

under the Survivor Benefit Plan (10 U.S.C. 1447).

[T.D. 7043, 35 FR 8478, June 2, 1970, as amended by T.D. 7562, 43 FR 38819, Aug. 31, 1978]

**§ 1.123-1 Exclusion of insurance proceeds for reimbursement of certain living expenses.**

(a) *In general.* (1) Gross income does not include insurance proceeds received by an individual on or after January 1, 1969, pursuant to the terms of an insurance contract for indemnification of the temporary increase in living expenses resulting from the loss of use or occupancy of his principal residence, or a part thereof, due to damage or destruction by fire, storm, or other casualty. The term "other casualty" has the same meaning assigned to such term under section 165(c)(3). The exclusion also applies in the case of an individual who is denied access to his principal residence by governmental authorities because of the occurrence (or threat of occurrence) of such a casualty. The amount excludable under this section is subject to the limitation set forth in paragraph (b) of this section.

(2) This exclusion applies to amounts received as reimbursement or compensation for the reasonable and necessary increase in living expenses incurred by the insured and members of his household to maintain their customary standard of living during the loss period.

(3) This exclusion does not apply to an insurance recovery for the loss of rental income. Nor does the exclusion apply to any insurance recovery which compensates for the loss of, or damage to, real or personal property. See section 165(c)(3) relating to casualty losses; section 1231 relating to gain on an involuntary conversion of a capital asset held for more than 1 year (6 months for taxable years beginning before 1977; 9 months for taxable years beginning in 1977); and section 1033 relating to recognition of gain on an involuntary conversion. In the case of property used by an insured partially as a principal residence and partially for other purposes, the exclusion does not apply to the amount of insurance proceeds which compensates for the portion of increased expenses attrib-

utable to the nonresidential use of temporary replacement property during the loss period. In the case of denial of access to a principal residence by governmental authority, the exclusion provided by this section does not apply to an insurance recovery received by an individual as reimbursement for living expenses incurred by reason of a governmental condemnation or order not related to a casualty or the threat of a casualty.

(4)(i) Subject to the limitation set forth in paragraph (b), the amount excludable is the amount which is identified by the insurer as being paid exclusively for increased living expenses resulting from the loss of use or occupancy of the principal residence and pursuant to the terms of the insurance contract.

(ii) When a lump-sum insurance settlement includes, but does not specifically identify, compensation for property damage, loss of rental income, and increased living expenses, the amount of such settlement allocable to living expenses shall, in the case of uncontested claims, be that portion of the settlement which bears the same ratio to the total recovery as the amount of claimed increased living expense bears to the total amount of claimed losses and expenses, to the extent not in excess of the coverage limitations specified in the contract for such losses and expenses.

(iii) In the case of a lump-sum settlement involving contested claims, the insured shall establish the amount reasonably allocable to increased living expenses, consistent with the terms of the contract and other facts of the particular case.

(iv) In no event may the amount of a lump-sum settlement which is allocable to increased living expenses exceed the coverage limitation specified in the contract for increased living expenses. Where, however, a coverage limitation is applicable to the total amount payable for increased living expenses and, for example, loss of rental income, the amount of an unitemized settlement which is allocable to increased living expenses may not exceed the portion of the applicable coverage limitation which bears the same ratio

to such limitation as the amount of increased living expenses bears to the sum of the amount of such increased living expenses and the amount, if any, of lost rental income.

(5) The portion of any insurance recovery for increased living expenses which exceeds the limitation set forth in paragraph (b) shall be included in gross income under section 61 of the Code.

(b) *Limitation*—(1) *Amount excludable*. The amount excludable under this section is limited to amounts received which are not in excess of the amount by which (i) total actual living expenses incurred by the insured and members of his household which result from the loss of use or occupancy of their residence exceed (ii) the total normal living expenses which would have been incurred during the loss period but are not incurred as a result of the loss of use or occupancy of the principal residence. Generally, the excludable amount represents such excess expenses actually incurred by reason of a casualty, or threat thereof, for renting suitable housing and for extraordinary expenses for transportation, food, utilities, and miscellaneous services during the period of repair or replacement of the damaged principal residence or denial of access by governmental authority.

(2) *Actual living expenses*. For purposes of this section, actual living expenses are the reasonable and necessary expenses incurred as a result of the loss of use or occupancy of the principal residence to maintain the insured and members of his household in accordance with their customary standard of living. Actual living expenses must be of such a nature as to qualify as a reimbursable expense under the terms of the applicable insurance contract without regard to monetary limitations upon coverage. Generally, actual living expenses include the cost during the loss period of temporary housing, utilities furnished at the place of temporary housing, meals obtained at restaurants which customarily would have been prepared in the residence, transportation, and other miscellaneous services. To the extent that the loss of use or occupancy of the principal residence results

merely in an increase in the amount expended for items of living expenses normally incurred, such as food and transportation, only the increase in such costs shall be considered as actual living expenses in computing the limitation.

(3) *Normal living expenses not incurred*. Normal living expenses consist of the same categories of expenses comprising actual living expenses which would have been incurred but are not incurred as a result of the casualty or threat thereof. If the loss of use of the residence results in a decrease in the amount normally expended for a living expense item during the loss period, the item of normal living expense is considered not to have been incurred to the extent of the decrease for purposes of computing the limitation.

(4) *Examples*. The application of this paragraph (b) may be illustrated by the following examples:

*Example (1)*. On March 1, 1970, A's principal residence, a dwelling owned by A no part of which was rented to others or used for non-residential purposes, was extensively damaged by fire. The damaged residence was under repair during the entire month of March making it necessary for A and his spouse to obtain temporary lodging and to take their meals at a restaurant. A and his spouse incur expenses of \$200 for lodging at a motel, \$180 for meals which customarily would have been prepared in his residence, and \$25 for commercial laundry service which customarily would have been done by A's wife. A makes (directly or through mortgage insurance), or remains liable for, the required March payment of \$190 on the mortgage note on his residence. The mortgage payment results from a contractual obligation having no causal relationship to the occurrence of the casualty and is not considered as an actual living expense resulting from the loss of use of the residence. A's customary commuting expense of \$40 for bus fares to and from work is decreased by \$20 for the month because of the motel's closer proximity to his place of employment. Other transportation expenses remain stable. Since there has been a decrease in the amount of A's customary bus fares, normal transportation expenses are considered not to have been incurred to the extent of the decrease. Finally, A does not incur customary expenses of \$150 for food obtained for home preparation, \$75 for utilities expenses, and \$10 for laundry cleansers. The limitation upon the excludable amount of an insurance recovery for excess living expenses is \$150, computed as follows:

## LIVING EXPENSES

	Actual re- sulting from cas- ualty	Normal not incurred	Increase (decrease)
Housing .....	\$200.00	.....	\$200.00
Utilities .....	.....	\$75.00	(75.00)
Meals .....	180.00	150.00	30.00
Transportation .....	.....	20.00	(20.00)
Laundry .....	25.00	10.00	150.00
Total .....	405.00	255.00	15.00

*Example (2).* Assume the same facts as in example (1) except that the damaged residence is not owned by A but is rented to him for \$100 per month and that the risk of loss is upon the lessor. Since A would not have incurred the normal rental of \$100 for March, the excludable amount is limited to \$50 (\$150 as in previous example less \$100 normal rent not incurred).

(c) *Principal residence.* Whether or not property is used by the insured taxpayer and members of his household as their principal residence depends upon all the facts and circumstances in each case. For purposes of this section, a principal residence may be a dwelling or an apartment leased to the insured as well as a dwelling or apartment owned by the insured.

[T.D. 7118, 36 FR 10729, June 2, 1971, as amended by T.D. 7728, 45 FR 72650, Nov. 3, 1980]

**§ 1.125-2T Question and answer relating to the benefits that may be offered under a cafeteria plan (temporary).**

Q-1: What benefits may be offered to participants under a cafeteria plan?

A-1: (a) Generally, for cafeteria plan years beginning on or after January 1, 1985, a cafeteria plan is a written plan under which participants may choose among two or more benefits consisting of cash and certain other permissible benefits. In general, benefits that are excludable from the gross income of an employee under a specific section of the Internal Revenue Code may be offered under a cafeteria plan. However, scholarships and fellowships under section 117, vanpooling under section 124, educational assistance under section 127 and certain fringe benefits under section 132 may not be offered under a cafeteria plan. In addition, meals and lodging under section 119, because they are furnished for the convenience of

the employer and thus are not elective in lieu of other benefits or compensation provided by the employer, may not be offered under a cafeteria plan. Thus, a cafeteria plan may offer coverage under a group-term life insurance plan of up to \$50,000 (section 79), coverage under an accident or health plan (sections 105 and 106), coverage under a qualified group legal services plan (section 120), coverage under a dependent care assistance program (section 129), and participation in a qualified cash or deferred arrangement that is part of a profit-sharing or stock bonus plan (section 401(k)). In addition, a cafeteria plan may offer group-term life insurance coverage which is includable in gross income only because it is in excess of \$50,000 or is on the lives of the participant's spouse and/or children. In addition, a cafeteria plan may offer participants the opportunity to purchase, with after-tax employee contributions, coverage under a group-term life insurance plan (section 79), coverage under an accident or health plan (section 105(e)), coverage under a qualified group legal services plan (section 120), or coverage under a dependent care assistance program (section 129). Finally, a cafeteria plan may offer paid vacation days if the plan precludes any participant from using, or receiving cash for, in a subsequent plan year, any of such paid vacation days remaining unused as of the end of the plan year. For purposes of the preceding sentence, elective vacation days provided under a cafeteria plan are not considered to be used until all nonelective paid vacation days have been used.

(b) Note that benefits that may be offered under a cafeteria plan may or may not be taxable depending upon whether such benefits qualify for an exclusion from gross income. However, a cafeteria plan may not offer a benefit that is taxable because such benefit fails to satisfy any applicable eligibility, coverage, or nondiscrimination requirement. Similarly, a plan may not offer a benefit for purchase with after-tax employee contributions if such benefit would fail to satisfy any eligibility, coverage, or nondiscrimination requirement that would apply if such benefit were designed to be provided on