

Part I. Rulings and Decisions Under the Internal Revenue Code of 1986

Section 61.—Gross Income Defined

26 CFR 1.61-1(a): *Gross income*
(Also §§ 102; 139; 7805; 1.102-1; 301.7805-1.)

Gross income; general welfare; gifts; disaster relief payments. This ruling holds that amounts paid to an individual by a state agency, a charity, or an employer to reimburse the individual for certain expenses the individual incurs as a result of a Presidentially declared disaster are excluded from the individual's gross income under the administrative general welfare exclusion, sections 102 and 139 of the Code, respectively.

Rev. Rul. 2003-12

ISSUES

(1) Are grants individuals receive under a state's program to pay or reimburse certain reasonable and necessary medical, temporary housing, or transportation expenses they incur as a result of a flood includible in gross income?

(2) Are grants individuals receive under a charitable organization's program to pay or reimburse certain medical, temporary housing, or transportation expenses they incur as a result of a flood includible in gross income?

(3) Are grants employees receive under an employer's program to pay or reimburse certain reasonable and necessary medical, temporary housing, or transportation expenses they incur as a result of a flood includible in gross income?

FACTS

Situation 1. An area within state *ST* was affected by a flood that was a Presidentially declared disaster as defined in § 1033(h)(3) of the Internal Revenue Code. *ST* enacted emergency legislation appropriating funds for grants to pay or reimburse medical, temporary housing, and transportation expenses individuals incur as a result of the flood that are not compensated for by insurance or otherwise. *ST* will not require individuals to provide proof of actual expenses to receive a grant payment. *ST*'s program, however, contains requirements (which are described in the program documents) to ensure that the grant amounts are reasonably expected to be commensurate with the amount of unreimbursed

reasonable and necessary medical, temporary housing, and transportation expenses individuals incur as a result of the flood. The grants are not intended to indemnify all flood-related losses or to reimburse the cost of nonessential, luxury, or decorative items and services.

Situation 2. *O*, a charitable organization described in § 501(c)(3) that is exempt from tax under § 501(a), whose purpose is to provide assistance to individuals who are affected by disasters, also makes grants to distressed individuals affected by the flood described in *Situation 1*. The grants will pay or reimburse individuals for medical, temporary housing, and transportation expenses they incur as a result of the flood that are not compensated for by insurance or otherwise.

Situation 3. Employer *R* makes grants to its employees who are affected by the flood described in *Situation 1*. The grants will pay or reimburse employees for medical, temporary housing, and transportation expenses they incur as a result of the flood that are not compensated for by insurance or otherwise. *R* will not require individuals to provide proof of actual expenses to receive a grant payment. *R*'s program, however, contains requirements (which are described in the program documents) to ensure that the grant amounts are reasonably expected to be commensurate with the amount of unreimbursed reasonable and necessary medical, temporary housing, and transportation expenses *R*'s employees incur as a result of the flood. The grants are not intended to indemnify all flood-related losses or to reimburse the cost of nonessential, luxury, or decorative items and services. The grants are available to all employees regardless of length or type of service with *R*.

LAW AND ANALYSIS

Section 61(a) provides that, except as otherwise provided by law, gross income means all income from whatever source derived. Rev. Rul. 131, 1953-2 C.B. 112, concludes, in part, that certain payments by an employer to its employees for the purpose of helping the employees defray costs they incurred from personal injury and property loss resulting from a tornado do not come within the concept of gross income to the employees under the predecessor of § 61 because the payments are gratuitous,

measured solely by need, not related to services rendered, and designed to place the employees in about the same economic position as they were before the tornado. In 1955, the Supreme Court of the United States held that Congress intended under § 61 to tax all gains or undeniable accessions to wealth, clearly realized, over which taxpayers have complete dominion. *Commissioner v. Glenshaw Glass Co.*, 348 U.S. 426 (1955), 1955-1 C.B. 207.

The Internal Revenue Service has concluded that payments made by governmental units under legislatively provided social benefit programs for the promotion of the general welfare (*i.e.*, based on need) are not includible in the gross income of the recipients of the payments ("general welfare exclusion"). For example, Rev. Rul. 98-19, 1998-1 C.B. 840, concludes that a relocation payment, authorized by the Housing and Community Development Act of 1974 and funded under the 1997 Emergency Supplemental Appropriations Act for Recovery From Natural Disasters, made by a local jurisdiction to an individual moving from a flood-damaged residence to another residence, is not includible in the individual's gross income. Likewise, Rev. Rul. 76-144, 1976-1 C.B. 17, concludes that grants received under the Disaster Relief Act of 1974 by individuals unable to meet necessary expenses or serious needs as a result of a disaster are in the interest of general welfare and are not includible in the recipients' gross income.

Section 102(a) provides that the value of property acquired by gift is excluded from gross income. Under § 102(a) a gift "must proceed from a 'detached and disinterested generosity,' ... 'out of affection, respect, admiration, charity or like impulses.'" *Commissioner v. Duberstein*, 363 U.S. 278, 285 (1960), 1960-2 C.B. 428, 431. In general, a payment made by a charity to an individual that responds to the individual's needs, and does not proceed from any moral or legal duty, is motivated by detached and disinterested generosity. Rev. Rul. 99-44, 1999-2 C.B. 549. Section 102(c) provides that § 102(a) shall not exclude from gross income any amount transferred by or for an employer to, or for the benefit of, an employee. Governmental grants in response to a disaster generally do not qualify as gifts because the govern-

ment's intent in making the payments proceeds from its duty to relieve the hardship caused by the disaster. *Kroon v. United States*, Civ. No. A-90-71 (D. Alaska 1974).

The Victims of Terrorism Tax Relief Act of 2001, Pub. L. No. 107-134, 115 Stat. 2427 (2001), added § 139 to the Code. Section 139(a) provides that gross income does not include any amount received by an individual as a qualified disaster relief payment.

Section 139(b) provides, in part, that the term "qualified disaster relief payment" means any amount paid to or for the benefit of an individual:

(1) to reimburse or pay reasonable and necessary personal, family, living, or funeral expenses incurred as a result of a qualified disaster (§ 139(b)(1));

(2) to reimburse or pay reasonable and necessary expenses incurred for the repair or rehabilitation of a personal residence or repair or replacement of its contents to the extent that the need for such repair, rehabilitation, or replacement, is attributable to a qualified disaster (§ 139(b)(2)); or

(3) by a Federal, State, or local government, or agency or instrumentality thereof, in connection with a qualified disaster in order to promote the general welfare (§ 139(b)(4)).

Thus, § 139(b)(4) codifies (but does not supplant) the administrative general welfare exclusion with respect to certain disaster relief payments to individuals. Section 139(b) also provides that the exclusion from income applies only to the extent any expense compensated by such payment is not otherwise compensated for by insurance or otherwise.

Section 139(c) provides that the term "qualified disaster" means:

(1) a disaster that results from a terrorist or military action (as defined in § 692(c)(2));

(2) a Presidentially declared disaster as defined in § 1033(h)(3) (generally, a disaster in an area that has been subsequently determined by the President to warrant federal assistance under the Disaster Relief and Emergency Assistance Act);

(3) a disaster resulting from any event that the Secretary determines to be of a catastrophic nature; or

(4) with respect to amounts described in § 139(b)(4), a disaster that is determined by an applicable Federal, State, or local au-

thority (as determined by the Secretary) to warrant assistance from the Federal, State, or local government or an agency or instrumentality thereof.

Because "of the extraordinary circumstances surrounding a qualified disaster, it is anticipated that individuals will not be required to account for actual expenses in order to qualify for the [§ 139] exclusion, provided that the amount of the payments can be reasonably expected to be commensurate with the expenses incurred." Joint Committee on Taxation Staff, *Technical Explanation of the "Victims of Terrorism Tax Relief Act of 2001," as Passed by the House and Senate on December 20, 2001*, 107th Cong., 1st Sess. 16 (2001). As under § 139, the Service will not require individuals to account for actual disaster-related expenses for governmental payments to qualify under the administrative general welfare exclusion if the amount of the payments is reasonably expected to be commensurate with the expenses incurred.

The grants that individuals receive from *ST*, *O*, and *R*, and the payments that the employees receive from their employer in Rev. Rul. 131, are accessions to wealth clearly realized over which the recipients have complete dominion, and therefore come within the concept of gross income under § 61 as described in *Glenshaw Glass*. Thus, these amounts are included in gross income unless specifically excluded by another provision of law. Accordingly, Rev. Rul. 131 is modified to the extent that it holds that the payments received by the employees from their employer do not come within the concept of gross income.

In *Situation 1*, the grants made by *ST* are reasonably expected to be commensurate with the unreimbursed reasonable and necessary medical, temporary housing, or transportation expenses individuals incur as a result of the flood. These expenses are personal, living, or family expenses within the meaning of § 139. Moreover, they are paid to compensate individuals for expenses that are not compensated for by insurance or otherwise. Thus, the grants are in the nature of general welfare and are, therefore, excluded from the recipients' gross income under the general welfare exclusion. The payments also qualify for exclusion from gross income under § 139. Because *ST*'s intent in making the grants proceeds from its duty to relieve the hardship caused by the disaster, not from a detached and dis-

interested generosity, the grants made by *ST* do not qualify for exclusion from income as gifts under § 102.

In *Situation 2*, the grants made by *O* are designed to help distressed individuals with unreimbursed medical, temporary housing, or transportation expenses they incur as a result of the flood. Under these facts, *O*'s grants are made out of detached and disinterested generosity rather than to fulfill any moral or legal duty. Thus, the grants are excluded from the gross income of the recipients as gifts under § 102. Because payments by non-governmental entities are not considered payments for the general welfare, the grants made by *O* are not excluded from the recipients' gross income under the general welfare exclusion. Rev. Rul. 82-106, 1982-1 C.B. 16. It is not necessary to reach the question of whether § 139 applies to the grants.

In *Situation 3*, the grants made by *R* to its employees do not qualify as gifts under § 102. Also, because payments by non-governmental entities are not considered payments for the general welfare, the grants made by *R* are not excluded from the recipients' gross income under the general welfare exclusion. The grants, however, are reasonably expected to be commensurate with the unreimbursed reasonable and necessary personal, living, or family expenses that *R*'s employees incur as a result of a flood that is a qualified disaster as defined in § 139(c). Moreover, they are paid to compensate individuals for expenses that are not compensated for by insurance or otherwise. Therefore, *R*'s grants are qualified disaster relief payments that are excluded from the gross income of *R*'s employees under § 139. Similar to the grants in *Situation 3*, the payments made by the employer described in Rev. Rul. 131 do not qualify as gifts under § 102 and are not excluded from the employees' gross income under the general welfare exclusion. Whether the payments described in Rev. Rul. 131 are included in an employee's gross income depends on whether the payments qualify for exclusion under § 139.

HOLDINGS

Under the facts of this ruling:

(1) Payments individuals receive under a state's program to pay or reimburse unreimbursed reasonable and necessary medical, temporary housing, or transportation expenses they incur as a result of a

flood are excluded from gross income under the general welfare exclusion. Such payments also qualify for exclusion under § 139.

(2) Payments that individuals receive under a charitable organization's program to pay or reimburse unreimbursed medical, temporary housing, or transportation expenses they incur as a result of a flood are excluded from gross income under § 102.

(3) Payments that employees receive under an employer's program to pay or reimburse unreimbursed reasonable and necessary medical, temporary housing, or transportation expenses they incur as a result of a flood are excluded from gross income under § 139.

Amounts that are excluded from gross income under this revenue ruling are not subject to information reporting under § 6041.

EFFECT ON OTHER DOCUMENTS

Rev. Rul. 131 is modified.

PROSPECTIVE APPLICATION

Pursuant to the authority contained in § 7805(b), this revenue ruling will not apply adversely to payments received on or before January 21, 2003.

DRAFTING INFORMATION

The principal author of this revenue ruling is Sheldon A. Iskow of the Office of Associate Chief Counsel (Income Tax and Accounting). For further information regarding this revenue ruling, contact Mr. Iskow at (202) 622-4920 (not a toll-free call).

Section 401.—Qualified Pension, Profit-Sharing and Stock Bonus Plans

26 CFR 1.401-1: *Qualified pension, profit-sharing and stock bonus plans.*

Whether an S corporation ESOP is eligible for the delayed effective date of section 409(p) of the Internal Revenue Code as added by section 656(d)(2) of the Economic Growth and Tax Relief Reconciliation Act of 2001. See Rev. Rul. 2003-6, page 286.

26 CFR 1.401(a)(17)-1: *Limitation on annual compensation.*

Limitation on annual compensation; section 611(c) of EGTRRA. This ruling pertains to whether the allowable compensation limit enacted by section 611(c) of EGTRRA may be applied to former employees and meet the nondiscrimination and coverage requirements of the Code.

Rev. Rul. 2003-11

ISSUE

Whether a plan amendment that reflects the increase in the allowable compensation limit contained in section 611(c) of the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA), Pub. L. 107-16, and applies that increase to former employees, will satisfy the nondiscrimination rules of § 401(a)(4) and the minimum coverage requirements of § 410(b) of the Internal Revenue Code (Code).

FACTS

Plan A is a nongovernmental defined benefit plan with a calendar year plan year and a benefit formula that provides for all participants an annual benefit at normal retirement age equal to the product of: (years of service) x (1 percent) x (high 3-year average compensation). For this purpose, high 3-year average compensation is the average of the compensation over the 3 consecutive plan years for which the average is the highest, and compensation for each year is limited to \$150,000, as adjusted for cost-of-living increases (the limit under § 401(a)(17) of the Code prior to the effective date of the EGTRRA amendments to that section). B is a former participant in Plan A who retired as of December 31, 2001. As of December 31, 2001, B has 10 years of service and compensation of \$250,000 for each of the 3 years 1999, 2000, and 2001. B's high 3-year average compensation of \$166,667 is determined as the average of annual compensation (as limited by § 401(a)(17) of the Code) of \$160,000 for 1999, \$170,000 for 2000, and \$170,000 for 2001. B's annual benefit under the plan formula as of December 31, 2001, is \$16,667, calculated as $(10) \times (.01) \times (\$166,667)$. As of December 31, 2001, B is a "highly compensated former employee," as defined in § 1.410(b)-9, and a "former HCE," as defined in § 1.401(a)(4)-12, for

purposes of applying the nondiscrimination rules under §§ 410(b) and 401(a)(4) respectively.

In 2002, Plan A is amended (1) to use the \$200,000 compensation limit for compensation paid in years beginning after December 31, 2001, (2) to use the \$200,000 compensation limit for compensation paid in years beginning prior to January 1, 2002, in determining benefit accruals in years beginning after December 31, 2001, and (3) to use the \$200,000 compensation limit in determining retirement benefits to be paid after December 31, 2001, to employees who retired on or before December 31, 2001. A high 3-year average compensation of \$200,000 is determined for B as of December 31, 2002, as the average of annual compensation (as limited by § 401(a)(17) of the Code, as amended by EGTRRA) of \$200,000 for 1999, \$200,000 for 2000, and \$200,000 for 2001. As of December 31, 2002, B's annual benefit under the plan formula is \$20,000, calculated as $(10) \times (.01) \times (\$200,000)$.

LAW AND ANALYSIS

Section 401(a)(17) limits the annual compensation that may be taken into account for purposes of determining a participant's benefit accruals under a defined benefit plan or a participant's allocations under a defined contribution plan. Section 401(a)(17) also limits the annual compensation that may be taken into account for purposes of certain nondiscrimination requirements, including those in §§ 401(a)(4), 401(a)(5), 401(l), 401(k), 401(m), 403(b)(12), 404(a)(2), and 410(b)(2), and for purposes of determining whether a definition of compensation is nondiscriminatory under § 414(s)(3). Under § 401(a)(17), as in effect prior to the effective date of the EGTRRA amendment, the compensation limit was \$150,000, indexed in \$10,000 increments for cost-of-living adjustments. For 2001, the compensation limit was \$170,000. A higher compensation limit applies to eligible participants in certain governmental plans. See § 1.401(a)(17)-1(d)(4)(ii) of the Income Tax Regulations.

Section 611(c) of EGTRRA amended § 401(a)(17) of the Code by increasing the \$150,000 limit (as adjusted) to \$200,000, and changing the method used for cost-of-living adjustments. Section 611(c) of EGTRRA made similar amendments to