DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, DC 20224

OFFICE OF
CHIEF COUNSEL

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MEMORANDUM FOR LINDA R. DETTERY
AREA COUNSEL CC:SB:1
Attn: Janet Appel

FROM: Lewis J. Fernandez
Deputy Associate Chief Counsel
(Income Tax & Accounting)

SUBJECT: WOTC Panel at MSG

This memorandum provides a general statement of legal principles regarding the income tax consequences of an individual's or a business' receipt of disaster relief grants from a government. We believe this information will help representatives of the Internal Revenue Service answer questions they may receive at a business symposium they are attending on October 2, 2002.

Generally, governmental grants made to help individuals and families meet disaster-related expenses are not includible in income because they are needs-based payments. In this context, we do not define "need" in terms of financial need and it applies equally to all residents of an affected area regardless of their income levels. The Internal Revenue Service has consistently applied this principle to governmental grants made to individuals affected by disasters (for example, Federal Emergency Management Agency grants to individuals to provide for family or living costs incurred due to a disaster).

Generally, governmental grants to businesses that compensate for lost profits are includible in business income. However, even if a grant is part of business income, taxpayers may offset their deductible business expenses or net operating losses against such grant proceeds.

In addition, depending on the facts and circumstances, the purpose of the grant, and the character of the expenditures, a business may exclude from income or defer tax on receipt of grant proceeds.[1] Again, these principles have been consistently applied by the I.R.S. to governmental grants to businesses, including Community Block Development Grants.

The Department of Treasury and the Office of Chief Counsel are expected to issue guidance on the federal income tax treatment of governmental grants made to businesses and individuals arising out of a disaster.

Attached is a page that reiterates the above principles. At your discretion, it may be copied and distributed at the WOTC meeting.

If you have any questions or need to discuss this matter further, please contact
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Attachment::
Addendum as stated.

[1] For example, § 118 allows corporations to exclude from gross income amounts (including governmental grants) received as a nonshareholder contribution to capital. And § 1033 allows taxpayers to defer recognizing gain on proceeds they receive in connection with the destruction of property if the proceeds are invested in property similarly related in service or use to the destroyed property.

ADDENDUM

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