DEPARTMENT OF THE TREASURY
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MEMORANDUM FOR MARY ENGDAHL
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FROM: Heather C. Maloy
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SUBJECT: CLARIFICATION OF FEDERAL EMERGENCY MANAGEMENT AGENCY (FEMA) PAYMENTS FOR LIVING EXPENSES–CERRO GRANDE FIRE

This technical assistance memorandum amplifies the discussion in our memorandum in WTA-N-131198-00, dated March 14, 2001 (prior memo), regarding the tax treatment of certain payments that individuals in New Mexico who suffered losses due to the Cerro Grande Fire have received from FEMA or their insurers. Technical assistance does not relate to a specific case and is not binding on directors (or their officers) or area directors, appeals, as those terms are described in Rev. Proc. 2001-2, § 1, 2001-1 I.R.B. 79, at 84. This document is not to be cited as precedent.

This memorandum incorporates by reference the Issues, Conclusions, Facts, and Law and Analysis in the prior memo, except as provided herein. As indicated in the prior memo, payments for certain losses, including "a temporary living or relocation expense," are authorized by the Cerro Grande Fire Assistance Act (the Act), Pub. L. No. 106-246, 114 Stat. 511. Some payments made under the Act may also be authorized by the Robert T. Stafford Disaster and Emergency Assistance Act, 42 U.S.C. § 5121 et seq. (the Stafford Act).

The Policy Guidelines for temporary living expenses payable under the Act indicate that Homeowners "are initially eligible [for compensation] for up to 12 months for loss of use of their home," which may be extended, in light of "active measures" to rebuild the house, "for up to three years total, or until the homeowner occupies the new home whichever comes first." Renters "are initially eligible for up to 12 months of loss of use of the residence, but only for the difference between their old and new rent, if the new rent is greater"; the period of compensation for such renters may be extended for up to

an additional six months on a case-by-case basis. Payments to both homeowners and renters are made on a reimbursement basis.

The policy guidelines also permit reimbursement for food costs associated with the evacuation, without deduction for normal food costs, and for necessary items rented or purchased during the evacuation because it may not have been possible to take their possessions with them. These claims under the Act would presumably be subject to the prohibition in 45 C.F.R. § 295.21 on paying compensation under the Act for costs that have been reimbursed already under the Stafford Act.

Our prior memo analyzed payments received from insurance companies separately from payments received under either the Act or the Stafford Act by uninsured or underinsured taxpayers. This analysis did not take into account that even insured taxpayers affected by the Cerro Grande fire were entitled to certain types of compensation under the Act or the Stafford Act. (In the event taxpayers were entitled to reimbursement under insurance contracts, their insurers under the Act were subrogated to their insureds' rights. Ultimately, then, payments even to insured taxpayers found their source in the two acts.) Accordingly, the central question presented here is whether payments received from FEMA either under the Act's authorization to pay a "temporary living or relocation expense" or under the Stafford Act's authorization to pay temporary assistance to individuals and families who, as a result of financial hardship caused by a major disaster, have been forced to vacate their residence are taxable.

While FEMA guidelines applicable to the period of evacuation provide for a wider range of payments, the FEMA guidelines for payment or reimbursement of expenses incurred after that time generally focus on reimbursing additional living expenses incurred because of the fire. As we indicated in our prior memorandum, the fact that FEMA had authority under the Stafford Act to pay certain expenses in excess of those additional living expenses makes the taxation of these specific payments an exceedingly close question; an impartial finder of fact could reasonably find that the payments are made under FEMA's disaster relief authority and are payments for the promotion of the general welfare.

As set forth in our March 14 memorandum, it could be said that a different line of analysis might apply to payments taxpayers affected by the Cerro Grande fire received under contracts of insurance. However, we counsel against applying that line of analysis in a mechanical fashion. To begin with, as we have indicated, FEMA, by virtue of subrogation, will be the ultimate source of disaster-related payments received even by taxpayers whose property was insured. Equally, even insured taxpayers might be eligible for the broader forms of relief FEMA is authorized to provide. Accordingly, we

doubt that any finder of fact would be persuaded that insured taxpayers should be treated differently than the uninsured or the underinsured.

For the foregoing reasons, we believe that it would be inadvisable to pursue inclusion in income for payments from FEMA within the Stafford Act authority in circumstances like those described in Rev. Rul. 76-144, involving payments covering disaster-related necessary expenses or serious needs during the repair or replacement of the damaged residence. We believe it would be appropriate for Service officials to indicate publicly that the Service generally will not require inclusion in income with respect to the living expense payments made to Cerro Grande Fire claimants (no matter whether those payments are made directly to the claimant by FEMA or initially are made by the claimant's insurance company), at least during the period of the Stafford Act authority to make such payments, so long as it is evident that the payments relate to necessary or additional expenses directly attributable to the disaster. We believe, however, that the Service need not apply this advice if amounts are received for luxuries or for living expenses of an individual who has abandoned efforts to re-occupy a dwelling comparable to the one whose occupancy or use was denied by the fire.

Even if excluded from income, however, to the extent that payments compensate the recipients specifically for medical expenses, the payments do reduce the amount of the recipients' deductions under § 213(a) for such expenses (see Rev. Rul. 76-144).

We hope this letter is helpful. If you have any further questions, please contact George Baker at (202) 622-4920.