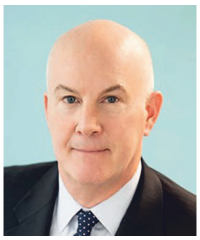
INSIGHT: Taxation of Virus Relief Grants to Households and Small Businesses



BY BRUCE HENDRICK, MICHAEL PETERSON, AND TED HARRINGTON

The CARES Act established the Coronavirus Relief Fund (CRF) to make payments for specified uses to states and local governments. CRF is a relief (not stimulus) program designed to mitigate the impact of the Covid-19 crisis. Texas was allocated $11.24 billion of CRF funds- the U.S. Treasury disbursed $3.2 billion directly to 18 Texas local governments (those with over 500,000 residents), and the remaining $8.04 billion will be distributed from the state to the local governments that did not receive direct disbursements.

Subject to the CRF compliance rules, Texas local governments have broad discretion on how to deploy the CRF funds within their communities. Pursuant to various governmental economic development programs, a significant portion of the CRF funds are being distributed as economic aid to (1) small businesses suffering business interruption losses caused by Covid-19, and (2) households suffering job and income losses caused by Covid-19 for housing and food relief.

Short Answer

Grants to households (i.e., individuals) are taxed differently than grants to small businesses. As explained below, need-based grants to households likely fall under the general welfare exclusion, and are therefore not taxable, whereas grants to small businesses are likely not covered by this exclusion, and would be taxable.

Household Grants

Taxpayers are taxed on their gross income, which is defined as "all income from whatever source derived." (Tax code Section 61.) However, there are several exclusions from that statutory rule, and the Internal Revenue Service has long recognized a non-statutory exclusion to that rule, i.e., the general welfare exclusion.

The general welfare exclusion exempts from the recipient's taxable income payments by governmental units under legislatively provided social programs that promote the general welfare. To qualify, the payments must (1) be made from a government fund, (2) be made for the promotion of general welfare (generally based upon individual or family needs), and (3) not represent compensation for services rendered. (Revenue Ruling 75-246; Rev. Rul. 82-106.)

Need-based grants to households are likely excluded from taxable income under the general welfare exclusion. However, there are other possible exclusions for the grant, including characterizing it as a gift under Section 102, as a qualified disaster relief payment under Section 139, or as a capital contribution to the business.

Small Business Grants

While grants to small businesses would appear to fit under the general welfare doctrine, the IRS has ruled that grants to a business generally do not qualify for the general welfare exclusion, because they are not based upon individual or family needs. (Rev. Rul. 2005-46)

Congress recently changed the tax code to make clear that any contribution by a governmental entity to the corporation is taxable. (Section 118(b)(2).) Although the rule only applies to corporations, the IRS would likely treat other businesses (e.g., sole proprietorships, partnerships, LLCs and S corps) similarly.

On July 6, 2020, the IRS confirmed that the receipt of a government grant by a business generally is not excluded from the business's gross income under the tax code and therefore is taxable.

Carrington Coleman LLP represents a North Texas County it its distribution of Coronavirus Relief Funds, including general CRF compliance, structuring and strategizing their distributions, and ultimately preparing for an audit by the US Treasury.

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