

Guidance and Resources

Issue Guidance -State and Local Tax Incentive

- Coordinated Issue Paper is planned to be issued in May, 2008.

Issue Guidance –Bioenergy Subsidies

- Coordinated Issue Paper on Characterization of Bioenergy Program Payments issued April 8, 2008.

Issue Guidance –Environmental Remediation

- Coordinated Issue Paper in process.
- Please contact Technical Advisors for additional guidance.

Appeals Settlement Guidelines (ASGs)

[USF Appeals Settlement Guidelines 2004:](http://www.irs.gov/pub/irs-utl/asg_-_usf_final_7-23-04.pdf)
[http://www.irs.gov/pub/irs-utl/asg - usf final 7-23-04.pdf](http://www.irs.gov/pub/irs-utl/asg_-_usf_final_7-23-04.pdf)

Executing IMT Strategy for Tier I Issues

Audit Teams Should:

- Establish the Tier I Issue on IMS using the UIL code per the ID Directive.
- Research the issue on the Tier I website.
- Communicate with the IMT early to determine the strategy and any special requirements for the issue.
- Consider the issue in the audit planning and risk assessment in accordance with the IMT strategy.
- Utilize the audit tools and techniques provided by the IMT to develop the issue.
- Resolve the issue using all resolution tools in alignment with the IMT strategy.

Issue Management Team (IMT)

Issue Executive Owner - Lavena Williams

CTM Counsel - Anthony Kim

PFTG Team Manager Group 5 - Richard Fleming

Telecommunications Industry Technical Advisor -
Kathy Follis

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Environmental Technical Advisor - Greg Pierce

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Tier 1



Tier I



Section 118 Abuse

Includes: Universal Service Fund (USF), State and Local Tax Incentives (SALT), Bioenergy Subsidies and Environmental Remediation

Quick Reference Guide

April, 2008

Issue Owner Executive (IOE)

Lavena Williams, DFO

**Communications, Technology
& Media**

Tier I: Section 118 Abuse Includes USF, SALT, Bioenergy Subsidies and Environmental Remediation

Issue Description

The Tier I issue, taxable income vs. non-shareholder contributions to capital under Section 118, includes four sub-issues:

1. Universal Service Fund issue (USF) affects telecommunications providers, primarily LECs, and concerns the proper tax treatment of disbursements received from federal and state universal service funds.
2. Tax Incentive issue is a cross industry issue that affects all types of corporations who have received a reduction, abatement, or rebate of state and/or local taxes as an inducement.
3. Bio Energy Program Subsidies issue affects primarily the agricultural industry and concerns the proper tax treatment of increased ethanol production subsidy payments.
4. Environmental Remediation issue affects primarily the petroleum industry but could affect any entity that removes an underground storage tank and then is subsequently reimbursed for their Section 162 currently deductible expenses associated with the tank removal or soil remediation.

Administrative Codes

Universal Service Fund UIL Codes:

- Non Shareholder Contribution to Capital v. Income - 61.40-1
- Basis Adjustment Under Section 362(c) - 118.01-03

Tax Incentive UIL Codes:

- Non Shareholder Contribution to Capital v. Income - 118.01-02
- Basis Adjustment Under Section 362(c) - 118.01-03

Bioenergy Program Payments UIL Codes:

- Non Shareholder Contribution to Capital v. Income Bioenergy 118.01-04
- Basis Adjustment Under Section 362(c) - 118-01-03

SAIN Code:

- Non Shareholder Contribution to Capital v. Income
 - Primary SAIN 401 Secondary SAIN 180
- Basis Adjustment Under Section 362(c)
 - Primary SAIN 110 Secondary SAIN 186

Tracking/Project Code: 0569

ITA Code: C179

Information Document Requests (IDRs)

These IDRs are not mandatory:

- Generic Section 118 Pro-Forma IDR 5/25/07 (46KB): <http://www.irs.gov/businesses/article/0,,id=174840,00.html>
- Universal Service Support Pro Forma IDR (55KB) <http://www.irs.gov/businesses/partnerships/article/0,,id=169261,00.html>

Administrative & Technical Guidance

Issue Guidance Universal Service Fund

- [Revenue Ruling 2007-31](#) communicates the Service's position in relation to the USF distributions that telephony providers receive from the Universal Service Administration Company in accordance with FCC guidelines. It concludes that USF payments are taxable in accordance with IRC Section 61 and not a non-shareholder capital contribution under IRC Section 118 (a). <http://www.irs.gov/pub/irs-drop/rr-07-31.pdf>
- [TAM 200332025](#) - Technical Advice Memorandum 200332025 was released on August 11, 2003 relating to the taxability of Universal Service Fund (USF). <http://www.irs.gov/pub/irs-wd/0332025.pdf>
- [Coordinated Issue Paper on Universal Service Fund Reimbursements:](#) http://www.irs.gov/pub/irs-utl/universal_service_fund_final.pdf

Industry Director Directives (IDDs)

- **Industry Issue Directive #1** - Section 118 Does Not Apply to Non-Corporate Entities: <http://www.irs.gov/businesses/partnerships/article/0,,id=165641,00.html>
- **Industry Issue Directive #2** - Provides field direction on a Tier I Issue relating to USF Programs: <http://www.irs.gov/businesses/partnerships/article/0,,id=169260,00.html>
- **Industry Issue Directive #3** - Non-Corporate Entities and Common Law Arguments: <http://www.irs.gov/businesses/article/0,,id=174839,00.html>
- **Industry Issue Directive #4** - State and Local Tax Incentives - in process.

Litigation Update

USF and Section 118: The U.S. District Court for the Southern District of Georgia issued a decision in the erroneous refund suit, [United States v. Coastal Utilities, Inc.](#), 483 F. Supp. 2d 1232 (S.D.Ga.2007), *aff'd per curiam*, 2008 U.S. App. LEXIS 1241 (11th Cir. Ga., Jan. 23, 2008). The case was appealed and affirmed.

Issue: Whether subsidies received by Coastal Utilities, Inc. from the Federal Universal Service High Cost Support Program and the Georgia Universal Access Fund constitute income under section 61 or capital contributions under Section 118(a). A three-judge panel of the U.S. Court of Appeals for the 11th Circuit affirmed the district court's order and adopted in full its analysis and opinion that Coastal utilities may not exclude federal and state USF payments from income under Section 118.

Current Status of Issue

A. USF: The 11th Circuit's decision favorable to government on [Coastal Utilities](#). Alternate touch compliance project was completed in FY 2007.

B. State and local tax incentives: Coordinated Issue Paper to be issued May, 2008 and Compliance Initiative Project is in process.

C. Bioenergy Compliance: Alternative touch project is in process. Coordinated Issue Paper issued April 8, 2008.

D. Environmental USTs: Coordinated Issue Paper is in process.