Congress of the United States
Washington, DC 20515

June 8, 2022

The Honorable Charles Rettig
Commissioner
Internal Revenue Service
1111 Constitution Ave., N.W.
Washington, D.C. 20224

Dear Commissioner Rettig:

On January 20, 2022, we sent a letter to you requesting tax guidance for claimants of the Fire Victim Trust ("Trust"), a $13.5 billion settlement established on July 1, 2020, after approval of a reorganization plan for Pacific Gas and Electric ("PG&E"). The mass settlement is made up of seventy thousand victims of California's 2015 Butte Fire, 2017 North Bay Wildfires, and 2018 Camp Fire. The Trust first began disbursing funds in November 2020 and continues to do so. While we wait for a response to our letter, we would like to supplement our request to emphasize the importance of providing immediate tax guidance for these fire victims and to provide you with more clarity on the key questions to which they seek answers.

These fire victims are at a loss to understand the complex tax laws governing their settlement awards. They would like guidance on the taxability of such awards and on the tax rules relevant to how proceeds may be used to replace or rebuild homes lost in the fires. To assist these taxpayers, we provide the following fact patterns and ask that you respond to the questions below.

<u>Taxpayer A</u>:

In 1980, Taxpayer A, a single filer, acquired her primary residence for $200,000. In January 2017, her home was destroyed by the North Bay Wildfires. Immediately prior to the wildfires, the fair market value of her home was $1 million, and her adjusted basis was $300,000. In 2017, A received insurance proceeds of $350,000 for her property loss.

In 2022, A received a settlement award from PG&E of $1 million, composed of: $50,000 for physical injuries; $50,000 for emotional distress resulting from the physical injury; and $900,000 for her property loss. Out of the $1 million award, she paid $300,000 to her attorney for contingent legal fees and received the remaining $700,000. In 2022, she paid $950,000 to rebuild her home.

<u>Taxpayer B</u>:

In 1980, Taxpayer B, a single filer, acquired his primary residence for $200,000. In January 2017, his home was destroyed by the North Bay Wildfires. Immediately prior to the wildfires, the fair market value of his home was $1 million, and his basis in the house remained at $200,000. In 2017, B received insurance proceeds of $500,000.

In 2022, B received a settlement award from PG&E of $400,000 for property loss. He paid $120,000 to his attorney for contingent legal fees and received the remaining $280,000. In 2022, he paid $950,000 to rebuild his home.

<u>Questions</u>:

1. What are the tax consequences of the insurance proceeds and the PG&E settlement award for Taxpayers A and B?

    a. Internal Revenue Code section 121 allows homeowners to exclude a portion of the gain realized upon the involuntary conversion of their property. Is section 121 available for A and B to exclude any portion of the gain realized from the insurance proceeds and/or the PG&E settlement award? Can A and B exclude from gross income the amount of $250,000 of gain realized from both the PG&E settlement award and the insurance proceeds? When must A and B utilize the section 121 exclusion? What is the character of gain realized, if any?

    b. Internal Revenue Code section 1033 allows taxpayers to defer gains from involuntarily converted property if the taxpayer replaces such property within a specified period of time. Is the election to defer gain under section 1033(a)(2) applicable to A and B? May A and B elect to defer their gain, if any, and apply it to the basis of a new home used as a personal residence? Section 1033(a)(2)(B) allows Treasury to extend the time for which A and B can elect to defer the gain.

Would Treasury consider using this existing authority to extend the election period for fire victims who have spent years waiting for financial assistance to rebuild their lives and are finally able to utilize their PG&E settlement proceeds to do so?

2. Can you clarify how to account for A's and B's attorney's fees when calculating their gain?

3. Can you clarify the taxability of payments A received for her physical injury and emotional distress resulting from the injury?

4. Some fire victims either did not receive any insurance proceeds or received an insignificant amount of proceeds. These victims had to wait to properly rebuild their lives and replace their losses until the PG&E settlement award was paid out.
    a. Can these homeowners apply section 121 in the year of receipt of the settlement award to exclude from income the statutorily allowed amount?

    b. Can you clarify the taxability of the settlement award if a taxpayer took a section 165 loss deduction in the year of the wildfire?

    c. What happens if the cost of taxpayer's replacement property is less than the amount realized from the sum of insurance payments in 2017 and settlement award in 2022?

The above fact patterns do not represent all the situations faced by fire victims. Therefore, in addition to responding to this letter and our prior letter, we urge the IRS to rapidly draft, finalize, and disseminate tax guidance on its website to help claimants of the Trust navigate the complex tax laws relating to PG&E settlement proceeds and other proceeds received as a result of the fires.

We appreciate your time and consideration of this matter.

Sincerely,

Mike Thompson

MIKE THOMPSON
Member of Congress

Doug LaMalfa

DOUG LAMALFA
Member of Congress