

INTERNAL REVENUE SERVICE

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Ms. Susan A. Mauriello  
County Administrative Officer  
County of Santa Cruz  
701 Ocean Street, Suite 520  
Santa Cruz, CA 95060-4073

Dear Ms. Mauriello :

I am responding to your letter dated March 10, 2005, to Mark W. Everson, Commissioner of Internal Revenue. You asked us to rescind the position taken in our June 2004 memorandum that taxpayers who receive grants to improve property under the Flood Mitigation Program, the Pre-Disaster Mitigation Program, and the Hazard Mitigation Grant Program must include the grants in gross income. These programs are administered by the Federal Emergency Management Agency (FEMA).

I 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. 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.

The Administration, however, believes that the Congress should amend the Internal Revenue Code to achieve the policy objective of reducing damages from future disasters. The Department of the Treasury, as part of the Administration's revenue proposals for fiscal year 2006, recommended amending the Internal Revenue Code to exclude from gross income FEMA mitigation grants used to purchase or repair property, and to allow taxpayers to elect to defer gain realized on the sale of property under FEMA mitigation grant programs. Under this proposal, the Treasury Department would have administrative authority to provide retroactive relief. Department of the Treasury, *General Explanations of the Administration's Fiscal Year 2006 Revenue Proposals*, 51-52 (February 2005).

In response to the Treasury Department's revenue proposals, the House of Representatives passed H.R. 1134, which, if enacted, would generally provide that payments under FEMA mitigation grant programs are not subject to current taxation for amounts received, or with respect to sales or other dispositions, after the date of enactment. During the debate on H.R. 1134, House Ways and Means Committee Chairman William Thomas urged the Treasury Department to exercise administrative authority to provide retroactive relief. 151 Cong. Rec. H1394 (daily ed. March 14, 2005). S. 586, a bill identical to that passed by the House of Representatives, has been introduced in the United States Senate.

In addition, Secretary of the Treasury Snow in his March 14, 2005, letters to Chairman Thomas and Senate Finance Committee Chairman Charles Grassley stated, “[I]t is our hope that Congress, consistent with the Administration’s budget proposal, will encourage the Treasury Department to provide retroactive relief to those individuals who have utilized FEMA mitigation grants in the past.”

I hope this information is helpful. If you have any questions, please contact of my office at (202) 622-4920.

Sincerely,

Robert A. Berkovsky  
Branch Chief  
Office of Associate Chief Counsel  
(Income Tax & Accounting)