request that the Service confirm that cancellation of indebtedness income from loans to for-profit business entities forgiven by charities in connection with the September 11th terrorist attacks is not taxable.

Grants.

We believe that, as a matter of law and policy, charitable grants made by Code section 501(c)(3) charities to for-profit business entities affected by the September 11th terrorist attacks are excludable from such entities' gross income as gifts within the meaning of Code section 102. As noted above, it is clear, in disaster-relief contexts, that grants received by individuals are excludible from income under the general welfare exception to Code section 61. However, in the context of business entities it is not clear whether the same exclusion applies.

Several authorities have found that a business entity can exclude from income as gifts certain payments received. For example, the Tax Court has found that contributions to an unincorporated association which were used to furnish bail for persons held in custody in certain types of cases were gifts and not includible in income (Bail Fund of the Civil Rights Congress of N.Y., 26 T.C. 482 (1956)). In a lengthy General Counsel Memorandum addressing the proper taxation of income received by an organization that had its exemption under Code section 501(c)(3) revoked, the Service stated definitively that Code section 102 is not limited in its application to gifts to individuals, and, therefore, that gifts to the revoked organization were properly excluded from the organization's income under Code section 102 as long as the gifts were not made as a result of a misrepresentation about the status of the organization (See Gen. Couns. Mem. 39813 (Apr. 2, 1990)).¹ However, in Chief Counsel Advice 2000-32-041, the

¹ Section 2(b)(6)(a) of Gen. Couns. Mem. 39813 states as follows: "One possible position is that section 102 is restricted to gifts received by individuals, out of personal affection or charitable impulses, and simply does not apply to amounts received by an organization. We conclude, however, that at this point such a restriction would not be upheld by the courts. In Duberstein, the Court expressly refused to read an implicit restriction to individuals as donors into a statute that does not draw such a distinction by its terms."

Service did not discuss whether Code section 102 could apply to treat flood relief payments to business entities as excludable gifts from income. Rather, the Service found that such payments were includible in income under Code section 61 to the extent they did not reduce the taxpayers' loss deductions under Code section 165 or the taxpayers did not elect nonrecognition under Code section 1033.

Code section 165 allows a taxpayer to deduct his or her losses to the extent the losses have not been compensated for by insurance or otherwise. Thus, for-profit business entities receiving grants from charities will be required to reduce their deductible losses under Code section 165 if the grants received compensate the entities for their losses. To the extent the grants do not reduce the business entities' losses, the grants will not affect any deduction a business entity might claim under Code section 165. However, the question still remains whether such a grant is includible in income under the Code. To the extent that charitable payments represent compensation for losses, it is possible that determining whether the grants are excludible from income may not have a practical impact on the recipient business entities. Specifically, the losses suffered by such business entities from the September 11th terrorist attacks are so great that the entities will still be entitled to claim significant loss deductions even if disaster-relief payments from charities mitigate these deductions to some degree. In addition, we believe that there are many business entities that have a low tax basis in their assets and may not be able to claim tax losses. Clarification of the treatment of charitable disaster-relief payments to business entities affected by the September 11th terrorist attacks is necessary in order to facilitate aid to such business entities.

Conclusion.

We believe that disaster-relief payments made by Code section 501(c)(3) charities, whether in the form of outright grants, below-market loans, or loan forgiveness, are all in the nature of gifts. These payments are motivated by the involved charities' core missions and commitments to their respective communities, *i.e.*, the classic detached and disinterested generosity that is articulated in the seminal Duberstein case on gifts. The charities involved have no expectation of receiving any goods or services in return, nor do they expect to earn any income, let alone profit, from these activities. Therefore, the analysis of these disaster-relief payments by charities to for-profit business entities as gifts is consistent with the manner in which the Service has evaluated payments of this kind when made to individuals (or in other contexts), which are treated as gifts.

Thus, we respectfully request that the Service promptly confirm that charitable loans and grants provided by charities to for-profit business entities affected by the September 11th terrorist attacks do not produce taxable income for the recipients. Of course, loss deductions otherwise available to such companies should be reduced by relief payments intended to compensate for those losses that are not taxed to avoid a double benefit.

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