

WAR LOSS RECOVERIES

§ 1.1331-1 Recoveries in respect of war losses.

(a)(1) The amount of any recovery in respect of *war loss property* must be included in gross income to the extent provided in section 1332 unless, pursuant to the taxpayer's election under section 1335, the provisions of section 1333 are applicable to such recovery. For the treatment of war loss recoveries under section 1333 and the manner of making the election under section 1335, see §§ 1.1333-1 and 1.1335-1.

(2) As used in this part, the term *war loss property* means property considered under section 127(a) of the Internal Revenue Code of 1939 as *destroyed or seized*, including any interest described in section 127(a)(3) of the Internal Revenue Code of 1939.

(3) For regulations governing the treatment of war losses under the Internal Revenue Code of 1939, see 26 CFR (1939) 29.127(a)-1 to 29.127(a)-4, inclusive, 29.127(b)-1, and 29.127(e)-1 (Regulations 111) and 26 CFR (1939) 39.127(a)-1 (Regulations 118).

(b) The recoveries in respect of any war loss property include the recovery of the same war loss property and the recovery of any money or property in lieu of such property or on account of the destruction or seizure of such property. For example, there is a recovery upon the return to the taxpayer after the termination of the war of his property which was treated as war loss property because it was located in a country at war with the United States. An award by a government on account of the seizure of the taxpayer's property by an enemy country is a recovery under this section. The amount obtained upon the sale or other transfer by the taxpayer of his right to any war loss property is also a recovery for the purpose of this section. Similarly, if a taxpayer who sustained a war loss upon the liquidation of a corporation has received the rights to any property of the corporation which was treated as war loss property, any recovery by the taxpayer with respect to such rights is a recovery by him for the purposes of this section.

(c) For the purpose of this section, the recoveries considered are only

those with respect to war losses sustained in prior taxable years. Similarly, the only deductions considered are those allowable for prior taxable years, and any allowable deductions for the year of the recovery are ignored for the purposes of applying such section to the recovery.

(d) If a deduction was claimed under section 127(a) of the Internal Revenue Code of 1939 by a taxpayer in computing his tax for any taxable year and if such deduction was disallowed in whole or in part, any recovery in respect of the portion disallowed shall not be subject to the provisions of part IV (section 1331 and following), subchapter Q, chapter 1 of the Code.

[T.D. 6500, 25 FR 12042, Nov. 26, 1960]

§ 1.1332-1 Inclusion in gross income of war loss recoveries.

(a) *Amount of recovery.* Except as provided in section 1333(1), the amount of the recovery in respect of a war loss in a previous taxable year is determined in the same manner for the purpose of either section 1332 or 1333. The amount of the recovery of any money or property in respect of any war loss is the aggregate of the amount of such money and of the fair market value of such property, both determined as of the date of the recovery. But see paragraph (a) of § 1.1333-1 for optional valuation where the taxpayer recovers the same war loss property.

(b) *Amount of gain includible.* (1) A taxpayer who has sustained a war loss described in section 127(a) of the Internal Revenue Code of 1939 and who has not elected to have the provisions of section 1333 apply to any taxable year in which he recovered any money or property in respect of a war loss in any previous taxable year must include in his gross income for each taxable year, to the extent provided in section 1332, the amount of his recoveries of money and property for such taxable year in respect of any war loss in a previous taxable year. Section 1332 provides that such recoveries for any taxable year are not includible in income until the taxpayer has recovered an amount equal to his allowable deductions in prior taxable years on account of such war losses which did not result in a reduction of any tax under chapter 1 or 2

of the Internal Revenue Code of 1939. War loss recoveries are considered as made first on account of war losses allowable but not actually allowed as a deduction, and second on account of war losses allowed as a deduction but which did not result in a reduction of tax under chapter 1 or 2 of the Internal Revenue Code of 1939. If there were deductions allowed on account of war losses for two or more taxable years which did not result in a reduction of any tax under chapter 1 or 2 of the Internal Revenue Code of 1939, a recovery on account of such losses is considered as made on account of such losses in the order of the taxable years for which they were allowed beginning with the latest. See §1.1337-1 for the determination of the amount of such deductions. Recoveries in excess of such amount are treated as ordinary income until such excess equals the amount of the taxpayer's allowable deductions in prior taxable years on account of war losses which did result in a reduction of any such tax under chapter 1 or 2 of the Internal Revenue Code of 1939. Any further recoveries in excess of all the taxpayer's allowable deductions in prior taxable years for war losses are treated as gain on an involuntary conversion of property as a result of its destruction or seizure, and such gain is recognized or not recognized under the provisions of section 1033. See section 1033 and the regulations thereunder. Such gain, if recognized, is included in gross income as ordinary income unless section 1231(a) applies to cause such gain to be treated as gain from the sale or exchange of a capital asset held for more than six months. See section 1231(a) and the regulations thereunder.

(2) The determination as to whether and to what extent any recoveries are to be included in gross income is made upon the basis of the amount of all the recoveries for each day upon which there are any such recoveries, as follows:

(i) The amount of the recoveries for any day is not included in gross income, and is not considered gain on an involuntary conversion, to the extent, if any, that the aggregate of the allowable deductions in prior taxable years on account of war losses which did not result in a reduction of any tax of the

taxpayer under chapter 1 or 2 of the Internal Revenue Code of 1939, as determined under §1.1337-1, exceeds the amount of all previous recoveries in the same and prior taxable years.

(ii) The amount of the recoveries for any day which is not excluded from gross income under subdivision (i) of this subparagraph is included in gross income as ordinary income, and is not considered gain on an involuntary conversion, to the extent, if any, that the aggregate of all the allowable deductions in prior taxable years on account of war losses (both those which resulted in a reduction of a tax of the taxpayer and those which did not) exceeds the sum of the amount of all previous recoveries in the same and prior taxable years and of that portion, if any, of the amount of the recoveries for such day which is not included in gross income under subdivision (i) of this subparagraph.

(iii) The amount of the recoveries for any day which is not excluded from gross income under subdivision (i) of this subparagraph and is not included in gross income as ordinary income under subdivision (ii) of this subparagraph is considered gain on an involuntary conversion of property as a result of its destruction or seizure. The following provisions then apply to this gain:

(a) Such gain is recognized or not recognized under the provisions of section 1033, relating to gain on the involuntary conversion of property. For the purpose of applying section 1033, such gain for any day is deemed to be expended in the manner provided in section 1033 to the extent the recovery for such day is so expended.

(b) If such gain is recognized, it is included in gross income as ordinary income or, if the provisions of section 1231(a) apply and require such treatment, as gain on the sale or exchange of a capital asset held for more than six months. For the purpose of applying section 1231(a), such recognized gain for any day is deemed to be derived from property described in that section to the extent of the recovery for such day with respect to such property, except such portion of such recovery as is attributable to the nonrecognized gain for such day.

(c) Section 1336 provides that in determining the unadjusted basis of recovered property, the total gain and the recognized gain with respect to such property must be determined. For such purpose, the recognized gain deemed to be derived from properties described in section 1231(a) may be allocated among such properties in the proportion of the recoveries with respect to such properties, reduced for each property by the portion of the recovery attributable to the nonrecognized gain for such day, and the recoveries with respect to properties not described in section 1231(a) may be similarly allocated. The total gain derived from any recovered property is the sum of the nonrecognized gain attributable to the recovery of such property and of the recognized gain allocable to such property.

(3) The foregoing provisions may be illustrated by the following examples:

Example 1. The taxpayer sustained war losses of \$3,000 on account of properties A, B, C, and D. Of this amount, \$1,000 did not result in a reduction of any income tax of the taxpayer, as determined under the provisions of § 1.1337-1. In a subsequent taxable year, he received an award of \$800 from the Government on account of property A. This is not included in income since it is less than the amount by which his allowable deductions for prior taxable years on account of war losses which did not result in any tax benefit (\$1,000) exceed \$0, the sum of all his previous recoveries. On a later date the taxpayer recovers property B, which is worth \$1,500 on the date of recovery. This recovery is not included in gross income to the extent of \$200, the amount by which the aggregate of the allowable deductions for prior taxable years on account of war losses which did not result in any tax benefit (\$1,000) exceeds the sum of all previous recoveries (\$800). The remaining \$1,300 of the recovery is included in gross income as ordinary income, and is not considered gain on the involuntary conversion of property, since it is less than the amount by which the aggregate of all the allowable deductions in prior taxable years on account of war losses (\$3,000) exceeds \$1,000, the sum of the \$800 of previous recoveries and of the \$200 portion of the recovery with respect to B which is not included in gross income. On a still later date the taxpayer sells for \$2,500 his rights to recover C. Since the allowable deductions for prior taxable years on account of war losses which did not result in any tax benefit (\$1,000) do not exceed the previous recoveries by the taxpayer (\$800 and \$1,500, or \$2,300), none of the recovery on ac-

count of C is excluded from gross income. This recovery is included in gross income as ordinary income, and is not considered gain on the involuntary conversion of property, to the extent of \$700, the amount by which the aggregate of all the allowable deductions for prior taxable years on account of war losses (\$3,000) exceeds \$2,300, the sum of the \$2,300 of previous recoveries and of the \$0 portion of the recovery on account of C which is not included in gross income. The remaining \$1,800 of the recovery is considered gain on an involuntary conversion of property on account of its destruction or seizure, and is not recognized if forthwith expended in the manner provided in section 1033. Thus, it is not recognized if it is forthwith expended for the acquisition of property related in service or use to C. On a later date the taxpayer recovers D, which has a fair market value of \$400 at the time of the recovery. Since the aggregate of all the allowable deductions for prior taxable years on account of war losses (\$3,000) does not exceed the previous recoveries by the taxpayer (\$800+\$1,500+\$2,500, or \$4,800), all of the recovery with respect to D is considered gain on an involuntary conversion of property as a result of its destruction or seizure. Under the provisions of section 1033, this gain is not recognized if D is used for the same purposes for which it was used before it was deemed destroyed or seized under section 127(a) of the Internal Revenue Code of 1939.

Example 2. The taxpayer on one day recovers \$3,000 for property A and \$7,000 for property B, both of which were treated as war loss property for a prior taxable year, and \$8,000 of such \$10,000 recoveries is considered gain on the involuntary conversion of property as a result of its destruction or seizure. The taxpayer forthwith expends \$5,000 in the acquisition of property similar in use to B. Therefore, \$5,000 of the \$8,000 gain is not recognized under section 1033, leaving \$3,000 of recognized gain. Property B is within the provisions of section 1231(a), relating to gains and losses on the involuntary conversion of certain described property, but property A is not. Therefore, the provisions of section 1231(a) apply to \$2,000 of the \$3,000 gain, that is, the amount of the recovery with respect to B which is not attributable to the nonrecognized gain for such day (\$7,000 minus \$5,000). If the taxpayer forthwith expended \$8,000 or more for the acquisition of property similar in use to B, none of the gain would be recognized. If the taxpayer forthwith expended the \$5,000 to acquire property related in use to A, the \$3,000 recognized gain would be considered derived from B to the extent of the recovery with respect to B (\$7,000), not reduced by any nonrecognized gain since none of such recovery is attributable to such nonrecognized gain, and therefore all of the \$3,000 recognized gain

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would be subject to the provisions of section 1231(a).

(4) An allowable deduction with respect to a war loss is any deduction to which the taxpayer is entitled on account of any war loss property, regardless of whether or not such deduction was claimed by the taxpayer or otherwise allowed in computing his tax. If a deduction was claimed by a taxpayer in computing his tax for any taxable year and if such deduction was disallowed, such deduction will not be considered an allowable deduction for such taxable year since the previous determination will not be reconsidered.

[T.D. 6500, 25 FR 12043, Nov. 26, 1960]

§ 1.1333-1 Tax adjustment measured by prior benefits.

(a) *Amount of recovery.* The amount of recovery for purposes of this section shall be determined in accordance with the provisions of section 1332(a). See paragraph (a) of § 1.1332-1. If, pursuant to the taxpayer's election under section 1335, the provisions of section 1333 are applicable to any taxable year in which he recovers the same war loss property, the fair market value of such property shall, at the option of the taxpayer, be considered an amount equal to the adjusted basis (for determining loss) of such property in the hands of the taxpayer on the date such property was considered as destroyed or seized. This option is exercisable by the taxpayer with respect to each separate war loss property. Also, if the provisions of section 1333 are applicable pursuant to the taxpayer's election, the amount of the recovery of any money or property in respect of war loss property shall be reduced for the purpose of section 1333 (2) and (3) by the amount of the obligations or liabilities with respect to such property, if the taxpayer for any previous taxable year chose under section 127(b)(2) of the Internal Revenue Code of 1939 to treat such obligations or liabilities as discharged or satisfied out of such property, and such obligations or liabilities were not so discharged or satisfied before the date of the recovery. See 26 CFR (1939) 29.127(b)-1 (Regulations 111).

(b) *Elective method; tax adjustment measured by prior benefits.* (1) If the taxpayer elects pursuant to section 1335

and in accordance with the provisions of § 1.1335-1 to have the provisions of section 1333 apply to any taxable year in which he recovers any money or property in respect of war loss property, the amount of the recovery in respect of such property for any taxable year shall not be included in income until the taxpayer has recovered an amount equal to his allowable deductions in prior taxable years on account of the destruction or seizure of such property, whether or not such allowable deductions resulted in a reduction of any tax under chapter 1 or 2 of the Internal Revenue Code of 1939. However, for the purposes of section 6012(a)(1), relating to the requirement of individual returns, section 6012(a)(2), relating to the requirement of corporation returns, and section 1312, relating to the mitigation of the effect of the statute of limitations, the entire amount of the recovery shall be deemed to be an item includible in gross income for the taxable year in which the recovery is made. In lieu of including such amount in gross income, there shall be added to, and assessed and collected as a part of, the tax imposed under subtitle A of the Internal Revenue Code of 1954 for the taxable year of the recovery an adjustment on account of any tax benefits in all prior taxable years resulting directly or indirectly from the fact that the loss from the destruction or seizure of such property was an allowable deduction. The amount of such adjustment shall be the total increase in the tax under chapters 1 and 2 of the Internal Revenue Code of 1939 for all taxable years which would result by decreasing such allowable deductions with respect to the destruction or seizure of such property by an amount equal to that portion of the amount of the recovery which is not included in gross income for the taxable year of the recovery. The portion of the amount of the recovery which is in excess of such allowable deductions is included in gross income for the taxable year of the recovery as gain on the involuntary conversion of property as a result of its destruction or seizure and is recognized or not recognized as provided in section