

## Part III – Administrative, Procedural, and Miscellaneous

### Federal Income Tax Consequences of Certain State Payments

Notice 2023-56

#### SECTION 1. PURPOSE

This notice describes the rules that the Internal Revenue Service (IRS) applies in determining the Federal income tax consequences of refunds of State or local taxes and certain other payments made by State or local governments (States) to individuals (State payments) and includes examples illustrating the application of these rules. This notice also describes the applicable Federal information reporting requirements. Section 5 of this notice requests comments, including comments on the application of the rules described in this notice.

#### SECTION 2. BACKGROUND

In 2022, a number of States implemented programs to provide State payments to certain individuals residing in their States. Many of these programs were related, directly or indirectly, to the various consequences of the Coronavirus Disease 2019 (COVID-19) pandemic, and the programs varied in terms of the types of payments, payment amounts, and eligibility criteria.

In response to numerous requests for guidance on how individuals should treat these payments on their 2022 Federal income tax returns, on February 10, 2023, the

IRS issued IRS News Release IR-2023-23<sup>1</sup> to provide certainty for the 2023 Federal income tax filing season. After noting that determining whether State payments qualify for the exclusion from Federal gross income under the general welfare doctrine or as disaster relief payments is a complex and fact-intensive inquiry that depends on a number of considerations, the News Release stated as follows:

The IRS has reviewed the types of payments made by various states in 2022 that may fall in these categories and given the complicated fact-specific nature of determining the treatment of these payments for federal tax purposes balanced against the need to provide certainty and clarity for individuals who are now attempting to file their federal income tax returns, the IRS has determined that in the best interest of sound tax administration and given the fact that the pandemic emergency declaration is ending in May, 2023 making this an issue only for the 2022 tax year, if a taxpayer does not include the amount of one of these payments in its 2022 income for federal income tax purposes, the IRS will not challenge the treatment of the 2022 payment as excludable from income on an original or amended return.

The News Release identified 2022 payment programs in 17 States that qualified for this treatment.

As the News Release made clear, the guidance in the News Release applied only for payments made in 2022. The IRS has received requests for guidance regarding the Federal income tax consequences of State payments made in 2023 and future years, as well as requests that States be allowed to provide comments on the guidance. This notice is issued in response to these requests.

### SECTION 3. SUMMARY OF APPLICABLE FEDERAL INCOME TAX LAW

.01 Gross Income. Section 61(a) of the Internal Revenue Code (Code)<sup>2</sup> provides that, except as otherwise provided in subtitle A of the Code, gross income for Federal

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<sup>1</sup> Available at <https://www.irs.gov/newsroom/irs-issues-guidance-on-state-tax-payments-to-help-taxpayers>.

<sup>2</sup> Unless otherwise specified, all “section” or “§” references are to sections of the Code or to the Income Tax Regulations (26 CFR part 1).

income tax purposes “means all income from whatever source derived” (Federal gross income). See *also* § 1.61-1(a). The U.S. Supreme Court has held that Federal gross income includes any “undeniable accession to wealth, clearly realized, over which a taxpayer has complete dominion.” *Commissioner v. Glenshaw Glass Co.*, 348 U.S. 426, 431 (1955), 1955-1 C.B. 207. State payments are subject to this general rule unless an exception applies to exclude such amounts from Federal gross income. Relevant exceptions include certain refunds of previously paid State taxes (State tax refunds), certain payments subject to the general welfare exclusion, and certain disaster relief payments (including certain payments made in connection with the COVID-19 pandemic).

.02 State Tax Refunds. In determining whether a State payment constitutes a State tax refund, as opposed to some other type of State payment, the particular label given to the payment under State law is not controlling for Federal tax purposes. Instead, Federal tax law looks to the substance of the payment to determine its purpose and Federal income tax characterization. See, e.g., *Morgan v. Commissioner*, 309 U.S. 78, 81 (1940); *Maines v. Commissioner*, 144 T.C. 123, 132 (2015). In *Maines*, the U.S. Tax Court considered whether payments referred to by the State as refunds for overpayment of State taxes were properly viewed as refunds for Federal income tax purposes. The payments in question related to three different types of refundable State income tax credits. The court held that where the refundable credit amount was limited to State taxes actually paid by the taxpayer, as in the case of one of the credits, the payments constituted refunds for Federal income tax purposes. In contrast, where the credit amount was not so limited, the court concluded that the payment was not in

substance a refund for overpayment of State taxes and was therefore includable in Federal gross income.

State payments that are properly treated as State tax refunds generally are not includible in the recipient's Federal gross income because, as the return of an overpayment of the recipient's State tax liability, these refunds are not an accession to wealth. See Rev. Rul. 70-86, 1970-1 C.B. 23 (holding that a refund by the State of real property taxes previously paid by an individual is a recovery of those taxes and is generally not includible in Federal gross income). However, certain State payments that are properly treated as State tax refunds may result in Federal gross income due to the application of the "tax benefit rule." See § 111; see also Rev. Rul. 2019-11, 2019-17 I.R.B. 1041; Rev. Rul. 93-75, 1993-2 C.B. 63. The tax benefit rule generally requires a taxpayer to include in Federal gross income an amount recovered during a taxable year that the taxpayer deducted for Federal income tax purposes in a prior taxable year to the extent the Federal income tax deduction reduced the taxpayer's Federal income tax liability in the prior taxable year. Thus, an individual who receives a State tax refund for a prior year tax payment that the individual did not previously deduct for Federal income tax purposes<sup>3</sup> is not required to include the State tax refund in Federal gross income because it is simply a reduction in the individual's prior year State tax liability, with no corresponding Federal income tax benefit. Generally, if an individual deducted a payment of State taxes in a prior taxable year for Federal income tax purposes that gives rise to a State tax refund in any subsequent taxable year, then the State tax

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<sup>3</sup> Section 164(a) generally allows a Federal income tax deduction for certain "State and local taxes" (as well as certain other taxes) for the taxable year within which paid or accrued.

refund is included in the individual's Federal gross income during the taxable year in which the State tax refund is received to the extent that the Federal income tax deduction in the prior taxable year reduced the individual's Federal income tax liability in the prior taxable year.

For most individuals, State tax refunds will not be includible in Federal gross income. For example, individuals who claimed the standard deduction (as most individuals do) will not include State tax refunds in Federal gross income because they would not have previously deducted on their Federal income tax returns the refunded amount of State taxes paid. Individuals who itemized deductions and deducted for Federal income tax purposes the amounts of any State taxes paid, however, generally are required to include the State tax refunds in gross income on their Federal income tax returns to the extent that they received a Federal income tax benefit from the prior Federal income tax deductions.<sup>4</sup>

.03 General Welfare Exclusion. Despite the general rule that Federal gross income includes all income from whatever source derived, payments made to, or on behalf of, individuals by governmental units under legislatively provided social benefit programs for the promotion of the general welfare are not includible in an individual recipient's Federal gross income (general welfare exclusion). See, e.g., Rev. Rul. 78-170, 1978-1 C.B. 24 (concluding that amounts paid under the laws of the State of Ohio to low-income elderly and disabled persons to help alleviate their cost of winter energy

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<sup>4</sup> Section 164(b)(6), as added by § 11042(a) of Public Law 115-97, 131 Stat. 2054 (December 22, 2017), commonly referred to as the Tax Cuts and Jobs Act (TCJA), limits an individual's deduction under § 164(a) (SALT deduction limitation) to \$10,000 (\$5,000 in the case of a married individual filing a separate return) for the aggregate amount of certain "State and local taxes" paid during the calendar year. This SALT deduction limitation applies to taxable years beginning after December 31, 2017, and before January 1, 2026.

consumption are made for the promotion of general welfare, and are not includible in the recipients' gross income for Federal income tax purposes); see *also* Rev. Rul. 76-395, 1976-2 C.B. 16 (applying the general welfare exclusion to home rehabilitation grants to low-income families to correct substandard conditions).

To qualify for the general welfare exclusion, State payments must (1) be paid from a governmental fund, (2) be for the promotion of general welfare (that is, based on the need of the individual or family receiving such payments), and (3) not represent compensation for services absent a specific Federal income tax exclusion. See Notice 2003-18, 2003-14 I.R.B. 699, and Rev. Rul. 76-229, 1976-2 C.B. 16.

Payments that are based on some criteria other than individual or family need do not qualify for the general welfare exclusion. *Compare* Rev. Rul. 76-395, 1976-2 C.B. 16 (home rehabilitation grants received by low-income homeowners residing in a defined area of a city under the city's community development program funded under the Housing and Community Development Act of 1974 are in the nature of general welfare and are not includible in their gross income) *with* Rev. Rul. 76-131, 1976-1 C.B. 16 (payments made by the State of Alaska to individuals at least 65 years of age who have maintained an Alaska domicile for at least 25 years to encourage them to continue their residence in the State did not qualify under the general welfare exclusion because the payments were made to residents regardless of financial status, health, educational background, or employment status).

.04 Disaster Relief. Section 139(a) provides that Federal gross income does not include any amount received by an individual as a qualified disaster relief payment. Section 139(b)(4) defines a "qualified disaster relief payment" to include, among other

things, any amount paid to, or for the benefit of, an individual if such amount is paid by a Federal, State, or local government, or agency or instrumentality thereof, in connection with a qualified disaster in order to promote the general welfare.<sup>5</sup> Under § 139(c)(2), a qualified disaster includes a Federally declared disaster as “defined by section 165(i)(5)(A).” Section 165(i)(5)(A) defines a Federally declared disaster as “any disaster subsequently determined by the President of the United States to warrant assistance by the Federal Government under the Robert T. Stafford Disaster Relief and Emergency Assistance Act.”

On March 13, 2020, the President declared that the novel COVID-19 outbreak in the United States constituted a national emergency under the National Emergencies Act (50 U.S.C. 1601 et seq.).<sup>6</sup> On that same day, the President determined that the COVID-19 pandemic was of sufficient severity and magnitude to warrant an emergency declaration under § 501(b) of the Robert T. Stafford Disaster Relief and Emergency Assistance Act (42 U.S.C. 5121-5207).<sup>7</sup> Because the President determined that the COVID-19 pandemic warranted assistance by the Federal Government under the Stafford Act, on March 13, 2020, the COVID-19 pandemic was also a “Federally declared disaster”

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<sup>5</sup> This notice does not address, and no inference is intended with respect to, the Federal income tax treatment of Indian general welfare benefits provided pursuant to § 139E. The Treasury Department and the IRS are actively working to develop proposed regulations under § 139E in coordination with the Department of the Treasury Tribal Advisory Committee established pursuant to § 3(a) of the Tribal General Welfare Exclusion Act of 2014, Public Law 113-168, 128 Stat. 1883 (2014). Those proposed regulations will be the subject of future Tribal Consultation pursuant to Executive Order 13175, President Biden’s Presidential Memorandum for Tribal Consultation and Strengthening Nation to Nation Relationships, and the Treasury Department’s Action Plan for Tribal Consultation and Collaboration.

<sup>6</sup> Proclamation 9994 of March 13, 2020, *Declaring a National Emergency Concerning the Novel Coronavirus Disease (COVID-19) Outbreak*, 85 Fed. Reg. 15337 (March 18, 2020), available at <https://www.federalregister.gov/documents/2020/03/18/2020-05794/declaring-a-national-emergency-concerning-the-novel-coronavirus-disease-covid-19-outbreak>.

<sup>7</sup> Letter from the President on Emergency Determination Under the Stafford Act, available at <https://trumpwhitehouse.archives.gov/wp-content/uploads/2020/03/LetterFromThePresident.pdf>.

under §§ 139(c)(2) and 165(i)(5)(A). On February 24, 2021, the President continued the national emergency concerning the COVID-19 pandemic beyond March 1, 2021.<sup>8</sup>

On February 10, 2023, the President announced that he anticipated terminating the national emergency concerning the COVID-19 pandemic on May 11, 2023.<sup>9</sup> On April 10, 2023, the President signed into law a Joint Resolution of Congress terminating the national emergency concerning the COVID-19 pandemic.<sup>10</sup> Accordingly, the related “Federally declared disaster,” as defined by §§ 139(c)(2) and 165(i)(5)(A), terminated on May 11, 2023.

The remaining criteria for disaster relief payments under § 139(b)(4) are that the payments be made “in connection with” a qualified disaster and that they are made in order to “promote the general welfare.” In the context of a qualified disaster such as the COVID-19 pandemic, payments made in connection with the disaster are presumed to be made in order to promote the general welfare (that is, based on individual or family need) for all individuals affected by the disaster. See Notice 2002-76, 2002-2 C.B. 917. As in the case of the general welfare exclusion outside of § 139(b)(4), payments cannot represent compensation for services.

.05 Information Reporting. Section 6041(a) generally requires that all persons engaged in a trade or business and making payment in the course of such trade or business to another person of rent; salaries; wages; premiums; annuities;

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<sup>8</sup> See Presidential Notice, 86 Fed. Reg. 11599 (February 24, 2021).

<sup>9</sup> See Notice of February 10, 2023, *Continuation of the National Emergency Concerning the Coronavirus Disease 2019 (COVID-19) Pandemic*, 88 Fed. Reg. 9385 (February 14, 2023), available at <https://www.federalregister.gov/documents/2023/02/14/2023-03218/continuation-of-the-national-emergency-concerning-the-coronavirus-disease-2019-covid-19-pandemic>.

<sup>10</sup> See *Joint Resolution relating to a national emergency declared by the President on March 13, 2020*, Public Law 118-3, 137 Stat. 6 (April 10, 2023), available at <https://www.congress.gov/118/plaws/publ3/PLAW-118publ3.pdf>.



compensations; remunerations; emoluments; or other fixed or determinable gains, profits, and income, of \$600 or more in any taxable year, must make a true and accurate return to the Secretary of the Treasury or her delegate (Secretary).

Section 6041(d) provides that every person required to make a return under § 6041(a) must furnish to each person with respect to whom such return is required a written statement showing the name, address, and phone number of the contact information of the person required to make such return, and the aggregate amount of payments to the person required to be shown on the return. Section 1.6041-1(b)(1) provides that the term “all persons engaged in a trade or business,” as used in § 6041(a), includes organizations the activities of which are not for the purpose of gain or profit. Thus, that term includes the organizations referred to in § 1.6041-1(i). Section 1.6041-1(i) provides that the United States or a State, or political subdivision thereof, or the District of Columbia, or any agency or instrumentality of any one or more of the foregoing must file Form 1099 Series information returns to report payments of \$600 or more and Form W-2, *Wage and Tax Statement*, to report wages paid to employees under the provisions of § 1.6041-2. The information returns must be made by the officer or employee having control of such payments or by the officer or employee appropriately designated to make such returns. Form 1099-G, *Certain Government Payments*, is used by States to report the amount of grants that are included in the Federal gross income of the recipient.

Section 6050E(a) provides that every person who, with respect to any individual, during any calendar year makes payments of refunds of State income taxes (or allows credits or offsets with respect to such taxes) aggregating \$10 or more must make a

return according to forms or regulations prescribed by the Secretary setting forth the aggregate amount of such payments, credits, or offsets, and the name and address of the individual with respect to whom such payment, credit, or offset was made. Section 6050E and § 1.6050E-1(k)(1) provide that every person required to make a return under § 6050E(a) and § 1.6050E-1(c) must furnish to each individual whose name is required to be set forth in such return a written statement showing the name of the State or political subdivision thereof, and the information required to be shown on the return with respect to refunds, credits, and offsets to the individual. Section 1.6050E-1(k)(2) provides that a State refund officer need not furnish a statement to an individual under § 1.6050E-1(k)(1) if the refund officer verifies that the individual did not claim itemized deductions for Federal income tax purposes for the taxable year giving rise to the State tax refund. Form 1099-G is used by States to report State tax refunds.

#### SECTION 4. GUIDANCE FOR INDIVIDUALS RECEIVING AND STATES MAKING CERTAIN STATE PAYMENTS

.01 State Income Tax Refunds. If an individual claimed the standard deduction on the individual's Federal income tax return for the taxable year in which the individual paid State taxes, a State income tax refund (related to the prior payment of those State taxes) in a subsequent taxable year is not includible in the individual's gross income for Federal income tax purposes. An individual who itemized deductions and deducted amounts of State income taxes paid, however, is required to include the State tax refund in gross income on the individual's Federal income tax return to the extent that the individual received a Federal income tax benefit from the prior Federal income tax deduction.

Example. In January 2023, State A enacted a statute providing that certain State A funds be returned to certain individuals as a refund of State A income taxes paid in 2021. Pursuant to that statute, State A will pay up to \$250 to individuals who filed State A income tax returns for taxable year 2021 as single filers and up to \$500 to spouses who filed as married, filing jointly, but the payment cannot exceed an individual's State A income tax liability for taxable year 2021. B, a single individual, filed a State A income tax return in 2022 for taxable year 2021 as a single filer. B reported State A income tax liability of \$2,500, all of which B paid through income tax withholding in 2021. B filed B's Federal income tax return in 2022 for taxable year 2021 and claimed the standard deduction. In 2023, State A paid B \$250 as a refund of B's State A income taxes paid for taxable year 2021.

State A's payment of \$250 to B is a State tax refund of B's State A income taxes paid for taxable year 2021. B claimed the standard deduction on B's Federal income tax return for taxable year 2021. Thus, B did not deduct State A income taxes paid on B's Federal income tax return for taxable year 2021. Accordingly, B is not required to include the \$250 State A income tax refund in B's Federal gross income on B's Federal income tax return for taxable year 2023.

Section 6050E requires State A to file with the IRS and furnish to B a Form 1099-G that includes the \$250 payment in Box 2, *State or local income tax refunds, credits, or offsets*, unless the State A refund officer (as defined in § 1.6050E-1(b)(1)) verifies that B did not claim itemized deductions for Federal income tax purposes. Thus, B may receive a Form 1099-G from State A that includes the \$250 payment even though B is not required to include the payment on B's Federal income tax return for taxable year

2023.

.02 State Property Tax Refunds. If an individual claimed the standard deduction on the individual's Federal income tax return for the taxable year in which the individual paid State taxes, a State property tax refund (related to the prior payment of those State taxes) in a subsequent taxable year is not includible in the individual's gross income for Federal income tax purposes. An Individual who itemized deductions and deducted amounts of State property taxes paid, however, is required to include the State tax refund in gross income on the individual's Federal income tax returns to the extent that the individual received a Federal income tax benefit from the prior Federal income tax deduction.

Example. In March 2023, State C enacted a statute providing that certain State C funds be returned to certain individuals who paid State C property taxes in 2021. Pursuant to that statute, State C will pay individuals a refund equal to the lesser of 10% of State C property taxes paid or \$300. D, an individual, was liable for State C property taxes of \$2,800 for taxable year 2021, which D paid in 2021. D filed D's Federal income tax return in 2022 for taxable year 2021 and claimed itemized deductions totaling \$9,000, which included the \$2,800 property tax payment and which reduced D's Federal income tax liability for the year. In 2023, State C paid D \$280 as a refund of D's State C property taxes paid for taxable year 2021 and made no other payments to D.

State C's payment of \$280 to D is a State tax refund of D's State C property taxes paid for taxable year 2021. D claimed the \$2,800 property tax payment as a deduction on D's Federal income tax return for taxable year 2021, with a corresponding reduction in D's Federal income tax liability for the year. Accordingly, D is required to include the

\$280 State C property tax refund in D's Federal gross income on D's Federal income tax return for taxable year 2023.

State C is not required to file or furnish an information return with respect to the \$280 payment to D. Section 6050E does not apply because the payment is a refund of State property taxes paid, not a refund of State income taxes. Section 6041 does not apply because the total payments from State C to D in 2023 were less than \$600. The fact that no information return is required does not relieve D of the obligation to include the \$280 in D's Federal gross income.

.03 Spillover Payments under 2022 Programs Covered by IRS News Release IR-2023-23. Some of the 2022 programs covered by the guidance in IRS News Release IR-2023-23 provided for certain State payments under the program to be made in early 2023. To the extent that the News Release provided that an individual taxpayer could exclude such a State payment received in 2022, individual taxpayers who did not receive a payment under the program during 2022 may exclude a State payment received in 2023 under the 2022 program from Federal gross income.

Example. In 2022, State E enacted a program to make State payments to its residents who met certain requirements (2022 program). Under the 2022 program, each State E resident who filed a 2021 State E income tax return was entitled to receive \$750. State E made most of the State payments under the 2022 program on or before December 31, 2022. Under the 2022 program, State E may make remaining 2022 program State payments in early 2023. State E made a 2022 program State payment of \$750 to F on January 15, 2023. State E's 2022 program was listed in IRS News Release IR-2023-23 as one of the programs that would be treated as qualifying for an

exclusion from Federal gross income for 2022 payments.

Because State E's January 15, 2023, State payment to F resulted from the 2022 program, which was listed in IRS News Release IR-2023-23 as qualifying for an exclusion from Federal gross income, F may exclude this State payment from Federal gross income on F's Federal income tax return for taxable year 2023. Because the State payment from the 2022 program is not Federal gross income to F, § 6041 and § 1.6041-1 do not require State E to file with the IRS or furnish to F a Form 1099-MISC, *Miscellaneous Information*.

.04 State Payments Excluded Under the General Welfare Exclusion. State payments made under a State program for the promotion of the general welfare are not includible in an individual's Federal gross income. To qualify under the general welfare exclusion, State payments must be made from a governmental fund; be for the promotion of the general welfare (that is, based on individual or family need); and not represent compensation for services.

Example. In 2023, State G makes State payments to eligible residents under an "Energy Relief Payment Program" to help those low-income residents who may not otherwise be able to afford to pay their heating bills. Eligible residents were limited to those who lived in State G full time in 2021 and filed a State G income tax return for taxable year 2021 no later than October 31, 2022. State G pays \$650 to low-income taxpayers who filed as single or married, filing separately, for taxable year 2021. Individual H filed a State G income tax return for taxable year 2021 as a single filer. State G paid a \$650 State payment to H in 2023.

State payments that State G makes under its Energy Relief Payment Program are

made for the promotion of general welfare and are excluded from Federal gross income under the general welfare exclusion. Thus, H may exclude the \$650 State payment from Federal gross income for taxable year 2023 under the general welfare exclusion. Section 6041 and § 1.6041-1 do not require State G to furnish to H an information return that includes the \$650 State payment.

## SECTION 5. REQUEST FOR COMMENTS

.01 In General. Comments are requested on the application of the rules described in this notice. Comments are also requested on specific aspects of State payment programs or additional situations with respect to which the issuance of Federal income tax guidance would be helpful. Comments are specifically requested on the Federal income tax treatment of payments that are characterized under State law as State sales tax refunds in light of the fact that it may not be practicable to determine the amount of State sales tax an individual paid during a particular taxable year. After considering the comments, the Department of the Treasury (Treasury Department) and the IRS intend to issue further guidance on the Federal income tax consequences of State payments.

### .02 Procedures for Submitting Comments.

(1) Timing. Comments should be submitted in writing on or before October 16, 2023. Consideration will be given, however, to any written comments submitted after October 16, 2023, if such consideration will not delay the issuance of further guidance.

(2) Form and manner. The subject line for the comments should include a reference to Notice 2023-56. All commenters are strongly encouraged to submit

comments electronically. However, comments may be submitted in one of two ways:

(a) Electronically via the Federal eRulemaking Portal at

<https://www.regulations.gov> (type IRS-2023-0033 in the search field on the <https://www.regulations.gov> homepage to find this notice and submit comments); or

(b) By mail to: Internal Revenue Service, CC:PA:LPD:PR (Notice 2023-56), Room 5203, P.O. Box 7604, Ben Franklin Station, Washington, D.C., 20044.

(3) Publication of comments. The Treasury Department and the IRS will publish for public availability any comment submitted electronically or on paper to its public docket on <https://www.regulations.gov>.

## SECTION 6. DRAFTING AND CONTACT INFORMATION

The principal author of this notice is Jonathan Hauck of the Office of the Associate Chief Counsel (Income Tax and Accounting). Other personnel from the Treasury Department and the IRS participated in its development. For further information regarding this notice contact Jonathan Hauck at (202) 317-7009 (not a toll-free number).