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IN FOCUS

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The Casualty and Theft Loss Deduction

The Internal Revenue Code has let some taxpayers deduct unreimbursed losses caused by recent disasters and thefts from their income subject to the income tax. Congress temporarily limited the casualty and theft loss deduction as part of the 2017 tax law (P.L. 115-97; popularly known as the Tax Cuts and Jobs Act or TCJA) to losses resulting from federally declared disasters for tax years 2018-2025. Among other recently proposed legislative changes, H.R. 7024, the Tax Relief for American Families and Workers Act of 2024, announced by Senator Ron Wyden and Representative Jason Smith, would expand this deduction retroactively.

The deduction offers financial relief to some taxpayers who suffer unexpected monetary damage; in doing so, it reduces federal revenue. It also subsidizes uninsured losses without offering similar benefits to insured losses or loss-mitigation expenses, potentially distorting taxpayers' incentives to insure themselves for losses or spend money on disaster loss mitigation expenses. This In Focus discusses the structure of the deduction—both before and after the changes that began in 2018—and analyzes its potential impact on the federal budget and taxpayers' decisionmaking.

Overview

Prior to 2018, households who itemized their deductions could deduct their unreimbursed net personal losses that "arise from fire, storm, shipwreck, or other casualty, or from theft" from their income. From 2018 through 2025, the TCJA provides that the deduction is limited to losses that result from federally declared disasters.

Under permanent law, taxpayers can only deduct such losses to the extent each loss exceeds $100, and their total exceeds 10% of the taxpayer's adjusted gross income (AGI). The damaged item does not need to be repaired or replaced for the taxpayer to claim the deduction. Taxpayers can claim this deduction regardless of their income, and there is no cap on the size of the deduction a taxpayer can claim. Those whose deductions exceed their taxable income can carry the deduction forward to subsequent tax years.

The restriction of eligibility for unreimbursed losses means that only losses that insurance does not compensate qualify. Additionally, it applies only to personal losses—losses on business property are subject to different rules.

Taxpayers must generally claim the deduction in the year in which they discover the loss, even if that differs from the year in which the loss occurred. However, under permanent law, taxpayers can generally choose to take the loss in the year prior to the casualty if it results from a federally declared disaster, meaning one declared by the President under the Robert T. Stafford Disaster Relief and Emergency Assistance Act (P.L. 100-707, as amended), and it occurs in the disaster area identified in that declaration.

Qualified Disaster Losses

Congress has passed legislation declaring certain losses to be "qualified disaster-related personal casualty losses." Taxpayers with qualified disaster losses can claim a more generous casualty and theft loss deduction than others. They can deduct qualified disaster losses even if they also claim the standard deduction. Their per-event limitation is generally $500 instead of $100, and they are not limited to deducting losses that exceed 10% of their AGI in sum.

This designation generally applies either to specific disasters or to any federally declared disasters incurred during a specific period. Among others, the disasters in this category have included

- federally declared disasters in 2016 or 2017;
- federally declared disasters that began in 2018 and before December 21, 2019, and continued no later than January 19, 2020; and
- federally declared disasters (besides those declared solely because of the COVID-19 pandemic) that were declared between January 1, 2020, and February 25, 2021, and occurred between December 28, 2019, and December 27, 2020.

Legislative History

The Revenue Act of 1913 (P.L. 63-16), which created the modern federal income tax, also created the modern deduction for casualty losses, without distinction between business-related and nonbusiness-related losses. Theft losses were eligible by 1916.

The Revenue Act of 1964 (P.L. 88-272) placed a $100-per-event floor on the deduction, corresponding to the $100 deductible provision common in property insurance coverage at that time. The limitation to losses that, in sum, exceed 10% of the taxpayer's AGI was created by the Tax Equity and Fiscal Responsibility Act of 1982 (P.L. 97-248).

Congress has at times expanded the deduction in response to specific disasters. The Katrina Emergency Tax Relief Act of 2005 (P.L. 109-73) eliminated the per-casualty and AGI floors for deductible losses arising from the consequences of Hurricane Katrina. Congress removed the floors for losses arising from several other disasters in subsequent years. The Emergency Economic Stabilization Act of 2008 (P.L. 110-343) expanded the deduction similarly for all federally declared disasters occurring in 2008 and 2009, but imposed a $500 per-casualty limitation and let taxpayers claim the deduction in addition to the standard deduction. Subsequent legislation offered similar tax benefits to those impacted by other disasters.

The TCJA limited the deduction to casualties and thefts resulting from federally declared disasters from 2018 through 2025. It also raised the standard deduction for tax years 2018 through 2025, meaning fewer taxpayers would claim any given itemized deduction.

Analysis

General

The casualty and theft loss deduction provides financial assistance to some taxpayers who suffer substantial casualties. It shifts part of the loss from the property owner to the federal government, and thus serves as a form of government coinsurance.

Economists have theorized that when uninsured losses are deductible but insurance premiums are not, it may make more financial sense for taxpayers to risk incurring a loss (for which they can claim a tax benefit) than to pay for insurance (for which they cannot). If so, this could discourage taxpayers from purchasing insurance. A similar principle could apply to the cost of mitigation activities to prevent losses, which are not currently deductible (although other subsidies may be available). There has not been substantial research into whether the casualty and theft loss deduction has these effects.

No distinction is made between losses on items considered basic to maintaining the taxpayer's household and livelihood versus discretionary personal consumption. As with all deductions, a dollar of deductible casualty or theft losses is worth more to taxpayers in higher-income tax brackets because of their higher marginal tax rates.

Recent Changes

In 2018, the first year that P.L. 115-97 took effect, 77% fewer taxpayers claimed the deduction than in the three years prior. Claims continued to decline through 2020, the most recent year for which data are available. This decline may have resulted partly from the expansion of the standard deduction, which made itemizing deductions appealing to fewer taxpayers. While about 31% of filers itemized their deductions for tax year 2017, about 11% did for tax year 2018. However, the share of itemizers who claimed the casualty and loss deduction also fell from 0.24% in 2017 to 0.15% in 2018. Among those who did claim the casualty and theft loss deduction, the average deduction claimed grew from $24,400 in 2017 to $41,700 in 2018 (**Table 1**).

Table 1. Average Casualty and Theft Loss Deduction Claims by Three-Year Period

	Households Claiming	Average Claim
2012-2014	115,573	$26,947
2015-2017	113,325	$26,921
2018-2020	14,528	$38,940

Source: IRS Statistics of Income and CRS analysis.

Notes: Data are averaged by three-year period to account for the annual variation in claims for the casualty and theft loss deduction.

Use of the deduction has always fluctuated meaningfully from year to year. This may be because disasters happen sporadically, Congress often expands the deduction in the wake of specific disasters, and taxpayers can carry any unused deduction forward and backward.

In early 2017, before passage of the TCJA, the Joint Committee on Taxation estimated that this deduction would cost the federal government roughly $400 million in lost revenue annually from FY2016 to FY2019, and $500 million in FY2020. Its most recent estimates put the deduction's cost at $100 million annually from FY2022 to FY2025, before rising to $500 million in FY2026, during which the changes made by the TCJA will expire.

Recent Legislative Activity

Lawmakers have introduced several proposed reforms to the casualty and theft loss deduction in the 118th Congress. Under H.R. 7024, the Tax Relief for American Families and Workers Act of 2024, qualified disaster losses would include disasters that occurred between December 28, 2019, and the date of the bill's enactment, and were declared within 60 days of enactment. This change is identical to that included in H.R. 5863, the Federal Disaster Tax Relief Act of 2023.

Similarly, H.R. 5343, the Federal Disaster Responsibility Act, would make losses from any disaster for which the incident period begins between 2020 and 2023 qualified disaster losses. H.R. 5873, the Natural Disaster Tax Relief Act of 2023, would do the same, but only for disasters that occurred in 2023. H.R. 1494, the Hurricane Tax Relief Act, would specifically make losses resulting from Hurricanes Ian, Nicole, and Fiona qualified disaster losses.

Other recent legislation has proposed partially or fully reversing the changes made by the TCJA. S. 2236, the Casualty Loss Deduction Restoration Act, would make otherwise eligible losses incurred between 2018 and 2025 that did not result from a qualified disaster eligible, subject to a $50,000 limit. H.R. 6938, the Tax Relief for Victims of Crimes, Scams, and Disasters Act, would reverse the changes with no limit on the deduction.

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