



OFFICE OF
CHIEF COUNSEL

DEPARTMENT OF THE TREASURY
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MEMORANDUM FOR GREGORY A. NYGREN, GROUP MANAGER 1436
NORTH CENTRAL DISTRICT

FROM: Assistant Chief Counsel (Income Tax & Accounting)

SUBJECT: Flood Insurance Reimbursement Program

This Technical Assistance responds to your memorandum dated March 31, 1998. You requested our views on the tax treatment of the Flood Insurance Assistance Program. Technical Assistance does not relate to a specific case and is not binding on Examination or Appeals. This document is not to be cited as precedent.

ISSUE:

Whether a business that receives reimbursements for flood insurance premiums may deduct its payment of those premiums as a trade or business expense under Internal Revenue Code § 162 in the taxable year in which paid or incurred, and whether it must include the reimbursement of its premiums in income.

CONCLUSION:

The portion of flood insurance premium payments that is reimbursed is not deductible under § 162. In addition, based on published Service position, we conclude that the portion of the premium payments that is reimbursed is not included in income.

FACTS:

The , located in a Presidentially-declared disaster area, established a program of grants to reimburse flood insurance premium payments made by businesses that are required to obtain flood insurance on their property located within the city limits. Under the program, flood insurance premiums will be reimbursed for up to 5 years to a maximum of \$5,000 over a 5-year period.

The premiums will be reimbursed on an annual basis for the first 2 years. The premiums for the third, fourth and fifth years will be reimbursed in the third year upon prepayment in the third year of the premiums for the fourth and fifth years. Thus, taxpayers are required to prepay their fourth and fifth years of flood insurance premiums in order to obtain reimbursement for those years. To be eligible for reimbursement a business must provide a copy of its flood insurance premium statement and proof of payment.

The assistance for the premium payments for 5 years is contingent upon the business remaining in operation. If the business ceases operation or transfers ownership before the end of the 5-year period the remaining flood insurance premiums must be refunded in full to the city.

LAW AND ANALYSIS:

Section 162(a) of the Code provides, in part, that there shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business.

However, taxpayers are not allowed deductions under § 162(a) for expenditures for which they have a right or expectation of reimbursement. In Rev. Rul. 78-388, 1978-2 C.B. 110, an accrual method taxpayer incurred expenses to move its business from property acquired by the state. Its request for a relocation payment under the Uniform Relocation Assistance and Real Property Acquisition Policies Act of 1970 was approved by the responsible government agency during the taxable year of the move and the payment was received in a subsequent year. The Service held that the moving expenses were not deductible to the extent that they were reimbursable. See also Rev. Rul. 79-263, 1979-2 C.B. 82 (cash method cattle farmer that received authorization under the Federal Disaster Assistance Administration's Emergency Livestock Feed Assistance Program for partial reimbursement of the anticipated cost of replacing feed destroyed as a result of a drought and was reimbursed for the feed expenditures the year after they were made could not deduct under § 162 the portion of the expenditures for which reimbursement was available); Charles Baloian Co., Inc. v. Commissioner, 68 T.C. 620 (1977), nonacq. on other grounds, 1978-2 C.B. 3, dismissed and affirmed in unpublished opinion (9th Cir. 1982) (moving expenses nondeductible to extent reimbursed because taxpayer's right to reimbursement was fixed and matured without substantial contingency prior to the move when the agency issued its written authorization to incur moving expenses in a specified amount).

Therefore, a taxpayer cannot deduct its payments¹ of flood insurance premiums to the extent that there is a right of reimbursement. However, as held in Rev. Rul. 79-263, the income attributable to the reimbursement payments would be excluded from the taxpayer's gross income.

If you find that the facts differ from those recited here, we will be happy to offer further assistance.

This technical assistance is advisory only, and is intended to call attention to well-established principles of tax law that apply in the situation described. Taxpayers uncertain whether these principles or interpretations of tax law should apply to their situations should consider seeking a private letter ruling or, if appropriate, technical advice. Procedures for issuing letter rulings and technical advice are in Rev. Proc. 98-1, 1998-1 I.R.B. 7, and Rev. Proc. 98-2, 1998-1 I.R.B. 74, respectively.

By _____
George Baker
Assistant to Branch Chief
Branch 2

¹ A taxpayer's payment of the premiums for years 4 and 5 in year 3 raises the question whether the deductions for the premium payments for years 4 and 5 would be deferred to those years because it is a prepayment. If the premium payment is a prepayment, then the taxpayer's deduction for the portion of the year 3 premium payment attributable to years 4 and 5 would be deferred until years 4 and 5.

However, since the premium payments and the reimbursements for years 4 and 5 are made in year 3, it is established in year 3 that the premium payment is not deductible. Therefore, there is no deduction to defer. Conversely, since there is no deduction, the portion of the reimbursement attributable to years 4 and 5 is not includible in the taxpayer's gross income.