

Discovering (or Revisiting) the General Welfare Exception from Gross Income

By Robert W. Wood and Richard C. Morris

Robert W. Wood and Richard C. Morris examine the general welfare exception from gross income.

For decades, tax practitioners have done more than pay lip service to the all inclusive properties of Code Sec. 61. Courts have told us over and over again that gross income is, after all, income from whatever source derived, be that wages, gains, prizes or treasure trove.¹ Indeed, a million dollars found inside a piano is clearly includible in income to the lucky finder.² So is that \$20 you found on the street; never mind that the person who lost the money probably can't claim a deduction. Who said tax law is fair?

We recently celebrated a milestone birthday for *Glenshaw Glass*,³ a case underscoring the nearly limitless reach of gross income. Who can forget its cogent holding? Income exists whenever there is an accession to wealth, clearly realized and over which taxpayers have complete dominion and control. Although it might appear that *Glenshaw Glass* is graying a bit on the edges as it turned 50 this year, this pillar of tax law jurisprudence is stronger than ever. Indeed, 34 cases and 13 law review articles have cited it since 2004 alone. Historically, the case commands over 1000 citations, including 15 from the Supreme Court, and 320 law review articles.

Even though most practitioners may find it difficult to remember the facts of the case,⁴ there is a persistent symbiosis between *Glenshaw Glass* and the accession to wealth doctrine. Nearly every tax textbook includes a chapter revolving around it, so tax lawyers start their careers with the case. *Glenshaw Glass* is a staple of tax doctrine.

Robert W. Wood practices law with Robert W. Wood, P.C., in San Francisco.

Richard C. Morris is an Associate with Robert W. Wood, P.C. in San Francisco.

Because of this case, everyone knows that virtually everything constitutes income for tax purposes. In fact, it seems that the breadth of the gross income concept is nearly limitless. Nevertheless, a little known administrative exception exists which circumvents these cases and their income inclusion mandate. It is called the general welfare exception (GWE).

Under the GWE, certain government payments do not constitute gross income to the recipients. While the IRS has applied the GWE doctrine to a handful of disparate government payments, historically, the classic example of the GWE's application is a government payment made to victims of a natural disaster. For example, although the IRS has not ruled on this particular issue, payments made by the Federal Emergency Management Agency (FEMA) to hurricane victims are of the type of payment that historically qualified for relief under the GWE.⁵

GWE's Little Known Existence

I think that most tax practitioners have never heard of the GWE. While tax practitioners may not have known about the existence of the GWE or that it can provide authority to exclude certain payments from income, nontax professionals may not be so hamstrung by the cases they read in law or tax school. Indeed, some nontax practitioners we have spoken to thought these types of payments were undoubtedly excludable from gross income, even though they couldn't put their fingers on the legal theory for the exclusion. Perhaps one reason why most tax practitioners are unaware of the existence of the GWE is that virtually all authority which discusses Code Sec. 61 simply does not mention it.⁶

©2005 R.W. Wood and R.C. Morris

As we all know, Code Sec. 61 provides the general rule that gross income includes all income from whatever source derived. Courts have agreed that all income is subject to taxation unless excluded by law.⁷ The position of the IRS is that income is defined as broadly as possible.⁸ Exclusions from income are narrowly construed, and generally have been limited to those specified in the Code.⁹ With such an inauspicious foundation, it is almost surprising to find that the IRS has recognized the GWE as an uncodified exclusion from income.

Under the GWE doctrine, the IRS has ruled that payments made under legislatively provided social benefit programs for promotion of the general welfare are excludable from gross income.¹⁰ Not surprisingly, almost all IRS GWE authority contains this very language. While there is a paucity of judicial authority on the GWE, it seems that all of it follows the IRS's position.¹¹

The GWE doctrine apparently originated in 1938, when the IRS determined that welfare payments (from the then recently enacted Social Security Act) could be excluded from gross income.¹² Throughout the ensuing thirty years, the IRS continued to issue opinions on this subject matter,¹³ and by 1971, the IRS used the word "long-standing" to describe the GWE doctrine.¹⁴

GWE Requirements

As noted above, the GWE requires that payments be made under legislatively provided for social benefit programs for the promotion of the general welfare. In determining whether the general welfare exception applies to payments, the IRS requires the payments to be:

- made from a governmental general welfare fund;
- for the promotion of the general welfare (*i.e.*, on the basis of need rather than to all residents); and
- not made as payment with respect to services.¹⁵

The GWE has generally been limited to individuals who receive governmental payments to help them with their individual needs (*e.g.*, housing, education and basic sustenance expenses).¹⁶ Grant payments that compensate for lost profits or business income (whether to individuals or to businesses) do not qualify for the GWE.¹⁷

Payment Origin

The first prong of the GWE requires that the payment be made from a governmental general welfare fund. It does not seem to matter whether these payments originate from the federal government, a state government or a county government.¹⁸

This requirement appears to be relatively straightforward, and there does not appear to be any authority which analyzes it. In extant GWE authorities, the fact that a payment originates in the general welfare fund appears to be assumed (or at least the IRS must believe that it is easy to determine), and therefore this first prong is not discussed. This suggests that the determination of whether a payment is made from a governmental general welfare fund is mechanical, and has not been subject to interpretive differences for which taxpayers would need guidance.

BLACK'S LAW DICTIONARY defines the "general fund" as a government's primary operating fund; a state's assets furnishing the means for the support of government and for defraying the legislature's discretionary appropriations. It goes on, noting that a general fund is distinguished from assets of a special character, such as trust, escrow and special-purpose funds.¹⁹

Governmental entities seem to adopt the same definition, though it does seem surprising that there are not more discussions of this point. For example, the federal government notes in its 2005 budget that there are several types of funds. The general fund, "which is the greater part of the budget, record[s] receipts not earmarked by law for a specific purpose" including the proceeds of general borrowing, and the expenditures of these moneys.²⁰ Other funds exist, including "special funds" which have receipts that are earmarked for a specific purpose, "public enterprise funds" which are revolving funds used for business-like operations with the public, "intragovernmental funds" which are revolving funds used for business-like operations within and between other governmental agencies, and "trust funds" which are for carrying out specific programs according to statute.²¹

State and local governments also address these issues. According to the California Legislative Analyst's Office, the general fund is the "main source of support for state programs" such as education, health and social services, and correctional programs.²² Special funds are used for "specific functions or activities of government designated by law" and differ from general funds which can be spent by the Legislature for any purpose. Examples of special funds include transportation funds, public utility commission funds and local government funds.

The city of San Francisco appears to follow these definitions. It notes that the general fund is San Francisco's "primary operating fund. It accounts for all financial resources of the city except those required

to be accounted for in another fund."²³ San Francisco has other distinct funds for specific purposes, such as the Airport Fund, the Municipal Transportation Agency Fund and the Water Fund.

Although we have not examined every California county, and only a sampling of other state governments, our research has found consistent results.

Promotion of General Welfare

The second prong of the GWE requires that the payment be for the promotion of the general welfare. This requirement has produced the vast majority of the GWE jurisprudence. As we'll see, the area continues to evolve, suggesting a more expansive exception to gross income than might first seem apparent.

Under this second prong of the GWE, the payment must be for the promotion of the general welfare. This can be a Quixotic inquiry. The IRS has consistently ruled that the governmental payments must be made on the basis of need.²⁴ Some authority looks to the payment recipient's income level, presumably as a means of assessing need. For example, in some authority, the GWE only applies to individuals who fall below certain income thresholds. In Chief Counsel Advice (CCA) 200022050, the IRS only applied the GWE to individuals whose income was below 80 percent of the county or metropolitan area median. Nevertheless, it seems that most GWE authority does not discuss precise income level thresholds, and appears to base the application of the GWE on the particular needs of individuals.²⁵

The IRS determination of what constitutes a needs-based payment seems to vary depending on the need for which the payment is being made. As noted above, the classic example of a needs-based payment qualifying for exclusion under the GWE is a payment made for disaster relief. In Rev. Rul. 2003-12,²⁶ a state was affected by a flood that was a Presidentially declared disaster area.²⁷ The state enacted emergency legislation to provide grants to pay or reimburse medical, temporary housing and transportation expenses not compensated by insurance. The grants were not intended to indemnify all flood losses, or to reimburse for non-essential, luxury items.

The IRS ruled that these "reasonable and neces-

sary" payments were excluded from the recipient's gross income under the GWE.²⁸ Notably, the IRS also ruled that these payments qualify for exclusion under recently enacted Code Sec. 139, noting that Code Sec. 139 codifies, but does not supplant, the GWE with respect to certain disaster payments. Next, the ruling discusses relief payments originating from charities and employers, neither of which meets the requirements of the GWE, since the payments do not stem from the government. Nonetheless, payments from charities were held to be excludable as gifts and payments from employers were held to be excludable under Code Sec. 139.²⁹

Many varieties of housing assistance meet the requirements of the GWE. In a series of CCAs, the IRS stated that certain housing payments to flood victims were excludable from income under the GWE. CCA 200022050 provides the payments by the state of North Carolina to assist low-income homeowners in replacing, repairing and

rehabilitating flood damaged homes were in the nature of general welfare, and not includible in the homeowner's gross income. State payments to assist home repair by reducing the affected individual's debt burden also qualify under the GWE.³⁰ Similarly, state supplemental payments to enable homeowners to purchase comparable housing outside a flood plain (after a federal program purchased the original flood-damaged house) were not income to the recipients.³¹ Moreover, state payments to enable renters to relocate after the flood were held to be excludable.³²

Not all housing rulings relate to disasters. The IRS has ruled that relocation assistance payments to low-income homeowners in the absence of a flood or other disaster can meet the requirements of the GWE.³³ In Rev. Rul. 76-395,³⁴ the IRS ruled that federally funded home rehabilitation grants received by low-income homeowners residing in a defined area of a city under the city's community development program were in the nature of general welfare and not includible in the recipients' gross incomes. In Rev. Rul. 75-271,³⁵ federally provided mortgage assistance payments to low-income homeowners were not includible in the recipient's income.

Basic sustenance payments have been held to meet the requirements of the GWE. In Rev. Rul. 78-170,³⁶ the state of Ohio provided credits to elderly and

We recently celebrated a milestone birthday for *Glenshaw Glass*, a case underscoring the nearly limitless reach of gross income.

disabled persons for payment of their winter energy bills. To qualify, an individual had to be the head of the household, at least 65 years old or permanently disabled, and have a total income under \$7,000. Propane dealers and utility companies were to reduce the amount charged by the amount of credits provided, and the state would reimburse the dealers and utility companies for the credits. The IRS ruled that the amounts paid, directly or indirectly, were relief payments made for the promotion of general welfare and were not includible in the gross income of the recipients.³⁷

Services Not Allowed

The third prong of the GWE requires that payments cannot be made with respect to services performed.³⁸ Payments for services constitute taxable income.³⁹ This axiom is well illustrated in CCA 200227003, where the state of Massachusetts had a program under which its senior citizens received property tax abatements for performing voluntary community service. The IRS found that these payments were includible in the seniors' incomes since the seniors had to perform services to receive the payments. The CCA also noted that these payments did not meet the second requirement of the GWE, that the payments be based on need. According to the CCA, age is not a demonstrated need.

Although the courts have rarely undertaken a review of the GWE, they have followed the IRS's position. For example, in *D.E. Bannon*,⁴⁰ the taxpayer received money from the San Joaquin County Human Resources Agency for taking care of her mentally retarded adult daughter. These services could have been (and sometimes were) provided by third parties. The court held these payments to be includible in the mother's income. On the other hand, the IRS conceded that government payments made directly to the disabled daughter which were to provide in-home support services to her, as a disabled citizen, were not includible in gross income.⁴¹

One area of the GWE that historically has been subject to special scrutiny is welfare benefits. Although welfare benefits are the genesis of the GWE doctrine, this area has provided a slew of GWE authority over the years. Generally speaking, payments for unemployment compensation have met the requirements of the GWE.⁴² Nevertheless, confusion arose from legislation enacted in many states under which recipients of unemployment benefits were required to perform some level of services to receive their benefits.

As noted below, the requirement that a person provide services will disqualify the payment from meeting the requirements of the GWE. The performance of training by the welfare recipient, on the other hand, is allowed under the GWE. Thus, the application of the GWE to welfare benefits seems to be based on whether the activity required to be performed is more in the nature of training, rather than in the nature of services. Consequently, vocational and occupational training provided to recipients designed to upgrade basic skills (such as remedial education) should not cause the benefits provided to fail to come within the GWE.⁴³

The GWE has also been applied to payments to work-training participants when the payments were made by the state welfare agency, based on need, and not for the value of the services performed.⁴⁴ In contrast, if the training is on the job experience, payments may be includible in income, depending on the degree of control exercised by the *de-facto* employer over the recipient of public benefits. Control by the *de-facto* employer (as opposed to control by the welfare agency) makes the training seem more like a typical employer-employee relationship, thus suggesting that the payments should be includible in income.⁴⁵ Moreover, if the training is just ancillary or if there is no training at all, the relationship looks far more like a typical employment relationship, and the payment should be includible in income.⁴⁶

Education, Adoption and Other Needs

What each of us "needs" may be subjective, but clearly for all of us that goes beyond food, water and shelter. The IRS has applied the GWE in varied contexts. Thus, the IRS has ruled that certain payments for education are of the type of welfare payment to which the GWE applies.

In LTR 200409033,⁴⁷ a Native American Tribe made education assistance payments to Tribe members. The IRS ruled that the payments made to qualifying Tribe members with an income below the national median income level were not includible in income. Payments made to those with income above the national median were includible in income. Notably, the LTR did not provide any explanation as to why the national median income level was the chosen threshold.

The IRS has determined that certain payments to facilitate adoption can qualify for the GWE.⁴⁸ In Rev. Rul. 74-153,⁴⁹ the state of Maryland provided

assistance to adoptive parents who met all state requirements for adoption except the ability to provide financially for the adoptive child. The IRS ruled that the adoption assistance payments met the requirements of the GWE, and were excludable from gross income.

Similarly, in CCA 200021036, the IRS reviewed the tax status of payments to adoptive parents of special needs children. The State made the payments to entice potential adoptive parents to adopt special needs children, but only in situations where it was reasonable to conclude that such children could

not be adopted without such assistance. The IRS found that the payments were not includible in income under the GWE, and that such payments were “based on the special needs of the children.”

There are other categories of payments which don't seem to fit the mold of the majority of authority. For example, certain economic development payment grants have met the requirements of the GWE. In LTR 199924026,⁵⁰ nonreimbursable economic development grants made by a Native American tribal nation to eligible members were held to be excludable from income.⁵¹ Another example is Rev. Rul. 74-74,⁵² where the IRS held that payments from the Crime Victims Compensation Board (CVCB) were not income. Specifically, the ruling held that awards made by the state of New York CVCB to victims of crime or their surviving spouse or dependents were not includible in income. Notably, the amount of the award was based on the financial resources of the recipient.

Payments Not Based on Need

In contrast, payments which are not based on need do not qualify for the GWE. In Rev. Rul. 76-131,⁵³ the state of Alaska made payments to persons over 65 years old who had maintained a continuous domicile in Alaska for 25 years regardless of financial status, health, educational background or employment status. The IRS ruled that the payments were not need-based and the purpose of making the payments was not for the public benefit.⁵⁴ Consequently, these payments were includible in income. While Rev. Rul. 76-131 is instructive in its ability to demonstrate when payments are not need-based, it does not appear to have dampened subsequent positive GWE authority.

The GWE is an administrative exclusion the application of which is subject to IRS discretion.

Although it may appear that all payments under the GWE must be based upon economic need, the IRS has ruled on occasion that payments meet the requirements of the GWE (and are not includible in income) even if the payments were not completely based on economic need. Authority supporting this position, however, is rare. For example, Rev. Rul. 57-102,⁵⁵ may be one of the only authorities

where the GWE has been applied to payments that were not based on economic need. The IRS ruled that government payments made to blind persons (solely because of their visual disability)

were excludable from gross income. Due to the age of this ruling and the lack of any subsequent authority following this rationale, taxpayers arguably may not want to rely on it.

There is at least one modern authority in which the IRS equivocated on the extent of the need required under the second prong of the GWE. In CCA 200114044, the IRS reviewed payments made by FEMA to victims of the Cerro Grande fire in New Mexico (which was started by a park ranger). The IRS ruled that payments from private insurance companies to persons who were privately insured were excluded from income under Code Sec. 123. Payments from FEMA to persons who were insured through FEMA were also excluded from income under Code Sec. 123.

Payments from FEMA to under-insured and non-insured persons presented a more interesting question. Since claimants had to waive their rights to file a claim against the government to receive payments, the IRS thought that the FEMA payments were best viewed as a substitute for judgment. However, the IRS acknowledged that a court might find that the payments met the requirement of the GWE. The IRS advised its agents not to pursue the matter—essentially equivocating on the decision whether the GWE applied. Thus, the IRS realized that the GWE might apply where economic need was not the primary issue. Nevertheless, the CCA advised agents to pursue the payments as taxable if IRS employees determined that payments were used for luxuries.

CCA 200114044 thus represents one of the more interesting pieces of GWE lore. It suggests that there is a sensitivity on the part of the IRS about the potential reach of the GWE, and yet a reluctance to

thoroughly vet the issue. At the same time, the IRS implicitly seems to recognize the fuzzy gray line between necessities and luxuries.

Payments to Others

In certain situations, government payments do not go directly to the person in need of assistance. Rather, parents or legal guardians may receive the payments on behalf of others. The IRS has ruled that the applicability of the GWE does not hinge on the fact that some portion of the payment goes to another, albeit related person, as opposed to being made directly to the affected individual. In CCA 200021036 discussed above, the IRS expressly noted that payments for the benefit of special needs children could be made directly to the parents without affecting the application of the GWE. The IRS noted that “[b]ecause the payments are intended to reimburse the parents’ expenses of promoting the health and well-being of these special needs children, the interposition of the parents as recipients of the payments does not preclude the application of the GWE.”⁵⁶

Reimbursements

Frequently, taxpayers receive certain government payments only after the fact, as reimbursement of prior expenses. The IRS has ruled that the applicability of the GWE does not depend on the fact that some of the amounts received may in fact be reimbursements. In LTR 200451022, a nonprofit was organized to provide services to the developmentally disabled. This organization requested an IRS private letter ruling on whether certain reimbursements were taxable.

The nonprofit was a regional center which provided certain items needed by developmentally disabled persons, such as daycare, diapers, nutritional supplies, etc. Family members sometimes purchased these items and obtained reimbursement from the regional centers. The amount of reimbursement was based on a sliding scale in accordance with the family’s economic need. The IRS ruled that the nonprofit met all three requirements of the GWE, so that the payments were excludable from the recipients’ income. The LTR suggests that taxpayers who have already personally expended funds could still benefit from the GWE, since reimbursement should not affect the GWE’s applicability.

When payments are received as reimbursements, it must be determined how the taxpayer previously treated the cost for which reimbursement has been

provided. For example, it would be common for a taxpayer to deduct under Code Sec. 165 any losses sustained if his house were destroyed in a natural disaster. The tax benefit rule could require individuals who claimed a deduction to later include a corresponding amount in income if the individual receives government grants.⁵⁷ Essentially, the tax benefit rule prevents taxpayers from getting a double benefit.

Applicability of the GWE under California Tax Law

Readers not from California will have to pardon us for a moment. We present here our thoughts on the application of the GWE under California tax law because we are from California. Unfortunately at this time, we are unable to comment on how other states might react (or have reacted) to the GWE. Of course, we would be glad to hear from readers on their own state research.

In our adventures into the GWE, we have found no clear authority bearing on whether California conforms (or would conform) to the GWE. Nevertheless, there are several indications that California might conform to the GWE if presented the opportunity, or at least would reach similar results even if it did not expressly conform. First, for tax years after January 1, 2002, California has incorporated the Internal Revenue Code as it existed on January 1, 2001 into the California Revenue and Taxation Code.⁵⁸ Although we understand that a bill is currently proceeding through the state legislature which would conform California law to the Internal Revenue Code as of January 1, 2005, the eventual passage of this bill does not seem to impact this analysis.

Full federal statutory conformity would be helpful of course, but it is clear that the GWE has not been incorporated into the Internal Revenue Code. The GWE is an administrative exclusion the application of which is subject to IRS discretion. Thus, incorporation of the Internal Revenue Code into the California Revenue and Taxation Code may not be sufficient to determine how the California taxing authorities would apply the GWE. The same would presumably be true for other states.

Recognizing the inherent limitations of only incorporating the federal tax Code, California also incorporates other “uncodified provisions that relate to provisions of the Internal Revenue Code.”⁵⁹ Although the term ‘uncodified provisions’ is not defined in the California Revenue and Taxation Code, it may refer to IRS administrative pronouncements, such

as Revenue Rulings, Revenue Procedures, General Counsel Memoranda, Chief Counsel Advice, and the like. If this interpretation is correct, then California has statutorily adopted all prior IRS GWE rulings.

It goes without saying that even if California has effectively adopted all prior federal administrative authorities, this would not be dispositive on the application of the GWE in California to any new scenario on which no federal authority already existed on a particular set of facts. Even so, it is worth noting that this interpretation of the California statute provides support that California should follow the federal position. California has adopted other federal nonstatutory income tax doctrines, including the assignment of income doctrine⁶⁰ and the step transaction doctrine.⁶¹

The California Revenue and Taxation Code expressly provides that Code Sec. 61, defining gross income, shall apply, unless otherwise provided.⁶² This suggests that items which are included in gross income for federal income tax purposes would also be included for California income tax purposes, unless California law provides otherwise. The *GUIDEBOOK TO CALIFORNIA TAXES* notes that “the same items are included under both [federal and California] laws, unless a specific exception [in California law] is spelled out.”⁶³

The California Revenue and Taxation Code does not discuss the GWE. This omission suggests that items excluded under the GWE for federal income tax purposes may also be excluded for California income tax purposes. Nevertheless, California’s taxing authorities could argue that the GWE does not apply, since California law only expressly incorporates Code Sec. 61, and does not incorporate nonstatutory exceptions to Code Sec. 61. Since the GWE is not part of the Internal Revenue Code, the California authorities could certainly argue that it has not been incorporated into California law.

Virtually no California judicial or administrative authority exists on the GWE. In 1975, the California Franchise Tax Board (FTB) issued a legal ruling which acknowledged the existence of the GWE, but the ruling did not opine on it.⁶⁴ The ruling discussed the qualified renters’ credit, which granted a credit against state income tax and a refund for the amount of the

unused credit. The ruling states that the refund is not included in gross income since it is “consistent with the long-standing judicial practice” of construing tax relief measures in favor of the intended beneficiaries.

The FTB’s brief and somewhat cryptic ruling does not provide much guidance on the GWE. The ruling states that its result is consistent with IRS policy under the GWE. Unfortunately, though, the ruling does not indicate whether the FTB is following the GWE, nor does it provide any indication of the FTB’s position regarding the GWE.

There is another piece of California authority which discusses the GWE.⁶⁵ It is a California State Board of Equalization (SBE) determination that expressly notes that it cannot be cited as precedent. Nonetheless, it is helpful in determining the SBE’s position on the GWE.

The SBE determination discusses a 1998 examination whether a taxpayer could file as head of household when her adult daughter and infant granddaughter lived with her. To file as head of household, the taxpayer needed to claim her daughter as a dependent. The daughter had received AFDC (Aid to Family with Dependent Children) government payments, and it was uncertain if such payments were gross income to her. If the payments were gross income, the daughter would have had too much income to be classified as a dependent of the taxpayer.

The SBE noted that the recipient of AFDC payments was the granddaughter, so the payments were not income to the daughter. While this conclusion alone was sufficient to make a determination that the taxpayer could file as head of household, significantly, the ruling continued, noting:

“[e]ven if the benefits were to appellant’s daughter, it appears that the benefits would not be included in appellant’s daughter’s gross income ... [T]he courts have acknowledged the existence of the general welfare doctrine of income exclusion. *Bannon v. Commissioner* 99 T.C. 60 (1992). Generally, government disbursements promoting the general welfare are not taxable.”

The SBE’s acknowledgment that the U.S. Tax Court upheld the GWE is helpful, as is its statement that

The GWE is a relatively unknown income exclusion doctrine which, paradoxically, has been around almost 70 years. As such, it is surprising how it continues to fly under the radar of many tax practitioners.

“generally, government disbursements promoting the general welfare are not taxable.” However, neither of these California authorities seem dispositive that California would definitively uphold the GWE. Nonetheless, taking into account these few authorities and the general principles of California income taxation, it does seem that California may conform, or that at least it should hopefully reach results similar to the GWE. Unfortunately, as any reader knows who has spent time fighting California tax cases, the Golden state has more than its fair share of uncertainties and surprises.

Conclusions

The GWE is a relatively unknown income exclusion doctrine which, paradoxically, has been around almost 70 years. As such, it is surprising how it continues to fly under the radar of many tax practitioners. The doctrine and the policy behind it seem simple: it doesn’t make sense for the government to tax government-provided assistance payments. Yet, given how few and far between exemptions from income are, the GWE merits a closer look.

Although the GWE originated as a simple idea, it has been expanded to all sorts of government payments, ranging from disaster payments to housing, education, adoption, even crime victim restitution. Curiosity makes me wonder whether the IRS will continue to expand the GWE’s reach. The government makes billions of dollars of payments to taxpayers annually based upon general welfare. That suggests some tax planners may be missing an opportunity here.

Creative tax planners may consider their own doctrinal exploration. Could the GWE apply to payments from the government that the taxpayer receives only after suing? Stated differently, if there is a governmental welfare benefit, should the applicability of the GWE hinge on whether the benefit is voluntarily provided? This kind of inquiry is worth making. Although lawsuits based on governmental programs (such as health, education and welfare) may be rare, an exclusion from income is rare too, and is worth including on a mental checklist.

There are other questions that approach the doctrine. How can one police the line between necessities and luxuries? If the governmental agency and the taxpayer agree what constitutes “necessities” (say a 2,000 square foot house), will that bind the IRS? Will it even influence the IRS?

Regardless of future doctrinal expansion, practitioners who do not explore the GWE may be missing a valuable tool found within their tax reduction arsenal. It is possible that some taxpayers (and practitioners) have reached results consistent with the GWE on some fundamental “this *can’t* be taxable” theory. However, there is probably a larger segment of taxpayers and tax advisers who conclude that payments are includible in income, when in fact the GWE could arguably be applied.

Thankfully, even in this era of tax practitioner scrutiny, where Circular 230 legends and lawsuits seem to abound, there does not (yet) appear to be any authority which suggests that ignorance of the GWE is malpractice. Still, we would all do well as a group to consider the GWE in appropriate cases.

ENDNOTES

¹ *Glenshaw Glass Co.*, S Ct, 55-1 USTC ¶9308, 348 US 426; *N.J. Vincent*, 89 TCM 1119, Dec. 56,007(M), TC Memo. 2005-95.
² *E. Cesarini*, DC-Ohio, 69-1 USTC ¶9270, 296 FSupp 3, *aff’d per curiam*, CA-6, 70-2 USTC ¶9509, 428 F2d 812; Reg. §1.61-14.
³ *Glenshaw Glass Co.*, *supra* note 1.
⁴ A summary of the facts are as follows: Glenshaw Glass was engaged in protracted litigation with the Hartford-Empire Company. The parties concluded a settlement by which Hartford paid Glenshaw approximately \$800,000. Through a Tax Court approved allocation, it was determined that \$324,529.94 represented payment of punitive damages. Glenshaw did not report the punitive portion of the settlement as income. The Commissioner determined a deficiency, claiming the total settlement as taxable.
⁵ Many disaster payments have now also been statutorily exempted from income under recently enacted Code Sec. 139. Rev. Rul.

2003-12, 2003-3 IRB 283 acknowledges that the GWE doctrine overlaps with the application of Code Sec. 139 in that both can apply.
⁶ *N.J. Vincent*, *supra* note 1. (Code Sec. 61 mandates gross income includes all income from whatever sources derived absent a specific statutory exclusion, and no mention of non-statutory exclusions.)
⁷ *T.A. Burke*, S Ct, 92-1 USTC ¶50,254, 504 US 229.
⁸ GCM 34424, (Feb. 08, 1971).
⁹ *K.M. O’Gilvie*, S Ct, 96-2 USTC ¶50,664, 519 US 79; *E.E. Schleier*, S Ct, 95-1 USTC ¶50,309, 515 US 323.
¹⁰ See Chief Counsel Advice (CCA) 200021036 (Feb. 15, 2000); LTR 200451022 (Sept. 13, 2004).
¹¹ See *D.E. Bannon*, 99 TC 59, 1992 U.S. Tax Ct. LEXIS 56, 99 TC No. 3 (1992).
¹² See I.T. 3194, 1938-1 CB 114, which held that lump sum payments made to individuals as Social Security benefits (under section

204(a), Title II of the Social Security Act) are not subject to federal income tax in the hands of the recipients; I.T. 3230, 1938-2 CB 136, which holds that payments on account of unemployment paid by a State agency out of funds received from the Federal Unemployment Trust Fund are not subject to federal income tax in the hands of the recipient.
¹³ See I.T. 3447, 1941-1 CB 191; Rev. Rul. 131, 1953-2 CB 112; Rev. Rul. 55-652, 1955-2 CB 21; Rev. Rul. 63-136, 1963-2 CB 19.
¹⁴ GCM 34506, (May 26, 1971).
¹⁵ See CCA 200021036 (Feb. 15, 2000).
¹⁶ Notice 2003-18, 2003-1, CB 699; *J. Bailey*, 88 TC 1293, 1300-1301, Dec. 43,924 (1987), *acq.*, 1989-2 CB 1; Rev. Rul. 76-131, 1976-1 CB 16.
¹⁷ Notice 2003-18, 2003-1, CB 699.; *A.V. Graff*, 74 TC 743, Dec. 37,079 (1980), *aff’d*, CA-5, 82-1 USTC ¶9337, 673 F2d 784; Rev. Rul. 76-75, 1976-1 CB 14; Rev. Rul. 73-408, 1973-2 CB 15.

- ¹⁸ See LTR 200451022 (Sept. 13, 2004) for the application of the GWE to payment from the federal government. See CCA 200021036 for the application of the GWE to payment from a state government. See *Bailey*, *supra* note 16, 88 TC 1293 for the application of the GWE to payment from a county government.
- ¹⁹ See BLACK'S LAW DICTIONARY, 7TH EDITION, at 682 (1999).
- ²⁰ See Analytical Perspectives, Budget of the U.S. Government Fiscal Year 2005, at 380, located at <http://www.whitehouse.gov/omb/budget/fy2005>.
- ²¹ *Id.*
- ²² See the Legislative Analyst's Office, 2005-06 Budget: Perspective and Issues, located at http://www.lao.ca.gov/analysis_2005/2005_pandi/pandi_05.pdf.
- ²³ For more information, see http://www.sfgov.org/site/uploadedfiles/controller/reports/CAFR/cafr_2004.pdf.
- ²⁴ See CCA 200002050 (Nov. 15, 1999); CCA 200017040 (Feb. 28, 2000); CCA 200016019 (Feb. 17, 2000); CCA 200013031 (Feb. 1, 2000).
- ²⁵ See LTR 200451022 (Sept. 13, 2004).
- ²⁶ Rev. Rul. 2003-12, 2003-3 IRB 283.
- ²⁷ A Presidentially declared disaster area is defined in Code Sec. 1033(h)(3).
- ²⁸ For other disaster related authority, see Rev. Rul. 98-19, 1998-1 CB 840 (relocation payment made by a local government to an individual moving from a flood-damaged residence is not includible in the individual's gross income); Rev. Rul. 76-144, 1976-1 CB 17 (grants received by individuals unable to meet necessary expenses or serious needs as a result of a disaster are not includible in the recipient's gross income); Rev. Rul. 75-28, 1975-1 CB 68; Rev. Rul. 71-260, 1971-1 CB 57.
- ²⁹ Rev. Rul. 2003-12 modified Rev. Rul. 131 which held that the GWE applied to disaster payments made by an employer.
- ³⁰ CCA 200016019 (Apr. 21, 2000).
- ³¹ CCA 200017040 (Feb. 28, 2000).
- ³² CCA 200013031 (Feb. 1, 2000). But see Rev. Rul. 82-16, 1982-1 CB 16 in which relocation assistance benefits required to be paid to tenants by landlords under a municipal ordinance were includible in the gross income of the tenant.
- ³³ Rev. Rul. 76-373, 1976-2 CB 16; Rev. Rul. 74-205 1974-1 CB 20.
- ³⁴ Rev. Rul. 76-395, 1976-2 CB 16.
- ³⁵ Rev. Rul. 75-271, 1975-2 CB 23.
- ³⁶ Rev. Rul. 78-170, 1978-1 CB 24.
- ³⁷ *Cf.* Rev. Rul. 79-142, 1979-1 CB 58 and GCM 37781 (Dec. 8, 1978) regarding daycare facility owners providing food to needy children.
- ³⁸ CCA 200227003 (July 5, 2002).
- ³⁹ *M. Dieter*, DC-Minn, 2003-1 USTC ¶150,439.
- ⁴⁰ *D.E. Bannon*, *supra* note 11.
- ⁴¹ See also *A.S. May*, 65 TCM 2063, Dec. 48,898(M), T.C. Memo 1993-86; *J.L. Meyer*, 68 TCM 1037, Dec. 50,203(M), T.C. Memo 1994-536; *P.L. Baldwin*, 80 TCM 431, Dec. 54,065(M), T.C. Memo. 2000-306.
- ⁴² Rev. Rul. 99-3, 1999-2 IRB 10; Rev. Rul. 76-229, 1976-1 CB 19.
- ⁴³ Rev. Rul. 75-246, 1975-1 CB 24; Rev. Rul. 63-136, 1963-2 CB 19.
- ⁴⁴ Rev. Rul. 71-425, 1971-2 CB 76.
- ⁴⁵ Rev. Rul. 75-246, 1975-1 CB 24.
- ⁴⁶ Rev. Rul. 65-139, 1965-1 CB 31, as clarified by Rev. Rul. 66-240, 1966-2 CB 19; Rev. Rul. 74-413, 1974-2 CB 333.
- ⁴⁷ LTR 200409033 (Nov. 24, 2003).
- ⁴⁸ Code Sec. 137 excludes certain adoption expenses. See Sheldon R. Smith, *Tax Exclusion for Adopting Children with Special Needs*, 108 TAX NOTES 9 (Aug. 22, 2005).
- ⁴⁹ Rev. Rul. 74-153, 1974-1 CB 20.
- ⁵⁰ LTR 199924026 (March 19, 1999).
- ⁵¹ See also Rev. Rul. 77-77, 1977-1 CB 11.
- ⁵² Rev. Rul. 74-74, 1974-1 CB 18.
- ⁵³ Rev. Rul. 76-131, 1976-1 CB 16.
- ⁵⁴ See also LTR 9717007; Rev. Rul. 73-408, 1973-2 CB 15.
- ⁵⁵ Rev. Rul. 57-102, 1957-1 CB 26.
- ⁵⁶ See also LTR 200451022 (Sept. 13, 2004); Rev. Rul. 74-153.
- ⁵⁷ See *Hillsboro Nat'l Bank*, SCt, 83-1 USTC ¶9229, 460 US 370; CCA 200016019 (Apr. 21, 2000).
- ⁵⁸ CAL. REV. & TAX. CODE §17024.5(a)(1)(M).
- ⁵⁹ CAL. REV. & TAX. CODE §17024.5(a)(2).
- ⁶⁰ See *In the Matter of the Appeal of Hans F. and M. Milo*, 1981 Cal. Tax LEXIS 89; *N.S. Meanley*, 49 Cal. App.2d 203, 121 P.2d 45 (1942). *Cf.* State Board of Equalization of the State of California Rulings: *Donoco Enterprises Trust and D.K. Mullins*, 2002 Cal Tax. LEXIS 454 (Sept. 12, 2002) and *R.A. Jacobson*, 99A-0039, 2000 Cal. Tax LEXIS 134 (June 15, 2000).
- ⁶¹ See *McMillinBCED/Miramar Ranch North v. County of San Diego*, 31 Cal. App. 4th 545 (1995).
- ⁶² CAL. REV. & TAX. CODE §17071.
- ⁶³ 2005 GUIDEBOOK TO CALIFORNIA TAXES, CCH INCORPORATED (2005).
- ⁶⁴ *Personal Income—Renter Credit Taxability of Refund*, Legal Ruling No. 380, 1975 Cal. FTB LEXIS 1 (Jan. 13, 1975).
- ⁶⁵ *D.L. Peterson*, 97A-0365, 1998 Cal. Tax LEXIS 341 (Aug. 11, 1998).