

Inclusion in Taxable Income of Government Aid: *CF Headquarters Corp. v. Commissioner*

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It is often unclear whether aid received to ameliorate the consequences of an extraordinary event – such as a natural disaster or terrorist attack -- is subject to tax. In *CF Headquarters Corp. v. Commissioner* (164 T.C. No. 5 (2025)), the Tax Court recently concluded that funds received by a corporation in 2007 under a government program intended to revitalize businesses affected by the attacks of September 11, 2001, could not be excluded from income as a nonshareholder contribution to capital, as a gift, or otherwise, and was taxable.

Under an amendment by the Tax Cuts and Jobs Act (P.L. § 115-97) to Internal Revenue Code (Code) Section 118(b), post-2017 contributions to the capital of a corporation by a governmental entity or civic group generally will not qualify for exclusion from income under Section 118. The meaning of the phrase “contribution to the capital of the taxpayer” as discussed in the Tax Court decision, however, may continue to be relevant in determining whether other nonshareholder transfers to a corporation qualify for exclusion from income as contributions to capital.

Facts in *CF Headquarters Corp.*

During 2007, Cantor Fitzgerald, L.P. (Cantor Fitzgerald) was a partnership that, through subsidiaries, was a broker and dealer in government securities and commodities contracts. Its offices at the World Trade Center had been destroyed and many of its employees killed in the terrorist attacks on September 11, 2001.

Cantor Fitzgerald applied for and ultimately received grants from the Empire State Development Corp. (Empire State), funded by the federal government, that were conditioned upon meeting employment commitments negotiated with Empire State and on incurring expenses for: wages; payroll taxes; employee benefits; rent; and movable equipment and furniture. The funds awarded were ultimately paid to CF Headquarters Corp. (CF), a subsidiary of Cantor Fitzgerald, in 2007 and were required to be used for expenses in these five categories.

A disbursement request form completed by CF in connection with payment of the grant described the expenses for which CF sought reimbursement as rent expenses, and CF attached to the request rent invoices and canceled checks. CF then received \$3,107,500 as reimbursement for rent expenses and immediately lent those funds to Cantor Fitzgerald for a 49-year promissory note maturing in 2056.

The Form 1120 corporate tax return filed by CF for 2007 neither reported the grant proceeds as income nor included a Form 8275 disclosure statement regarding the exclusion of the proceeds from income. Following an audit, the IRS issued a notice of deficiency asserting additional tax because the grant proceeds were includible in

income. The notice also asserted a penalty under Code Section 6662 on the basis of a substantial understatement of income tax.

Discussion

CF first argued that the payments were excludible from income under *Edwards v. Cuba Railroad Co.* (268 U.S. 628 (1925)), which concluded that subsidies received from Cuba by a railroad to induce it to construct and operate a railroad were not income subject to tax under the Sixteenth Amendment. The Tax Court responded by emphasizing the broad sweep that has been given by subsequent cases to Section 61(a), which defines “gross income” as “all income from whatever source derived” (except as otherwise provided in subtitle A of the Code). In light of cases such as *Commissioner v. Glenshaw Glass Co.* (348 U.S. 426 (1955)) that have discussed and distinguished *Cuba Railroad*, the court observed that *Cuba Railroad* was entitled to little, if any, weight, and that the grant proceeds must therefore be included in income subject to tax under Section 61(a) absent a specific statutory exclusion.

CF asserted that the grant was excluded from income under Section 118(a) as then in effect. That provision excluded from income (in general) contributions to the capital of a corporation. Regulation Section 1.118-1 makes clear that the exclusion may apply to a contribution to capital by a person who is not a shareholder of the corporation, such as a contribution of land or other property to induce a corporation to locate its business in a community or to expand its operating facilities. The regulation cautions, however, that the exclusion “does not apply to any money or property transferred to the corporation for goods or services rendered, or to subsidies paid for the purpose of inducing the taxpayer to limit production.”

The Tax Court observed, citing an earlier case, that Section 118 was intended to codify pre-Section 118 decisions that excluded from income contributions to capital by nonshareholders. The Tax Court opinion also discusses at some length *Commissioner v. BrokerTec Holdings, Inc.* (967 F.3d 317 (3d Cir. 2020)), a decision involving a New Jersey grant program that was similar to the New York program at issue in *CF Headquarters*.

Grants were made to subsidiaries of BrokerTec Holdings, Inc. under the New Jersey program after the September 11 attacks. In reversing a Tax Court memorandum decision in the taxpayer’s favor, the Court of Appeals for the Third Circuit in *BrokerTec* discussed at length the scope of the “contribution to capital” concept. Under the case law as summarized in *BrokerTec*, in order for a nonshareholder contribution to capital to be excludible from income under Section 118, it “must become a permanent part of the transferee’s working capital structure,” and result in the acquisition of an asset that will be used in, or otherwise contribute to the production of additional income. *United States v. Chicago, Burlington & Quincy R.R. Co.* (412 U.S. 401 (1973)).

The Court of Appeals concluded in *BrokerTec* that the Section 118 exclusion did not apply to grant proceeds under the New Jersey program, because the grants were not limited to the acquisition of capital assets that become part of the permanent working capital of the corporation.

Unlike the New Jersey program at issue in *BrokerTec*, the New York program in which CF participated restricted the use of grant proceeds to specific categories of expenses. However, the expenses for which Empire State grants could be used included four categories -- wages, payroll taxes, employee benefits, and rent -- that are generally currently deductible.

Although grant proceeds could also be used to make expenditures to acquire equipment and furniture that would not, in general, result in a current deduction, documentation provided by CF indicated that the proceeds were in fact applied to reimburse rent expenses.

Further, the proceeds were in fact immediately lent to Cantor Fitzgerald under a 49-year promissory note – a use that, in the view of the court, cut against any assertion that the funds became part of the permanent working capital of the corporation. Rather, this use indicated that the funds were intended to supplement the income of Cantor Fitzgerald and pay operating costs.

CF also argued that the grant proceeds were a gift excludible from income under Code Section 102(a), which provides that “[g]ross income does not include the value of property acquired by gift.” Under case law cited in *CF Headquarters*, a gift must “proceed from a detached and disinterested generosity.” The Tax Court found that the motivation for the grant by Empire State was not detached and disinterested generosity, but rather to increase employment within lower Manhattan, and emphasized that the grant was conditioned on CF’s demonstration of compliance with specified employment goals. The court further noted that the use of federal funds for the economic revitalization of New York City was among the stated purposes of the legislation that funded the grants. Under these circumstances, the grant could not be considered a gift under Section 102(a).

One possible rationale for exclusion of income that has been applied in somewhat similar contexts, but that is not referenced in *CF Headquarters*, is the “general welfare” exclusion, which the IRS has found to be applicable where grants are made to individuals based on need. The apparent view of the IRS, as expressed in published guidance including an IRS notice cited in *CF Headquarters* that addressed the consequences of grants of aid following the September 11 attacks, is that “[p]ayments to businesses generally do not qualify for the [general welfare] exclusion because they are not based on individual and family needs” (IRS Notice 2003-18, Q&A 2). The IRS has, however, found the general welfare exclusion to be applicable in one instance involving payments to individuals under a federal program to expand profit-making enterprises through grants to Indians and Indian tribes (Rev. Rul. 77-77, 1977-1 C.B. 11).

The court did relieve CF from the penalty asserted under Section 6662(a) on the basis of substantial understatement of income. That penalty does not apply, generally, with respect to the tax treatment of an item for which there is “substantial authority” (Code Section 6662(d)). In the view of the court, there was substantial authority -- including *Cuba Railroad* and other cases cited in the Tax court opinion, Code Section 118, and Reg. Section 1.118-1 -- that could reasonably be characterized as supporting the exclusion from income of the funds received, such that the penalty should not apply.

Observations

Q&A 5 in Notice 2003-18 indicated that, if a grant under certain World Trade Center grant programs was sought, received, and utilized for the purpose of acquiring furniture and equipment, the funds could be excluded from income as a contribution to capital under Section 118 – although the tax basis of the property so acquired would then be reduced under Code Section 362(c) by the amount of the grant proceeds excluded from income. The view expressed in the Notice on this point, and the Tax Court’s indication in *CF Headquarters* of a similar view, underscore the potential connection between (i) the anticipated use of funds as indicated in an award and related documentation and (ii) the determination of whether the funds constitute a contribution to capital.

The Tax Court, in declining to uphold the penalty asserted against CF, relied in part on a regulation under Section 118 regarding contributions to capital that is exceedingly brief, that has not been amended since 1956, and that does not reflect much of the law limiting the scope of the term “contribution of capital” which is set forth in cases decided after the regulation was issued. This result may suggest that, notwithstanding the lesser deference by courts to regulations that is expected in light of *Loper Bright Enterprises v. Raimondo* (603 U.S. 369 (2024)), the fisc would still benefit from the modernization of regulations so as to better reflect the government’s current understanding of the law.

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