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MEMORANDUM December 1, 2017

To:	Senator Bill Cassidy Attention: Christopher D. Gillott
From:	Erika K. Lunder, Legislative Attorney Molly F. Sherlock, Specialist in Public Finance
Subject:	**Section 11029 of the Tax Cuts and Jobs Act, as Reported by the Senate Committee on Finance (Updated)**

This memorandum responds to your November 22, 2017 request for a memorandum explaining the provisions found in Section 11029 of the Tax Cuts and Jobs Act, as reported by the Senate Committee on Finance, pertaining to temporary disaster tax relief for individuals affected by the 2016 storms in Louisiana, Mississippi, and Texas. As requested, this memorandum first provides background on the provisions found in Section 11029. The memorandum then describes how Section 11029 would change current law, first with respect to the use of certain retirement funds and then with respect to the use of the casualty loss deduction. The memorandum next provides examples of how to calculate the casualty loss deduction. The updated version, which updates a memorandum initially sent on November 30, 2017, includes as an example a joint filer with income of $75,000 and a casualty loss of $40,000, as requested via email on December 1, 2017. The memorandum concludes with a brief discussion of recent disaster relief legislation and cost estimates for such legislation and the current proposal in Section 11029.

Description and Background Information

If enacted, Section 11029 would provide special rules for taxpayers affected by storms and flooding in 2016 in Louisiana, Mississippi, and Texas with respect to their use of certain retirement funds and the casualty loss deduction for individuals, each as described further below.[1] The special provisions would apply in the "Mississippi River Delta flood disaster area," which would be defined as:

- The areas declared a major disaster under the Robert T. Stafford Disaster Relief and Emergency Assistance Act[2] ("Stafford Act") prior to March 31, 2016, due to the severe storms and flooding occurring in Louisiana, Mississippi, and Texas during March 2016 ("March 2016 disaster area") and

[1] Tax Cuts and Jobs Act, 115th Cong. § 11029 (2017) (as reported by S. Comm. on Finance, Nov. 16, 2017).

[2] Pub. L. No. 100-707, 102 Stat. 4689 (1988) (codified as amended at Chapter 68 of Title 42, U.S. Code).

- The areas declared a major disaster area under the Stafford Act prior to September 3, 2016, due to the severe storms and flooding in Louisiana during August 2016 ("August 2016 disaster area").[3]

One point to note is that the Section 11029 provisions relate to events that occurred in 2016 and, therefore, some taxpayers may need to file an amended return in order to take advantage of the provisions, should they be enacted into law.[4]

Use of Retirement Funds

Under current law, an individual who receives an early distribution from a retirement plan prior to turning age 59½ may be required to include at least part of the distribution as income for purposes of the regular income tax and may be subject to an additional 10% penalty tax on the amount.[5] The 10% penalty tax does not apply to certain types of distributions from a retirement plan, such as distributions that are used to pay for the taxpayer's qualifying medical expenses.[6]

Section 11029 would provide four special rules relating to early distributions from a retirement plan for taxpayers affected by the 2016 storms and flooding in the Mississippi River Delta flood disaster area.[7] First, Section 11029 would waive the 10% penalty for any individual taking an early distribution from a retirement plan if the individual's principal place of abode was in the March 2016 disaster area or the August 2016 disaster area and the individual sustained an economic loss due to the disaster.[8] To qualify for this waiver, the taxpayer would have to take the distribution between March 1, 2016, and January 1, 2018, for individuals in the March 2016 disaster area, and between August 11, 2016, and January 1, 2018, for individuals in the August 2016 disaster area.[9] Under the proposal, the maximum amount that a taxpayer could withdraw without the 10% penalty would be $100,000.[10] Second, Section 11029 would allow a taxpayer to re-contribute funds to a qualified retirement plan over a three-year period and receive tax-free rollover treatment.[11] Third, with respect to any taxable portion of the early distribution from a retirement plan, Section 11029 would provide that the individual could include one-third of such amount as gross income over the course of three tax years rather than be subject to tax on the entire amount in the year of distribution.[12] Finally, Section 11029 would also provide that qualified retirement plans (i.e., those plans whose contributions and distributions receive tax-favored treatment under the Internal Revenue Code) would not lose their tax-qualified status by allowing individuals to take advantage of these special rules.[13]

[3] Tax Cuts and Jobs Act, 115th Cong. § 11029(a) (2017) (as reported by S. Comm. on Finance, Nov. 16, 2017).

[4] 26 U.S.C. § 6511; 26 C.F.R. § 301.6402-3.

[5] 26 U.S.C. §§ 61, 72(t).

[5] *Id.* § 72(t).

[6] *Id.* § 72(t)(2).

[7] For information on laws providing similar relief to taxpayers affected by other disasters, see CRS Report R42839, *Tax Provisions to Assist with Disaster Recovery*, by Erika K. Lunder and Jennifer Teefy.

[8] Tax Cuts and Jobs Act, 115th Cong. § 11029(b) (2017) (as reported by S. Comm. on Finance, Nov. 16, 2017).

[9] *Id.*

[10] *Id.*

[11] *Id.*

[12] *Id.*

[13] *Id.* § 11029(b)(2).

Casualty Loss Deduction

Under current law, individuals may deduct unreimbursed losses of property not connected to a trade or business when the losses are due to a casualty, such as a storm.[14] The amount of the casualty loss is the lesser of the (1) the decrease in the property's fair market value (FMV) as a result of the casualty or (2) the taxpayer's adjusted basis in the property (i.e., the cost of the property with certain adjustments).[15] A casualty loss is deductible only to the extent that (1) it exceeds $100 and (2) the aggregate amount of the net loss (after applying the $100 limitation and offsetting any casualty gains[16]) exceeds 10% of the taxpayer's adjusted gross income (AGI).[17] The deduction is generally claimed in the year of the loss,[18] although taxpayers may elect to deduct a loss in a federally declared disaster area on returns filed for the year prior to the disaster.[19] Casualty losses are deducted as an itemized deduction,[20] which means that taxpayers who claim the standard deduction because it exceeds their total itemized deductions will not be able to deduct their casualty losses.

Section 11029 would amend current law to create special casualty loss deduction rules for individuals affected by the 2016 storms and flooding in the Mississippi River Delta flood disaster area who have a qualifying disaster loss for any taxable year after December 31, 2017, and before January 1, 2026.[21] The section would do three things, if enacted:

- Waive the 10% restriction for qualifying casualty losses, so that eligible taxpayers would not be limited to deducting such losses only to the extent the losses exceed 10% of the taxpayer's AGI.[22]
- Increase the standard deduction by the amount of such casualty losses, thus permitting eligible taxpayers who do not itemize their deductions to deduct their losses.[23]
- Increase the $100 limitation described above to $500, so that eligible taxpayers would not be able to deduct the first $500 of any qualified casualty loss.[24]

[14] 26 U.S.C. §§ 165(a), (c)(3).

[15] *Id.* § 165(b); Treas. Reg. § 1.165-7(b). *See also* 26 U.S.C. § 1011 (providing for adjustments to a property's basis). In order to determine the decrease in the property's FMV, the taxpayer must generally either use a "competent appraisal" or the actual costs of repairs to the property as the basis for the determination. Treas. Reg. § 1.165-7(a)(2). *See also* Coates v. Comm'r, 112 T.C.M. (CCH) 470, *14-*15 (T.C. 2016) (explaining that a "competent appraisal" does not require a professional appraiser and that a court may use the landowner's opinion as the basis of for determining the property's FMV); Lamphere v. Comm'r, 70 T.C. 391, 396 (1978) (discussing requirement of actual, not estimated, costs of repairs).

[16] Casualty gains are the recognized gain from an involuntary conversion of property due to the casualty. 26 U.S.C. § 165(h)(3)(A). An example of an involuntary conversion is when property is converted to money or other property because of its complete or partial destruction, such as when an individual receives an insurance payment for damaged property. *See id.* § 1033. For information on the tax consequences of involuntary conversions, see CRS Report R42839, *Tax Provisions to Assist with Disaster Recovery*, by Erika K. Lunder and Jennifer Teefy.

[17] 26 U.S.C. §§ 165(h)(1), (2).

[18] *Id.* at § 165(a); Treas. Reg. § 1.165-7(a)(1).

[19] 26 U.S.C. § 165(i). *See also* Treas. Reg. § 1.165-11T (providing the manner for making the election).

[20] *See* 26 U.S.C. § 63.

[21] Tax Cuts and Jobs Act, H.R. 1, 115th Cong. §§ 11029(a), (c) (2017) (as reported by S. Comm. on Finance, Nov. 16, 2017). For information on laws providing temporary casualty loss provisions for taxpayers affected by other disasters, see CRS Report R42839, *Tax Provisions to Assist with Disaster Recovery*, by Erika K. Lunder and Jennifer Teefy.

[22] Tax Cuts and Jobs Act, 115th Cong. § 11029(c)(1) (2017) (as reported by S. Comm. on Finance, Nov. 16, 2017).

[23] *Id.*

[24] *Id.*

For taxpayers to qualify for these special rules, their loss would have to be attributable to the 2016 storms and flooding and arise on or after March 1, 2016, for losses in the March 2016 disaster area or August 11, 2016, for losses in the August 2016 disaster area.[25]

Examples for Casualty Loss Deduction

As described above, provisions in the Senate Finance Committee's proposed version of the Tax Cuts and Jobs Act would create special rules for personal casualty losses related to Louisiana severe flooding and storms. These special rules would (1) allow a deduction for losses whether or not such losses exceed 10% of a taxpayer's adjusted gross income (AGI); (2) require that losses exceed $500 per casualty to be deductible; and (3) allow taxpayers claiming the standard deduction to deduct such losses.

The examples below calculate the value of the deduction. Ultimately, the amount of tax savings that result from the deduction will depend on the taxpayer's tax rate. Additionally, for low- and moderate-income taxpayers with no income tax liability due to deductions, exemptions, and other tax credits, an additional deduction for casualty losses may not result in reduced tax liability.

The current law example illustrates what taxpayers may have been able to claim for losses under current law in 2016. The proposal examples illustrate what taxpayers may be able to claim as a net disaster loss for taxable years beginning after December 31, 2017, and before January 1, 2016. A loss deduction related to a single event may only be claimed in one tax year.

Example 1

Assume a single taxpayer with adjusted gross income (AGI) of $50,000. This taxpayer claims the standard deduction ($6,300 in 2016). Assume the taxpayer suffers a casualty loss of $15,000 due to flooding in the Mississippi River Delta flood disaster area. The taxpayer has no other casualty losses in the tax year. No part of the loss was covered by insurance.

Current Law[26]

Under current law, the taxpayer would be eligible for a deduction of $9,900. This deduction is calculated as the loss, $15,000, less the $100 for non-deductible loss, less $5,000 (10% of the taxpayer's $50,000 AGI). The taxpayer would choose to itemize deductions and claim the casualty loss, since the $9,900 amount exceeds the amount of the standard deduction.

Assuming the taxpayer has no other itemized deductions, the ability to claim the $9,900 casualty loss deduction, as opposed to the $6,300 standard deduction, would mean that the taxpayer was effectively allowed an additional deduction of $3,600.

Proposal

Under the proposal, the taxpayer would be eligible for a deduction of $14,500. The deduction is calculated as the loss, $15,000, less the $500 for non-deductible loss. The $14,500 would be in addition to the taxpayer's standard deduction.

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[25] *Id.*

[26] More current law examples can be found in Internal Revenue Service, "Casualties, Disasters, and Thefts," Publication 547, January 4, 2017, available at https://www.irs.gov/pub/irs-pdf/p547.pdf.

Example 2

Assume a married taxpayer with AGI of $70,000. This taxpayer itemizes deductions. Assume the taxpayer loses a vehicle valued at $8,000 and sustains $60,000 in damage to their residence, as a result of flooding in the Mississippi River Delta flood disaster area. The taxpayer also had theft losses of $1,500 in the same tax year, but from a different incident. The loss of the vehicle was not covered by insurance. However, the taxpayer was able to collect $30,000 from their insurance company to compensate for damage to their residence.

Current Law

Under current law, the taxpayer would be eligible for a deduction of $32,300. There are several factors to consider in calculating this deduction. First, the deduction includes the loss from flooding: $30,000 after insurance for damage to the residence plus $8,000 in casualty loss related to the vehicle, less the $100 for non-deductible loss (or $37,900). Then, there is the loss from theft, or $1,500 less the $100 for non-deductible loss (or $1,400) (the $100 reduction applies separately to each event). These combined losses of $39,300 (the $37,900 plus the $1,400 loss) can only be deducted to the extent that such losses exceed 10% of the taxpayer's AGI. Therefore, the deduction is $32,300 (or $39,300 less 10% of $70,000).

Proposal

Under the proposal, the taxpayer would be eligible for a deduction of $37,500. The deduction for the disaster loss is calculated as the loss, $30,000 after insurance for damage to the residence plus $8,000 related to the vehicle, less the $500 for non-deductible loss (or $37,500). The deductible non-disaster casualty loss is $0 ($1,500 is less than $7,000 (10% of the taxpayer's $70,000 AGI)).

Example 3

Assume a single taxpayer with AGI of $30,000. This taxpayer claims the standard deduction ($6,300 in 2016). Assume the taxpayer suffers a casualty loss of $2,500 due to flooding in the Mississippi River Delta flood disaster area. The taxpayer has no other casualty losses in the tax year. No part of the loss was covered by insurance.

Current Law

Under current law, the taxpayer would not be able to claim a deduction for this loss. The loss is less than 10% of the taxpayer's AGI (10% of $30,000 is $3,000, more than the $2,500 loss).

Proposal

Under the proposal, the taxpayer would be eligible for deduction of $2,000. The deduction is calculated as the loss, $2,500, less the $500 for non-deductible loss. The $2,000 deduction would be in addition to the taxpayer's standard deduction.

Example 4

Assume a married taxpayer with an AGI of $75,000. Assume the taxpayer suffers a casualty loss of $40,000 due to flooding in the Mississippi River Delta flood disaster area. The taxpayer has no other casualty losses in the tax year. No part of the loss was covered by insurance.

Current Law

Under current law, the taxpayer would be eligible for a deduction of $32,400. This deduction is calculated as the loss, $40,000, less the $100 for non-deductible loss, less $7,500 (10% of the taxpayer's $75,000 AGI). The taxpayer would choose to itemize deductions and claim the casualty loss, since the $32,400 amount exceeds the amount of the standard deduction.

Assuming the taxpayer has no other itemized deductions, the ability to claim the $32,400 casualty loss deduction, as opposed to the $12,600 standard deduction, would mean that the taxpayer was effectively allowed an additional deduction of $19,800.

Proposal

Under the proposal, the taxpayer would be eligible for a deduction of $39,500. The deduction is calculated as the loss, $40,000, less the $500 for non-deductible loss. The $39,500 would be in addition to the taxpayer's standard deduction.

Recent Disaster Legislation and Cost of Proposals

Legislation has been enacted in the 115th Congress to provide tax benefits to taxpayers affected by certain disasters. Specifically, the Disaster Tax Relief and Airport and Airway Extension Act of 2017 (P.L. 115-63) provided special tax benefits for certain taxpayers affected by Hurricanes Harvey, Irma, or Maria (2017 hurricanes). The Joint Committee on Taxation (JCT) estimated that the special disaster-related rules for use of retirement funds related to the noted 2017 hurricanes would reduce federal revenues by $53 million over the FY2018 to FY2027 budget window.[27] The provision providing special rules for qualified disaster-related personal casualty losses for the same 2017 hurricanes was estimated reduce federal revenues by $4.0 billion over the same time frame.[28]

The JCT has estimated that the provisions in Section 11029 of the Tax Cuts and Jobs Act providing relief for Mississippi River Delta flooding, as ordered reported by the Senate Committee on Finance, would reduce federal revenues by $0.5 billion between FY2018 and FY2027.[29]

[27] *See* Joint Committee on Taxation, "Estimated Revenue Effects of the Revenue Provisions Contained in Titles II and V or H.R. 3823, the 'Disaster Tax Relief and Airport and Airway Extension Act of 2017,' Scheduled for Consideration by the House of Representatives on September 27, 2017," JCX-44-17, September 27, 2017, available at https://www.jct.gov/publications.html?func=startdown&id=5024.

[28] *Id.*

[29] *See* Joint Committee on Taxation, "Estimated Revenue Effects of the 'Tax Cuts and Jobs Act,' as Ordered Reported by the Committee on Finance on November 16, 2017," JCX-59-17, November 17, 2017, available at https://www.jct.gov/publications.html?func=startdown&id=5043.