

# *Sy Accountancy Corporation*

Member, American Institute of CPAs

704 Mira Monte Place, Pasadena, California 91101

Tel (626) 744-0200 • Fax (626) 744-0300 • vsy@victorsycpa.com • www.victorsycpa.com

## HOW TO TREAT COMMISSIONS PASSED ALONG BY REALTORS TO BUYERS

By Victor Sy, CPA, MBA

The IRS recently determined that certain commissions received by real estate brokers that were passed on to their home-buying clients were **neither reportable payments to the brokers nor gross income to clients.** ☺

**Facts.** The taxpayer was a **real estate broker** who represented customers buying homes. The homes were offered for sale on a database used by brokers representing sellers under a listing contract which required a seller to pay commission on the sale of a home. A portion of the commission was paid to the seller's agent/broker, and the remainder to the buyer's agent/broker.

The taxpayer (broker for buyer) entered into written agency agreements in which the taxpayer agreed to pay the buyer (its client) a certain portion ("rebate") of any commission it received from the seller. The taxpayer paid the rebate to the buyer in one of two ways:

1. The buyer's broker **wrote a check** to the buyer, or
2. The **buyer received a credit toward the down payment, closing costs, or purchase price.**

Two issues were raised under this scenario:

1. First, did the rebate have to be **included in the buyer's gross income?**
2. Second, did the taxpayer have to **submit Form 1099 to the IRS?**

**IRS analysis.** With regard to the first issue, the Service analyzed two Rulings. Revenue Ruling 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. Another IRS Revenue Ruling 76-96, 1976-1 CB 23 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. Applying these two Revenue Rulings to the present situation, the Service determined that a **payment or credit from the taxpayer was an adjustment to the purchase price of the home.** Accordingly, the home buyers were **not required to include the rebate in their gross incomes.**

With regard to the second issue, the IRS determined that the taxpayer was **not required to file** a Form 1099 because the payment or credit of the rebate 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:

1. The increasing use of internet databases in the real estate industry means that the situation described in Letter Ruling 200721013 will have widespread applicability.
2. The current downturn in many residential real estate markets across the country should cause this scenario to occur more frequently. As home sales decrease and agents compete more aggressively for those clients who remain in the market, real estate sales and loan agents may take more creative steps, such as directly or indirectly transferring 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.