

Office of Chief Counsel
Internal Revenue Service

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memorandum

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to: Assistant District Counsel, Kansas-Missouri District, CC:MSR:KSM:KCY
Attention: Dale P. Kensinger

from: Assistant Chief Counsel
(Employee Benefits and Exempt Organizations), CC:EBEO

subject: Significant Service Center Advice

This responds to your request for Significant Advice dated June 17, 1998, regarding whether amounts received for services performed in a work release program or while at a halfway house qualify as earned income for purposes of the earned income tax credit (EIC) under section 32 of the Internal Revenue Code.

Disclosure Statement

Unless specifically marked "Acknowledged Significant Advice, May Be Disseminated" above, this memorandum is not to be circulated or disseminated except as provided in Paragraphs III.D.4. and IV.A.5. of Part (35) of the CCDM. (See Office of Chief Counsel Notice dated February 10, 1997, regarding Service Center Advice Procedures.) This document may contain confidential information subject to the attorney-client and deliberative process privileges. Therefore, this document shall not be disclosed beyond the office or individual(s) who originated the question discussed herein and are working the matter with the requisite "need to know." In no event shall it be disclosed to taxpayers or their representatives.

Issue

Whether amounts received for services performed in a work release program or while at a halfway house are earned income for purposes of the EIC.

Conclusion

Amounts received for services performed in a work release program or while at a halfway house are amounts received while the individual is an inmate at a penal institution. Those amounts are excluded from the definition of earned income under section 32(c)(2)(B)(iv) of the Code.

Law and Analysis

Section 32(a) of the Code allows an EIC in the case of an eligible individual. Generally, the amount of the EIC is based on earned income. Earned income is defined in section 32(c)(2)(A)(i) of the Code to include wages, salaries, tips, and other employee compensation. Amounts received for services provided by an individual while the individual is an inmate at a penal institution are excluded from the definition of earned income by section 32(c)(2)(B)(iv) of the Code.

Section 32(c)(2)(B)(iv) of the Code was added by section 723(a) of the Uruguay Round Agreements Act, Pub. L. 103-465, enacted on December 8, 1994. The Ways and Means Committee Report and the Senate Finance Committee Report contain an identical explanation of this addition:

The EITC is designed to alleviate poverty and to provide work incentives to low-income individuals. Because of the compulsory nature of much of the work performed by prison inmates, it does not further the objectives of the EITC to include in earned income for EITC calculations any amounts paid for inmates' services. See H.R. Rep. 826 (Part I), 103d Cong., 2d Sess. 182 (1994); S. Rep. 412, 103d. Cong., 2d Sess. 148 (1994).

Although not defined in section 32 of the Code or its legislative history, the phrase "penal institution" is a generic term that includes places of confinement for individuals convicted of a crime such as jails, prisons, workhouses, and other correctional facilities. See Black's Law Dictionary (6th Ed.); 60 AmJur.2d sec. 2 (1987 and 1988 Supp.). An inmate is a person confined to a prison, penitentiary, or penal institution. See Black's Law Dictionary (6th Ed.)

No case law arising under section 32(c)(2)(B)(iv) of the Code addresses the issue of whether amounts received for services performed through a work release program or while at a halfway house are considered earned income. However, discussions of these programs in other contexts provide guidance on this issue.

Rev. Rul. 75-325, 1975-2 C.B. 415, concerns the status of prison inmates who performed services for Federal Prison Industries, Inc. By authority of the President and Congress, the corporation was required to provide employment for all inmates in penal and correctional facilities. Inmates were paid a sub-minimum wage pursuant to the Fair Labor Standards Act of 1938 and were subject to disciplinary action for refusing to work. The Service held that the relationship between the inmates and Federal Prison Industries, Inc. arises from the incarceration of the inmates and the legal duty of the corporation to provide rehabilitative labor. Accordingly, the Service held that there was no legal relationship of employer and employee for federal employment tax purposes.

In cases considering whether there is a violation of due process when an individual is transferred out of a work release program or halfway house, courts indicate that an individual who participates in a work release program or is transferred to a halfway house is still an inmate under confinement even though that individual is allowed to leave the prison facilities to work through the work release program or through the halfway house. These cases also indicate that the individual has not been released from the penal institution, the imposed sentence has not ended, and the individual can be returned to the general prison population for violation of the work release program or halfway house rules. See generally, Brennan v. Cunningham, 813 F.2d 1 (1st Cir. 1987); Whitehorn v. Harrelson, 758 F.2d 1416 (11th Cir. 1985); Dominique v. Weld, 880 F. Supp. 928 (D.C. Mass. 1995).

Although an individual may be allowed to participate in a work release program, those individuals are still confined to the penal institution and must return to the penal institution when not performing services. Although the work performed by those individuals is not performed at the penal institution itself, it is performed while the individual is an inmate at a penal institution. Neither section 32(c)(2)(B)(iv) of the Code nor its legislative history suggests that the place where the work is performed is relevant to a determination of whether the services are provided while the individual is an inmate at a penal institution. Thus, any payments received by the inmate while performing services in a work release program are amounts received while the individual is an inmate at a penal institution. Those amounts are excluded from the definition of earned income under section 32(c)(2)(B)(iv) of the Code.

With respect to individuals transferred to a halfway house, those individuals have not been released from their sentences, can be returned to the prison facility, and are usually required to perform services. Although these individuals are not confined to a prison, jail, or penitentiary, they are confined to the halfway house for the remainder of their sentence. Thus, a halfway house falls within the general definition of a penal institution. Accordingly, any amounts received for services performed by an inmate while at a halfway house are amounts received for services performed while at a penal institution. Those amounts are excluded from the definition of earned income under section 32(c)(2)(B)(iv) of the Code.

