

Internal Revenue Service memorandum

date: Jan. 13, 2000

to: Acting EO Area Managers

(signed) Steven T. Miller

From: Director, Exempt Organizations T:EO

Subject: Refund Claims Involving IRC 45B

The purpose of this memorandum is threefold: (1) to alert you to the likelihood of certain refund claims being forwarded from the Ogden Service Center ("OSC") to your office, (2) to describe the underlying issue, and (3) to provide guidance in handling these cases.

The OSC has informally advised this office that it has received a number of refund claims from exempt organizations that want to use the IRC 45B credit in computing their unrelated business taxable income ("UBTI") under IRC 512. These exempt organizations base their claims on a technical advice memorandum ("TAM") issued last year, which is currently under reconsideration. The OSC has indicated that it will send such claims to the appropriate EO Area office pending final resolution of such matter.

The following is a brief description of the issue being considered. A business such as a bar or restaurant that employs individuals who receive tips has a FICA tax obligation with respect to such tips. Under IRC 45B, however, such a business is allowed a credit for a portion of the FICA taxes which are attributable to employee tips. An exempt organization, such as a social club described in IRC 501(c)(7) that operates a bar or restaurant with employees receiving tips is generally subject to the same FICA tax rules as those applicable to a taxable business. Whether and under what circumstances the IRC 45B credit may be available to exempt organizations are questions that have been given extensive consideration during the past year.

In a TAM dated April 28, 1999, this office concluded that in the case of a social club described in IRC 501(c)(7), the credit provided in IRC 45B is an allowable credit in computing UBTI under IRC 512(a)(3). The TAM stated that the IRC 45B credit is

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not limited to the taxes associated with the unrelated trade or business activity, but may be claimed with respect to all tips received by the club's employees. The TAM is largely based on a memorandum dated April 26, 1999, in which the Chief Counsel's office having jurisdiction over IRC 45B stated the following:

Section 45B does not prohibit tax-exempt organizations from claiming the credit, nor does it limit the credit to FICA taxes associated with an unrelated business activity. Therefore, provided the requirements of section 45B of the Code are satisfied, a tax-exempt organization is allowed to calculate the section 45B credit on the basis of all tips received by its employees, not just the tips received in an unrelated business activity.

On August 9, 1999, the April 28 TAM was released to the public under IRC 6110 as TAM 1999-31-041. After the TAM became public, questions arose as to whether the case was correctly decided. The conclusion that an exempt organization may use the IRC 45B credit in calculating its UBTI seems correct. However, there was concern that the conclusion that such calculation may be made with respect to all tips received by an exempt organization's employees. The question is whether such calculation should be limited to tips received by employees in connection with an unrelated trade or business. The case has been reopened, and the Chief Counsel's office has been asked to give further consideration to the question of how the IRC 45B credit should be calculated.

This issue is currently under consideration in the Chief Counsel's office. Our expectation is that this process will be concluded in the very near future. Until then, any refund claims involving IRC 45B should be suspended. Once this issue has been resolved, we will provide you with additional guidance.

If there are any questions, please contact Terry Hallihan at (202) 622-7787, or Charles Barrett at (202) 622-8152.

cc: Director, EO Examinations T:EO:E