

Industry Director Directive on Section 118 Abuse

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MEMORANDUM FOR INDUSTRY DIRECTORS  
DIRECTOR, FIELD SPECIALISTS  
DIRECTOR, PREFILING AND TECHNICAL GUIDANCE  
DIRECTOR, INTERNATIONAL COMPLIANCE  
STRATEGY AND POLICY

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SUBJECT: Tier I Issue – Section 118 Abuse Directive #1

This memorandum is intended to provide field direction on a Tier I issue relating to Section 118 abuse. While the core issue relates to whether or not income qualifies as a non-shareholder contribution to capital under I.R.C. §118, this memorandum is intended to provide guidance relating to the applicability of this code section to payments received by partnerships.

Background/Strategic Importance:

Taxpayers operating in corporate and partnership form are using I.R.C. § 118 to exclude certain payments from gross income. The field should disregard I.R.C. § 118 arguments by a taxpayer operating in partnership form. I.R.C. § 118 is only applicable to corporations. I.R.C. § 118(a) provides that “[i]n the case of a corporation, gross income does not include any contribution to the capital of the taxpayer.” Thus, taxpayers operating in partnership form cannot benefit from the use of I.R.C. § 118.

Issue Tracking:

UIL: 118-01-02 Non-shareholder Contributions

Planning and Examination Guidance:

Issue Identification: The issue can be identified via review of the Schedule M for income recorded on books but not included on Schedule K.

Planning and Examination Risk Analysis: The field should challenge all arguments by taxpayers operating in partnership form that I.R.C. § 118 allows them to exclude payments from gross income.

Audit Techniques: A generic Information Document Request should be issued asking the taxpayer for a list of all I.R.C. § 118 exclusions from income.

This Directive is not an official pronouncement of law or the position of the Service and can not be used, or cited, or relied upon as such.

cc: Commissioner, LMSB  
Deputy Commissioner, LMSB  
Division Counsel, LMSB  
Commissioner, SBSE  
Chief, Appeals  
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