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Rev. Rul. 76-144

Advice has been requested whether grants received pursuant to section 408 of the Disaster Relief Act Amendments of 1974, 42 U.S.C.A. section 5178 (Supp. 1975), are includible in the gross income of recipients under section 61 of the Internal Revenue Code of 1954.

The Disaster Relief Act of 1974 authorizes state governors to request that Federal funds be made available to a state for the purpose of such state making grants to individuals and families who as a result of a major disaster are unable to meet necessary expenses or serious needs. The grant program authorized by 24 CFR section 2205.48 (1975) is 75 percent Federally funded and 25 percent state funded. Where a state is unable to immediately pay its share, the President is authorized to advance to the state its 25 percent share, and any such advance will be repaid to the United States when the state is able to do so. No individual and no family will receive any grant or grants in excess of \$5000 for any one major disaster.

The purpose of the Disaster Relief Act of 1974 is to provide an orderly and continuing means of assistance by the Federal Government to state and local governments in carrying out their responsibilities to alleviate the suffering and damage resulting from disasters.

The grant program is intended to provide funds to states for financial assistance grants to meet extraordinary disaster-related necessary expenses or serious needs of individuals or families adversely affected by a major disaster where such individuals or families are unable to meet such expenses or needs through other governmental assistance or from other means. Assistance may be made available to meet necessary expenses or serious needs in the categories of medical or dental, housing, personal property, transportation, and funeral expenses. The recipient is advised of the specific amount granted for each particular purpose. The grant program is not intended to indemnify all disaster losses or to purchase items and services that may generally be characterized as nonessential, luxury, or decorative.

Section 61(a) of the Code provides that, except as otherwise provided, gross income means all income from whatever source derived.

Section 165(a) of the Code provides that there shall be allowed as a deduction any loss sustained during the taxable year and not compensated for by insurance or otherwise.

Section 213(a) of the Code allows a deduction, subject to certain limitations, for expenses paid during the taxable year, not compensated for by insurance or otherwise, for medical care of the taxpayer, the taxpayer's spouse, or the taxpayer's dependent.

Disbursements from a general welfare fund in the interest of the general welfare are not includible in gross income. See Rev. Rul. 75-271, 1975-2 C.B. 23, which holds that mortgage assistance payments that are in substance interest subsidies paid under section 235 of the National Housing Act are in the nature of general welfare and not includible in gross income. See also Rev. Rul. 74-205, 1974-1 C.B. 20, which states, in part, that the Internal Revenue

Service has consistently held that payments made under legislatively provided social benefit programs for promotion of the general <Page 18> welfare are not includible in a recipient's gross income.

Accordingly, grants received pursuant to section 408 of the Disaster Relief Act of 1974 are in the interest of the general welfare and not includible in the gross incomes of the recipients.

Pursuant to sections 165(a) and 213(a) of the Code, the grantee may qualify for a casualty loss deduction or a medical expense deduction. Whether these deductions must be reduced to reflect the amount of the grant received depends on whether the grant is "insurance or otherwise" and whether the Disaster Relief Act of 1974 can be considered as providing the grantee with a claim against the government for the amount of loss.

In Rev. Rul. 71-160, 1971-1 C.B. 75, the recipient of a loan received pursuant to the Disaster Relief Act of 1969 was required to reduce a casualty loss by an amount equal to the amount of the loan that was forgiven. The Revenue Ruling states that the Disaster Relief Act of 1969 provided for the forgiveness of those amounts of the loan in excess of \$500 with a maximum forgiveness of \$1800 (later increased to \$2500). Further, Rev. Rul. 71-160 states that the provisions of the Disaster Relief Act of 1969 that provided for the forgiveness of a portion of the loan are similar in operation to an insurance policy with a \$500 deductible clause. The Revenue Ruling reasons that since the purpose of these provisions is to compensate disaster victims for certain property losses by means of cancelling portions of certain Federal loans, the portions of debts cancelled under the Disaster Relief Act of 1969 are "compensation" within the meaning of section 165(a) of the Code. The amount of the forgiveness of debt will therefore reduce the casualty loss deduction otherwise allowable under section 165.

In Rev. Rul. 74-74, 1974-1 C.B. 18, it is held that when an individual receives an award from the Crime Victims Compensation Board, such award is in the nature of a welfare payment and not includible in the gross income of the individual. Further, when an individual receives such an award, any medical expenses incurred by the individual that are compensated for by the award are not deductible under section 213 of the Code.

In *Shanahan v. Commissioner*, 63 T.C. 21 (1974), the United States Tax Court held that the taxpayers whose home had been damaged by an earthquake and who had received an unsecured loan from the Small Business Administration, pursuant to the Disaster Relief Act of 1970, that was ultimately cancelled in part, must reduce the amount of the casualty loss in an amount equal to the cancellation of indebtedness because the taxpayers were compensated by such cancellation within the meaning of section 165(a) of the Code. The Court stated it viewed the financial aid to the taxpayers, that is, the loan and cancellation thereof, as being in the nature of insurance.

The assistance that a government grants its citizens who sustain personal injury and property damage as the result of hurricanes, tornadoes, earthquakes and other natural disasters is motivated by its obligation to assist in alleviating the suffering and damage caused by the disaster. This assistance granted by the government is provided to compensate the victims of a natural disaster for their losses. Thus, the government can be viewed as an insurer of its citizens with respect to natural disasters.

Unlike the Disaster Relief Acts of 1969 and 1970, the Disaster Relief Act of 1974 does not provide loans to disaster victims but rather provides for outright grants to enable the grantee to meet extraordinary disaster-related necessary expenses. Certainly, if the cancellation of loans pursuant to the Disaster Relief Acts of 1969 and 1970 is compensation and in the nature of

insurance, then the outright grants pursuant to the Disaster Relief Act of 1974, which the grantee has a right to, are compensation and in the nature of insurance.

Accordingly, no deduction is permitted under section 165(a) and 213(a) of the Code with respect to expenses paid or incurred by the taxpayer to the extent the taxpayer is specifically reimbursed for such expenses by a grant received pursuant to section 408 of the Disaster Relief Act of 1974.