COMMISSIONER

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, DC 20224

June 16, 2022

The Honorable Doug LaMalfa
U.S. House of Representatives
Washington, DC 20515

Dear Representative LaMalfa:

Thank you for your letter dated January 20, 2022. You asked the IRS to issue guidance on funds claimants receive from the Fire Victims Trust, a $13.5 billion settlement established on July 1, 2020, to provide support for those affected by the tragic events related to multiple fires. The settlement of PG&E Corporation's and Pacific Gas and Electric Company's jointly-filed, Chapter 11 bankruptcy protection case created the Fire Victims Trust after the 2015 Butte Fire, the 2017 North Bay Wildfires, and the 2018 Camp Wildfire affected 70,000 people. We also received your recent letter with additional questions on this topic, and we are working on that response.

I understand the importance of providing guidance so claimants of the Fire Victim Trust can understand their tax filing obligations.

As you wrote in your letter, claimants need guidance on:

- taxability of amounts from the Fire Victims Trust settlement; and
- the tax treatment of rebuilding.

I hope the following general information helps clarify these issues and helps taxpayers determine what amount of their claims can be used to rebuild their lives or replace their losses, as you noted in your letter. While the law in this area is complex, at the end of this letter, we have provided links to additional resources your constituents may find useful.

Some Fire Victims Trust Settlement Payments may be Exempt from Tax

Under Section 61 of the Internal Revenue Code (IRC), individuals generally must pay federal tax on all income from whatever source. As mentioned in your letter, certain IRC provisions exclude from income amounts from lawsuit settlements for specific types of damages.

IRC Section 104(a)(2) provides that gross income does not include any damages, other than punitive damages, on account of personal physical injuries and physical sickness. Taxpayers may only exclude damages for emotional distress or mental anguish if the damages are on account of personal physical injuries or sickness, or are for actual reimbursement of medical expenses that the taxpayer did not deduct under IRC Section 213. IRC Section 213 allows a taxpayer to deduct expenses the taxpayer paid for the medical care of the taxpayer, a spouse, or dependents that are not compensated for by insurance or otherwise.

IRC Section 139 provides that gross income does not include any amount an individual receives as a qualified disaster payment. Under IRC Section 139(b), a qualified disaster payment means amounts paid to, or for the benefit of, an individual for several purposes, including:

- to reimburse or pay reasonable and necessary personal, family, living, or funeral expenses the individual incurred as a result of a qualified disaster; or
- to reimburse or pay reasonable and necessary expenses the individual 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.[1]

For any federally-declared disaster, an individual may exclude from income a valid disaster relief payment, which includes any amounts the individual receives from the settlement award for a purpose listed above.

For purposes of IRC Section 139, a qualified disaster includes any federally-declared disaster, as defined in IRC Section 165(i). A federally-declared disaster is any disaster the President of the United States determines warrants assistance from the federal government under the Robert T. Stafford Disaster Relief and Emergency Assistance Act (Stafford Act).[2] A federally-declared disaster area is the area eligible for assistance under the applicable declaration.[3] While the President determined certain areas affected by the California wildfires during specific incident periods needed assistance from the federal government, claimants should confirm their particular area was within the federally-declared disaster area during the disaster declaration period. You can find this information on the Federal Emergency Management Agency's website, www.fema.gov.

Rebuilding Amounts may be Tax-Deferred

Generally, IRC Section 1001(a) provides that a taxpayer must recognize gain or loss realized from the sale or other disposition of property. Proceeds from property losses

[1] See IRC Section 139(b)(1) and (2).
[2] See Treasury Regulation (Treas. Reg.) Section 1.165-11(b)(1).
[3] See Treas. Reg. Section 1.165-11(b)(2).

are gains to the extent the proceeds exceed the adjusted basis of the property. IRC Section 1033 provides an exception to this general rule.

IRC Section 1033 allows taxpayers to defer recognizing gain when property is converted, compulsorily or involuntarily. An involuntary conversion may happen with destruction of property in whole or in part, theft of the property; seizure of the property; condemnation of the property, etc. Destruction of property by wildfire is an example of involuntary conversion. An involuntary conversion may include a conversion into money.

Under the general rule in IRC Section 1033(a)(2)(A), if the destruction of a property results in an involuntary conversion into money, the taxpayer recognizes the gain (if any). However, if the taxpayer elects, the taxpayer does not recognize gain to the extent the taxpayer purchases qualified replacement property. Qualified replacement property is property similar or related in service or use to the converted property the taxpayer purchases within the replacement period in IRC Section 1033(a)(2)(B). Taxpayers who make this election will recognize gain only to the extent the conversion amount exceeds the cost of the replacement property. Only those amounts the taxpayer received as compensation for damages to real or personal property qualify for deferral under IRC Section 1033.

Available Guidance

The following IRS Publications have more detailed information:

- Publication 4345, Settlements – Taxability, for more information on tax implications when claimants receive a settlement.[4]
- Publication 976, Disaster Relief, for more information on tax benefits available for disaster victims.[5]
- Publication 547, Casualties, Disasters, and Thefts, for more information on the tax treatment of disaster and casualty losses.[6]

Affected individuals can find these publications and updated information online at IRS.gov. Taxpayers can also get general assistance on their tax questions through the interactive tax law assistant.[7]

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[4] Available at https://www.irs.gov/pub/irs-pdf/p4345.pdf?msclkid=3b96b1f9a6e311ec93ca08ccc17fba51.
[5] Available at https://www.irs.gov/pub/irs-pdf/p976.pdf.
[6] Available at https://www.irs.gov/pub/irs-pdf/p547.pdf.
[7] Available at https://www.irs.gov/help/ita.

I hope this information is helpful. If you have questions, please contact me, or a member of your staff may contact [redacted] at [redacted]

Sincerely,

Charles P. Rettig

Digitally signed by Charles P. Rettig
Date: 2022.06.16 18:40:16 -04'00'

Charles P. Rettig

cc: The Honorable Tom McClintock
The Honorable John Garamendi
The Honorable Mike Thompson
The Honorable Jared Huffman
The Honorable Dianne Feinstein
The Honorable Alex Padilla