**INTERNAL REVENUE SERVICE**
NATIONAL OFFICE TECHNICAL ADVICE MEMORANDUM

April 09, 2004

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Index (UIL) No.: 461.05-00
CASE-MIS No.: TAM-162872-03, CC:ITA

District Director: LMSB:CTM

Taxpayer's Name:
Taxpayer's Address:

Taxpayer's Identification No
Years Involved:
Date of Conference: No Conference Held

LEGEND:

Taxpayer =

State A =

ISSUE:

Is the taxpayer's liability for an "estimated" monthly license fee, described below, fixed and incurred when paid under I.R.C. § 461?

CONCLUSION:

The taxpayer's liability for the estimated monthly license fee is fixed and incurred when paid on the 24th of each month.

FACTS:

Taxpayer is a group of affiliated corporations filing a consolidated return; it uses an accrual method of accounting for the calendar year. The taxpayer is a gaming and entertainment company that owns and operates hotel/casino properties in State A.

Taxpayer operates licensed gaming establishments in State A subject to the provisions of State A law governing gaming activities. State A's gaming authority, a state regulatory body, imposes a license fee based upon the gross gaming revenue collected by licensees, such as the taxpayer's casino operations. Except for the first month of a casino's operation, State A requires the license fee to be estimated and paid in advance of the month whose gross gaming revenue gives rise to the license fee. Each month's license fee payment has two components: (1) the fee required as an estimated payment of the license fee for the third month following the month whose gross revenue is used as its basis; and (2) the fee based upon the gross revenue of the preceding calendar month. The second component determines the exact license fee owed based on the preceding month's gross revenue. The second component is determined by comparing the exact license fee owed based on the preceding month's gross revenue with the amount of the estimated payment from three months back, yielding the "true-up" amount.

The licensee is required to file a report with the State A gaming authority on or before the 24th for each calendar month showing all gross revenue received during the preceding calendar month, with the license fee due based on the revenue of the month covered by the report. Also, the report must show an adjustment for the estimated fee previously paid for the month covered by the report and the fee due for the actual gross revenue earned in that month. If the adjustment is less than zero, a credit must be applied to the estimated fee due with that report. For example, the payment on November 24th, based on October gross revenues, is the estimated license fee (with adjustment for the estimated fee previously paid) for January of the next tax year, to be "trued-up" on February 24th. The payment on December 24th , based on November gross revenues, is the estimated fee for February (with adjustment), to be "trued-up" on March 24th.

Failure to pay the fees as required under the statute shall be deemed a surrender of the license at the expiration of the period for which the estimated payment of fees has been made.

If the amount of the license fees required to be reported and paid is later determined to be greater or less than the actual amount reported and paid, the commission may charge and collect the additional license fees due, with interest, or may refund any overpayment, with interest.

If the licensee ceases operation, the commission shall charge and collect any additional license fees due, with interest, or may refund any overpayment, with interest.

LAW AND ANALYSIS:

Section 461(a) provides that the amount of any deduction or credit must be taken for the taxable year that is the proper taxable year under the method of accounting used in computing taxable income.

Under an accrual method of accounting, a liability is incurred, and is generally taken into account for federal income tax purposes, in the taxable year in which (1) all the events have occurred that establish the fact of the liability, (2) the amount of the liability can be determined with reasonable accuracy, and (3) economic performance has occurred with respect to the liability. *See* § 1.461-1(a)(2)(i)*; see also* § 1.446-1(c)(1)(ii)(A). Conditions (1) and (2) are known as the traditional "all events test," existing before the addition of condition (3). *See* § 461(h)(4).

In this case, the taxpayer meets condition (3), the economic performance requirement. Section 1.461-4(g)(6)(ii) provides generally that, if a taxpayer is liable to pay a licensing fee to a governmental authority, economic performance occurs as the license fee is paid to the governmental authority.

To satisfy the traditional all events test, conditions (1) and (2) above, the liability must be final and definite in amount, must be fixed and absolute, and must be unconditional. *United States v. Hughes Properties, Inc.*, 476 U.S. 593, 600-601 (1986). The all events test is based on legal rights or obligations existing at the close of a particular accounting period, not on the probability – or even absolute certainty – that such right or obligation will arise at some point in the future. *United States v. General Dynamics Corp.*, 481 U.S. 239, 243-4 (1987); *Brown v. Helvering*, 291 U.S. 193, 200-201 (1934).

Under the all events test, the principal requirement is that the taxpayer's liability must be "fixed." A liability is fixed when payment is unconditionally due or when the required performance occurs on the part of the other party. *See*, *e.g.*, Rev. Rul. 80-230, 1980-2 C.B. 169; Rev. Rul. 79-410, 1979-2 C.B. 213, 214.

State law requires payment of a monthly license fee. The fee is based upon gross revenues of a licensee. The fee must be paid on or before the 24th day of the next month. The state requires that a licensee pay in advance an amount that approximates the fee that will be owed each month. The amount paid in advance is a monthly rolling figure, and the statutory scheme assumes the prior month's gross revenues will be similar to the future month's gross revenues.

Failure to pay the fee results in a forfeiture of the license for the month for which the estimate is required; that is, failure to pay the estimated license fee on November 24th, based on October's gross receipts, results in the forfeiture of the license beginning on January 1 of the next year.

The liability for the estimated license fee is fixed and the liability is incurred when the taxpayer makes the monthly payments. In order for the taxpayer to do business as a gaming operation, it must have the approval of the state and must abide by the state's licensing laws. State A requires prepayment of the license fee amount on a rolling forward basis. Payment of the estimated license fee is mandatory, and is the only way a gaming establishment may maintain a license. The amount of the estimated license fee is also mandated by state law, and is based on the prior month's gross receipts.

The prepayment each month is not a deposit. Since deposits are not considered payments, such amounts are not deductible by either a cash method taxpayer or an accrual method taxpayer. *See generally Glassel v. Commissioner*, 12 T.C. 232 (1949), *acq.*, 1949-2 C.B. 2; *Estate of Lowenstein v. Commissioner,* 12 T.C. 694 (1949), *acq.*, 1949-2 C.B. 2, *aff'd sub nom. First Nat'l Bank of Mobile, Exec. v. Commissioner*, 183 F. 2d 172 (5th Cir. 1950). Whether a particular expenditure is a deposit or a payment depends on the facts and circumstances of each case. *Rev. Rul. 79-229*, 1979-2 C.B. 210.

Regarding whether a payment is an advance receipt or a deposit under section 451, the focus is whether a taxpayer has complete dominion over the sum received. *Commissioner v. Indianapolis Power & Light*, 493 U.S. 203 (1990). The crucial point is not whether the use of funds by the recipient is unconstrained during some interim period, but whether the recipient has some guarantee that it will be allowed to keep the money. *Id.* at 210. Whether an amount received is treated as a security deposit or as advanced rent is based on the intention and conduct of the parties as ascertained from the lease agreement and the related circumstances. *J. and E. Enterprises, Inc. v. Commissioner*, T.C. Memo. 1967-191. If an amount is intended primarily to secure only payment of rent due rather than other covenants, this is considered advance rent. *Rev. Rul. 72-519*, 1972-2 C.B. 32. If a sum is received by a lessor, subject to unfettered control, and is to be applied as rent for a subsequent period, such sum is income in the year of receipt even though in certain circumstances a refund may be required. *Hirsch Improvement Co. v. Commissioner*, 143 F.2d 912 (2nd Cir. 1944), *aff'g a Memorandum Opinion of the Tax Court*, *cert. denied* 323 U.S. 750 (1944).

In order to continue as a going concern, the taxpayer is required to make payments each month under state law. These payments secure and satisfy the taxpayer's license fee liability. State A holds the payments for application in the later "true up" month. Absent surrendering its license and going out of business, the taxpayer will not receive a refund of its monthly payments. If, based on the state formula (the prior month's gross receipts), the taxpayer's payment overestimates the amount due for the future month, the taxpayer does not receive amounts as a refund. Rather, State A retains the payments for current or future license obligations.

Additionally, the payments provide the taxpayer with the right to operate its business at the close of the future month, the payments are anticipated to be used to satisfy the taxpayer's monthly license fee obligations, and any obligation to refund these amounts extends only to amounts that might remain after the taxpayer has ceased business operations. Because the payment entitles the taxpayer to operate its business through the month for which the payment is used to "true-up", the full amount of the funds paid are expected to be applied to the taxpayer's obligations prior to any surrender of the taxpayer's license. Therefore, based on all the facts and circumstances, taxpayer's monthly payments are not deposits.

By operation of state law, the liability for the estimated license fee is final and definite in amount, is fixed and absolute, and is unconditional. *See United States v. Hughes Properties, Inc.*, 476 U.S. 593, 600-601 (1986). Accordingly, the taxpayer's liability for the estimated monthly license fee is fixed and incurred when paid by the 24th of each month.

Our conclusion is based upon the following considerations: (1) state law requires payment and sets the amount of the payments; (2) the taxpayer actually pays the required amounts; and (3) State A retains and applies any overpayments for current or future obligations. Furthermore, this Technical Advice Memorandum addresses only when the liability for the payments is incurred. How the taxpayer takes these payments into account, whether as a current deduction or through capitalization, is not addressed in this Technical Advice Memorandum.

Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.