

INTERNAL REVENUE SERVICE

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The Honorable Richard H. Baker  
U.S. House of Representatives  
Washington, DC 20515

Dear Mr. Baker:

I am responding to your letter dated November 3, 2004, to Secretary Bodman. You asked us to revisit the issues addressed in our June 2004 memorandum that taxpayers who receive grants to improve property under the Flood Mitigation Assistance Program (FMA) and related mitigation programs must include the grants in gross income. You believe that recent legislative changes made to the FMA and characteristics differentiating the FMA from other mitigation grant programs administered by the Federal Emergency Management Agency (FEMA) would alter our view that such grant payments are included in property owners' income. You also expressed concern that including such payments in gross income would dilute the effectiveness of the FMA in contravention of Congressional intent, and cause hardship to property owners.

Let me assure you that we have thoroughly reviewed the position taken in the memorandum because of its importance to taxpayers who wish to participate in the mitigation programs. Upon completion of the review, we concluded that our position is consistent with current law, and that the mitigation grants do not qualify for existing statutory or administrative exceptions that would exclude them from income tax. While the recently-amended FMA has distinct characteristics, as highlighted in your letter, these characteristics would not alter the effect of existing tax law.

Under current law, gross income generally includes all income from whatever source derived. Under specific existing statutory and administrative exceptions, gross income does not include certain governmental payments made to individuals in response to need resulting from particular disaster damage that already has occurred. For example, post-disaster relief, such as FEMA grants that help individuals meet necessary expenses or serious needs for medical, dental, housing, personal property, transportation, or funeral expenses is excluded from gross income. The nontaxability of those payments remains unaffected by the June 2004 memorandum. However, grants under the FMA and related mitigation programs are made to communities, businesses, and individuals to reduce the risks to hazard-prone properties from future events. For

this and other reasons, grants under the FMA and related programs generally do not qualify for existing statutory or administrative exceptions.

The Administration shares your concerns, however, and believes that the Internal Revenue Code should be amended to achieve the policy objective of reducing damages from future disasters. In September 2004, then-Treasury Deputy Secretary Bodman wrote to House Ways and Means Committee Chairman William Thomas and Senate Finance Committee Chairman Charles Grassley to urge enactment of appropriate legislation. In addition, the President, in his recent budget recommendations for fiscal year 2006, recommended that Congress amend the Code to explicitly exclude FEMA mitigation grants from income. See Department of the Treasury, General Explanations of the Administration's Fiscal Year 2006 Revenue Proposals, 51-52 (February 2005).

As for prior payments, I understand that recognition of the history with respect to particular taxpayers will certainly be taken into account as to whether any enforcement activity by the IRS in this regard is warranted.

I hope this information is helpful. If you have any questions, please contact me at

Sincerely yours,

Robert M. Brown  
Associate Chief Counsel  
(Income Tax & Accounting)