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LETTER RULINGS

Tax Treatment of Commissions Passed Along by Realtors to Buyers

The IRS determined in Ltr. Rul. 200721013 that certain commissions received by real estate brokers that were passed along to their home-buying clients were neither reportable payments to the brokers nor gross income to the clients.

Facts. The taxpayer was a real estate broker who represented customers buying homes. The homes were offered for sale on a database used to share information about properties by brokers representing sellers under a listing contract. The law required a seller to pay a commission when the seller offered a home for sale on the database. A portion of the commission was paid to the seller's agent/broker, and the remainder to the buyer's agent/broker. Thus, the taxpayer received commissions from the seller when it acted as a buyer's agent/broker in connection with real estate transactions.

The taxpayer entered into written agency agreements with each buyer it represented. In these contracts, the taxpayer agreed to pay the buyer (i.e., its client) a certain portion ("amount 1") of any commission it received from the seller in a completed transaction. The taxpayer paid amount 1 to the buyer in one of two ways:

- (1) After closing, the cash and loan proceeds were distributed to the seller and the agents, and after the taxpayer received its share of the commission, it wrote a check to the buyer pursuant to the agency agreement.
- (2) The buyer received a credit at closing equal to amount 1. The agency agreement permitted the buyer to use the payments toward the down payment, closing costs, or purchase price.

Two issues were raised under this scenario. First, did amount 1 have to be included in the buyer's gross income? Second, did the taxpayer have to submit an information return to the IRS with respect to the payment of amount 1?

IRS analysis. With regard to the first issue, the Service analyzed two Rulings. Rev. Rul. 2006-27, 2006-21 IRB 915, involved a nonprofit corporation that provided down payment assistance to low-income individuals who were buying homes. There, the IRS determined that such assistance constituted a rebate or a downward adjustment to the purchase price. As such, it was not included in the buyer's gross income. (See generally Megaard and Megaard, "IRS Clarifies Guidance for Exempt Housing Organizations and Tax Consequences for Participants," 105 JTAX 98 (August 2006).)

Rev. Rul. 76-96, 1976-1 CB 23 (as modified by Rev. Rul. 2005-28, 2005-1 CB 997), involved an automobile manufacturer that gave rebates to its retail customers who bought or leased new automobiles. The IRS concluded that the rebate represented an adjustment to the purchase price, and therefore was not included in the customers' gross incomes.

Analogizing the two Revenue Rulings to the present situation, the Service determined that a payment or credit of amount 1 at closing from the taxpayer was an adjustment to the purchase price of the home. Accordingly, the home buyers were not required to include amount 1 in their gross incomes.

After analyzing the payee side of the transaction, the IRS turned to the payor's duties. Section 6041(a) provides that all persons engaged in a trade or business and making payments in the course of such trade or business to another person of rent, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, or other fixed or determinable gains, profits, and income of \$600 or more in any tax year must submit an information return (Form 1096 or 1099) to the IRS containing the pertinent information, and must furnish the payee with a copy. Under Reg. 1.6041-1(c), income is "fixed" when it is to be paid in amounts definitely predetermined, and income is "determinable" when there is a basis of calculation by which the amount may be ascertained. Here, the IRS determined that the taxpayer was not required to file an information return under Section 6041 because the payment or credit of amount 1 was an adjustment to the home's purchase price and generally was not includable in the buyer's gross income.

Implications. This ruling is important for two main reasons. The increasing use of Internet databases in the real estate industry means the situation described in Ltr. Rul. 200721013 will have widespread applicability. The current downturn in many residential real estate markets across the country should cause this scenario to occur more frequently, too. Indeed, as home sales decrease and agents compete more fiercely for those clients who remain in the market, the agents may be more apt to take drastic measures, such as transferring (directly or indirectly) a portion of their traditional commission to the buyer or seller. In such circumstances, both home buyers and their agents will find favorable treatment in this ruling.

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