

INTERNAL REVENUE SERVICE

December 13, 2002

Number: **INFO 2002-0283**
Release Date: 12/31/2002
UILN: 61.40-00

CONEX-163573-02
CC:ITA:B4

[REDACTED]

Dear [REDACTED]:

I am responding to your letter dated October 29, 2002, on behalf of your constituent, [REDACTED]. [REDACTED] suggested a change to the tax status of governmental grants to businesses that were tenants of the World Trade Center. You asked about the actions the IRS will take to ensure those tenants receive assistance in recovering the losses they incurred due to the attack on the World Trade Center.

We expect to publish guidance on the income tax treatment of governmental grants to businesses in response to the September 11, 2001, attacks on the World Trade Center in the near future. This letter summarizes well-established principles of current law on the income tax treatment of governmental grants paid to individuals and businesses. Our published guidance will be consistent with these principles.

Gross income generally means all income from whatever source derived and encompasses all accessions to wealth, clearly realized, over which taxpayers have complete dominion. Gross income is subject to tax unless specifically exempted [*Commissioner v. Glenshaw Glass Co.*, 348 U.S. 426 (1955)]. The IRS has ruled, however, that payments made under legislatively provided social benefit programs for the promotion of the general welfare are not included in a recipient's gross income (Rev. Rul. 74-205, 1974-1 C.B. 20; Rev. Rul. 98-19, 1998-1 C.B. 840). To qualify, the payments must (i) be made from a governmental fund, (ii) be for the promotion of general welfare (i.e., based on need), and (iii) not represent compensation for services (Rev. Rul. 82-106, 1982-1 C.B. 16; Rev. Rul. 75-246, 1975-1 C.B. 24).

Governmental grants to businesses generally do not qualify for exclusion from income under the general welfare exclusion because that exclusion relates to payments based on individual need (rather than business need) (See Rev. Rul. 80-330, 1980-2 C.B. 29 *obsoleted by* Rev. Rul. 82-195, 1982-2 C.B. 34; Rev. Rul. 76-131, 1976-1 C.B. 16). In addition, governmental grants to businesses do not qualify for exclusion from income as qualified disaster relief payments, in part, because that exclusion applies only to payments to individuals (Section 139).

Governmental grants to businesses in response to a disaster generally do not qualify for exclusion from income as gifts because the government's intent in making the payments proceeds from its duty to relieve the hardship caused by the disaster. Also, part of the government's reason in providing the grants is to spur an economic recovery that would increase the government's tax base. [See *Kroon v. United States*, Civ. No. A-90-71, 1974 U.S. Dist. LEXIS 8656 (D. Alaska 1974)].

Under current law, individuals and businesses must include in gross income payments representing lost profits or income replacement. However, even if a governmental grant is part of business income, the business will generally not pay tax on the entire amount of the grant because the business may offset its deductible business expenses or net operating losses against the grant proceeds.

Other provisions of law allow businesses to exclude governmental grant proceeds from income, or defer tax on receipt of the grant proceeds, depending on the facts and circumstances, the purpose of the grant, and the character of the expenditures. For example, businesses that are corporations do not include in gross income amounts (including governmental grants) received as nonshareholder contributions to capital (Section 118). And businesses may defer recognizing gain on proceeds (including governmental grant proceeds) they receive in connection with the destruction of property if they invest the proceeds in property similarly related in service or use to the destroyed property (Section 1033). In addition, if property is destroyed in a Presidentially declared disaster, such as the World Trade Center disaster, businesses may use the grant proceeds to purchase any tangible business property for any service or use and still defer the recognition of gain [Section 1033(h)(2)]. The IRS has consistently applied these principles to governmental grants to businesses, including Community Development Block Grants.

To summarize, current provisions of tax law allow businesses to exclude governmental grant proceeds from income or defer tax on the receipt of the proceeds in certain circumstances. Legislative action, however, would be required to ensure that proceeds of all governmental grants received by businesses affected by the World Trade Center disaster are treated as nontaxable.

I hope this information is helpful. If you have any questions, please call me or [REDACTED].

Sincerely,
Lewis J. Fernandez
Deputy Associate Chief Counsel
(Income Tax & Accounting)