



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

OFFICE OF  
CHIEF COUNSEL

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The Honorable Lincoln Davis  
Member, U.S. House of Representatives  
Rockwood District Office  
P.O. Box 88  
Rockwood, TN 37854

Attention:

Dear Congressman Davis:

I previously responded to your inquiry dated February 28, 2009, on behalf of your constituent, \_\_\_\_\_ on whether he must pay federal income taxes on the proceeds of the sale of his home to the Tennessee Valley Authority (TVA). \_\_\_\_\_ now asks if he must pay taxes on a lump-sum payment from the TVA that includes relocation costs, casualty losses, and damages for personal physical injury.

In December 2008, a retention pond at the TVA's Kingston steam plant collapsed spilling an estimated 3.1 million cubic feet of fly ash and water over hundreds of acres in Roane County, Tennessee, to depths of four to six feet. \_\_\_\_\_ has accepted a payment from the TVA intended to compensate for relocation costs, casualty losses, and personal physical injuries he incurred due to the ash spill.

I hope that the following general information is helpful in responding to \_\_\_\_\_.

**Overview.** Taxpayers must include in gross income under section 61 of the Internal Revenue Code (Code) damage awards they receive unless the award is for a recovery of capital or another provision of the Code excludes the award from income.

**Compensation for Relocation Costs.** A taxpayer whose property (including a principal residence) is involuntarily converted (for example, due to its destruction) into money may elect to defer recognizing gain from the conversion of that property if the taxpayer timely purchases qualified replacement property with a cost equal to or exceeding the amount realized from the conversion (section 1033 of the Code). Some courts have held that the recipient can defer condemnation awards for the costs of moving equipment and fixtures under section 1033 of the Code. See *E.R. Hitchcock v.*

*United States*, 514 F.2d 484 (2d Cir. 1975); *Graphic Press v. Commissioner*, 523 F.2d 585 (9<sup>th</sup> Cir. 1975); *Buffalo Wire Works Co. Inc. v. Commissioner*, 74 T.C. 925 (1980), *nonacq.*, 1982-1 C.B. 1, *aff'd in unpublished opinion*, 659 F.2d 1058 (2d Cir. 1981).

**Compensation for Casualty Losses.** A taxpayer may deduct casualty losses incurred during the taxable year and not compensated for by insurance or otherwise (section 165 of the Code). The Code, however, does not permit a double deduction, or a deduction and exclusion, for the same item. Therefore, \_\_\_\_\_ may exclude any amount that compensates him for casualty losses if he has not claimed a loss on his return.

**Compensation for Personal Physical Injuries or Physical Sickness.** Gross income generally does not include damages received on account of personal physical injuries or physical sickness (section 104(a)(2) of the Code). Therefore, \_\_\_\_\_ may exclude from gross income any portion of the damage award that is properly allocable to personal physical injuries or physical sickness and do not represent a recovery of medical expenses he deducted in a prior year.

If you have any questions concerning this matter, please call me or \_\_\_\_\_, Identification Number \_\_\_\_\_, at \_\_\_\_\_.

Sincerely,

Michael J. Montemurro  
Chief, Branch 4  
Office of Associate Chief Counsel  
(Income Tax and Accounting)