Office of Chief Counsel
Internal Revenue Service
memorandum

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to: Victor Aledo
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(Wage & Investment)

from: Norma C. Rotunno
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subject: TCJA Section 11044 - Effective Date and Scope of New Casualty Loss Limitation

This memorandum provides non-taxpayer specific legal advice regarding the application of TCJA section 11044. This advice may not be used or cited as precedent.

ISSUES

(1) For taxable years 2018-2025, section 165(h)(5), as amended by TCJA section 11044, limits personal casualty losses to losses attributable to a Federally declared disaster (as defined in subsection (i)(5)). The amendment applies to losses incurred in taxable years beginning after December 31, 2017. If a personal non-federally declared disaster loss occurred prior to December 31, 2017, but was not sustained until after December 31, 2017, is the loss deductible?

(2) For taxable years 2018-2025, section 165(h)(5), as amended by TCJA section 11044, limits personal casualty losses to losses attributable to a Federally declared disaster (as defined in subsection (i)(5)). Must the personal casualty loss also occur in a “disaster area” to be deductible?

CONCLUSIONS

(1) No, a personal non-federally declared disaster loss that occurred prior to December 31, 2017, but was not sustained until after December 31, 2017, is not deductible. The personal non-federally declared disaster loss must have been sustained prior to December 31, 2017, to be deductible.

(2) No, the personal casualty loss does not have to occur in a “disaster area” to be deductible. The personal casualty loss must occur in the state receiving the federal

disaster declaration.

FACTS

The two issues addressed herein are based on the following non-taxpayer specific scenarios. The scenarios do not depict actual casualty events or an actual disaster declaration and were drafted for illustrative purposes only.

Scenario #1

On May 1, 2017, a flood damaged Taxpayer A's house resulting in a personal casualty loss. The flood did not constitute a Federally declared disaster. Taxpayer A filed a claim with Insurance Company and had a reasonable prospect of recovering the entire amount claimed. In February 2018, Insurance Company paid Taxpayer A 70% of the amount Taxpayer A claimed. Also in February 2018, it became reasonably certain that Taxpayer A would not be able to recover the unreimbursed amount. Taxpayer A did not suffer any additional personal casualty losses in 2018.

Scenario #2

On September 1, 2018, a severe storm damaged Taxpayer B's house in Kansas resulting in a personal casualty loss. On September 7, 2018, the President issued a major disaster declaration for the State of Kansas under the authority of the Robert T. Stafford Disaster Relief and Emergency Assistance Act, 42 U.S.C. 5121 et seq. (the Stafford Act) relating to the storm. The declaration authorized, under the Stafford Act, the Federal Emergency Management Agency (FEMA) to provide Individual Assistance and Public Assistance. FEMA determined that five counties in Kansas were eligible for Individual Assistance and/or Public Assistance. Taxpayer B's personal casualty loss is attributable to the Federally declared disaster. Taxpayer B's house is not located in one of the counties designated as eligible for Individual Assistance and/or Public Assistance.

LAW AND ANALYSIS

Section 165(a) of the Internal Revenue Code provides that there shall be allowed as a deduction any loss sustained during the taxable year and not compensated for by insurance or otherwise.

Section 165(c) provides that in the case of an individual, the deduction under subsection (a) shall be limited to--
(1) losses incurred in a trade or business;
(2) losses incurred in any transaction entered into for profit, though not connected with a trade or business; and
(3) except as provided in subsection (h), losses of property not connected with a trade or business or a transaction entered into for profit, if such losses arise from fire, storm, shipwreck, or other casualty, or from theft.

Subsection 165(h)(5), added by section 11044 of the Tax Cuts and Jobs Act, Pub. L. No. 115-97 (December 22, 2017) (TCJA), provides a limitation for taxable years 2018 through 2025. Section 165(h)(5)(A) provides that in the case of an individual, except as provided in subparagraph (B), any personal casualty loss which (but for this paragraph) would be deductible in a taxable year beginning after December 31, 2017, and before January 1, 2026, shall be allowed as a deduction under subsection (a) only to the extent it is attributable to a Federally declared disaster (as defined in subsection (i)(5)). Section 165(h)(5)(B) provides an exception related to personal casualty gains. The effective date of TCJA section 11044 provides, “The amendment made by this section shall apply to losses incurred in taxable years beginning after December 31, 2017.”

Section 165(i)(5)(A) provides that the term “Federally declared disaster” means any disaster subsequently determined by the President of the United States to warrant assistance by the Federal Government under the Stafford Act.

Section 165(i)(5)(B) provides that the term “disaster area” means the area so determined to warrant such assistance.

A Federally declared disaster includes a major disaster declaration under section 401 of the Stafford Act and an emergency declaration under section 501 of the Stafford Act.

Under the Stafford Act, the President can authorize FEMA to implement several different types of assistance in response to a disaster. Pursuant to this authority, and based on the severity of the disaster, FEMA designates certain areas affected by the disaster as eligible for certain assistance, such as Individual Assistance and/or Public Assistance.

Section 1.165-1(b) of the Income Tax Regulations provides that to be allowable as a deduction under section 165(a), a loss must be evidenced by closed and completed transactions, fixed by identifiable events, and, except as otherwise provided in section 165(h) and § 1.165-11, relating to disaster losses, actually sustained during the taxable year.

Section 1.165-1(d)(1) provides that a loss shall be allowed as a deduction under section 165(a) only for the taxable year in which the loss is sustained. For this purpose, a loss shall be treated as sustained during the taxable year in which the loss occurs as evidenced by closed and completed transactions and as fixed by identifiable events occurring in such taxable year.

Section 1.165-1(d)(2)(i) provides that if a casualty or other event occurs which may result in a loss and, in the year of such casualty or event, there exists a claim for reimbursement with respect to which there is a reasonable prospect of recovery, no portion of the loss with respect to which reimbursement may be received is sustained, for purposes of section 165, until it can be ascertained with reasonable certainty whether or not such reimbursement will be received.

Scenario #1

Taxpayer A suffered a personal casualty loss on May 1, 2017, when Taxpayer A's house flooded. The flood did not constitute a Federally declared disaster. While the loss occurred on May 1, 2017, the loss was not sustained on May 1, 2017, because Taxpayer A had a claim for reimbursement with respect to which there was a reasonable prospect of recovery. Rather, the loss was sustained in February 2018 when it could be ascertained with reasonable certainty whether Taxpayer A would receive reimbursement. Treas. Reg. § 1.165-1(d)(2)(i).

Accordingly, because Taxpayer A's personal casualty loss was not sustained until February 2018, the new casualty loss limitation provided in section 165(h)(5) applies, and Taxpayer A may not claim a casualty loss deduction for the unreimbursed flood damage.

Scenario #2

Taxpayer B suffered a personal casualty loss on September 1, 2018, when Taxpayer B's house located in Kansas was damaged by a severe storm. On September 7, 2018, the President issued a major disaster declaration for the State of Kansas under the Stafford Act. Even though Taxpayer B's house is not located in one of the counties FEMA designated as eligible for Individual Assistance and/or Public Assistance, Taxpayer B is not precluded from claiming a casualty loss deduction. Section 165(h)(5) does not require the loss to occur in a disaster area and be attributable to a Federally declared disaster. Rather, section 165(h)(5) only requires the loss to be attributable to a Federally declared disaster. Since federally declared disasters are issued on a state-wide basis, the loss must occur in the state receiving the federal disaster declaration.

Accordingly, because Taxpayer B's personal casualty loss occurred in Kansas and was attributable to the Federally declared disaster in Kansas, Taxpayer B is eligible to claim a casualty loss deduction so long as Taxpayer B satisfies all other requirements under section 165 and the regulations.

Please call (202) 317-7003 if you have any further questions.