



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

OFFICE OF
CHIEF COUNSEL

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Representative Kevin Calvey
Chairman, Revenue & Taxation Committee
437 State Capitol Building
Oklahoma City, OK 73105

Dear Mr. Calvey:

This is in response to your letter of _____, in which you ask the Internal Revenue Service to reconsider its opinion that _____ and _____ payments that the State _____ to its taxpayers pursuant to _____ are includible in gross income for federal income tax purposes. It is your opinion that these payments ("State payments") should be treated as rebates of state income taxes rather than a general distribution from the State treasury, and thus should not be included in gross income.

We have reviewed our prior analysis and conclude that it is correct. Under section 61 of the Internal Revenue Code, gross income means all income from whatever source derived unless another provision of law specifically excludes the payment from gross income. The State payments do not qualify under any of the general exclusions from gross income: (i) refunds of state income taxes paid for which a taxpayer does not receive a federal tax benefit, (ii) gifts, and (iii) general welfare payments.

It is our understanding that the State payments are not a reduction in the amount of state income tax, or other tax, that a recipient previously paid. Under the program, a citizen can receive a rebate in excess of any state income tax paid. In addition, the amount of the rebate is not reflected in a taxpayer's state income tax account. In other words, the total of the tax payments made by a resident of _____ in 2005, to our knowledge, was not reduced by the rebate he or she received. Thus, that individual was enriched by that amount and therefore is subject to tax.

The State payments do not qualify for exclusion from income as gifts under section 102 of the Code. To qualify as a gift, a payment must be made from a "detached and disinterested generosity ... out of affection, respect, admiration, charity, or like

impulses.” Generally, governmental payments have been treated as gifts only if the payments have been made to a limited group of individuals based on merit or service, such as a state’s payments to war veterans. Neither _____ nor its legislative background indicates that the State payments are made to a limited class out of affection, generosity, charity, or like impulses.

The State payments also do not qualify for exclusion under the administrative exclusion for general welfare payments. To qualify as general welfare payments, the payments must (i) be made from a governmental fund, (ii) be for the promotion of the general welfare (*i.e.*, generally based on individual or family needs), and (iii) not represent compensation for services. The State payments do not satisfy the second requirement, *i.e.*, to help needy individuals pay for expenses such as housing, education, and basic sustenance. Therefore, the State payments are not excludable as general welfare payments.

Because the State payments do not qualify for any of the possible exclusions from gross income, taxpayers must include the payments in gross income for federal income tax purposes.

You are concerned that many taxpayers are required to file Forms 1040 rather than Forms 1040A or Form 1040EZ if they are required to report the State payments because Forms 1040A and 1040EZ do not have specific lines for these payments. As you may already know, the Internal Revenue Service addressed this concern and is allowing the State _____ rebate to be reported on line 13 of Form 1040A and line 3 of Form 1040EZ. A copy of the IRS news release announcing this position is enclosed.

If you have any questions concerning this matter, please call me at _____ .

Sincerely,

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

Enclosure