Denver Law Review

Volume 43
Issue 1 *Symposium - Oil Shale*

Article 8

April 2021

Casualty Losses

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I. INTRODUCTION

In view of Colorado's recent flood experiences, it seeems appropriate to explore in some detail the taxpayer's burden of establishing a casualty loss for income tax purposes. Section 165 of the Internal Revenue Code of 1954 provides: "There shall be allowed as a deduction any loss sustained during the taxable year and not compensated for by insurance or otherwise." As a general proposition it would appear that the sole criterion in section 165 for a loss deduction is simply that the taxpayer suffer a loss. As to individuals, however, section 165(c) in addition requires that the loss must either (1) be incurred in a trade or business or in a transaction entered into for profit; or (2) arise from fire, storm, shipwreck, or other casualty or theft. In short, any loss arising from fire, storm or other casualty is allowable as a deduction under section 165(c) for the taxable year in which the loss is sustained,[1] and the loss is allowable whether or not it was incurred in connection with property used in a trade or business or held in a transaction entered into for profit.[2] This general rule, deceptively simple in statement, presents numerous problems in application.

II. CASUALTY DEFINED

A. *Introduction*

Although section 165(c)(3) of the Internal Revenue Code of 1954 suggests the definition of a casualty by including the illustrative events, "fire, storm, shipwreck, or other casualty," the regulations fail to expand on the code language and in the discussion

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[1] It should be noted that an estate is required to deduct from the value of the gross estate losses incurred during the settlement of the estate arising from fires, storms, shipwrecks, or other casualties if the loss is not compensated for by insurance or otherwise. INT. REV. CODE of 1954 § 2054; Treas. Reg. § 20.2054.1 (1958). However, if the estate so elects and satisfies the requirements set forth in Treas. Reg. § 1.642(g)-1 (1956), the loss may be claimed under section 165(a) in computing the taxable income of the estate. Treas. Reg. § 1.165-7(c) (1960) as amended, T.D. 6786, 1965-1, CUM. BULL. 107.

[2] INT. REV. CODE of 1954 § 165(c)(3); Treas. Reg. § 1.165-7(a) (1960), as amended, T.D. 6786, 1965-1 CUM. BULL. 107.

actually presume an understanding of the term. However, the Internal Revenue Service in its pamphlet entitled *Disasters, Casualties and Thefts,*[3] gives the following definition of a casualty: "A casualty is the complete or partial destruction of property resulting from an identifiable event of a sudden unexpected, or unusual nature."

The pamphlet proceeds to list the following items as casualties: Damage from hurricane, tornado, flood, snow, storm, shipwreck, fire, or accident. With additional explanation, it also lists auto accident, mine cave-in, and sonic boom. By way of contrast the pamphlet states:

> Progressive deterioration through a steadily operating cause and damage from a normal process are not casualty losses. Thus, the steady weakening of a building caused by normal or usual wind and weather conditions is not a casualty loss.
>
> Since termite damage normally occurs over a fairly long period of time, a loss from such damage is not a casualty loss.
>
> Moth damage to property is not a casualty, and such loss is not deductible.

A similar definition was given in Rev. Rul. 59-102[4] which discussed the relationship between section 165 and section 1033:

> The term "casualty" denotes an accident, a mishap, some sudden invasion by a hostile agency; it excludes the progressive deterioration of property through a steadily operating cause. *Charles J. Fay v. Helvering,* 120 Fed. (2d) 253. Also, an accident or casualty proceeds from an unknown cause, or is an unusual effect of a known cause. Either may be said to occur by chance and unexpectedly. *Chicago, St. Louis & New Orleans Railroad Co. v. Pullman Southern Car Co.,* 139 U.S. 79.
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> To be of the same nature or kind as fires, storms and shipwreck for purposes of section 165 (c) (3) of the code, an event must first be unexpected and, second, be identifiable as the cause of a provable loss. There must be a provable event which not only has a casual [*sic*] relation to the diminution in value of the damaged property but can be isolated from other events or sequences leading to changes in value in the damaged property. The primary significance of the latter requirement is that generally the amount of a casualty loss deduction is in part determined with reference to the value of the property before the casualty and its value immediately after the casualty so that it is necessary to fix a time at which the casualty took place.

A casualty may be the result of natural causes, *i.e.,* through the action of fire, wind, storm or the like, or may be the result of

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[3] INTERNAL REVENUE SERVICE, U.S. DEP'T OF TREASURY, DOC. NO. 5174, DISASTERS, CASUALTIES, AND THEFTS, p. 2 (March 1964).

[4] 1959-1 CUM. BULL. 200.

human intervention so long as the human action is one which would or should not be expected to produce the resultant loss.[5] The element of human intervention as giving rise to a casualty loss is illustrated by *Ray Durden*,[6] which involved damage to a residence from blasting in a nearby quarry. The residence was constructed in 1938 and occupied by December 7, 1938. During the period of construction and after occupancy, a series of quarry blastings took place and, though these blasts shook the house, they gave rise to no apparent damage. On January 20, 1939, a severe blast took place and thereafter the damage to petitioner's house became apparent. One issue confronting the court was whether the taxpayers sustained a loss arising from a casualty. The court held that the damage did result from a casualty, stating:

> Under the doctrine of *ejusdem generis*, it is necessary to define the word "casualty" in connection with the words "fires, storms, shipwreck" immediately preceding it. "Casualty" has been variously defined, including "an undesigned, sudden and unexpected event" — Webster's New International Dictionary; also as "an event due to some sudden unexpected or unusual cause" — *Matheson v. Commissioner*, 54 Fed. (2d) 537. The term "casualty" "excludes the progressive deterioration of property through a steady operating cause." *Fay v. Helvering*, 120 Fed. (2) 253; also, "an accident or casualty proceeds from an unknown cause or is an unusual effect of a known cause. Either may be said to occur by chance and unexpectedly." *Chicago, St. Louis & New Orleans Railroad Co. v. Pullman Southern Car Co.*, 139 U.S. 79. The blast causing the damage to the houses of petitioners was unusual, heavier than those occuring during the day by day blasting operations which had theretofore been carried on. The damage was not caused by any progressive deterioration of property. We conclude that it was caused by a casualty in the ordinary sense of the word. Whether under the application of the doctrine of *ejusdem generis* it was a casualty of the same general nature or kind, as "fires, storms, shipwreck," offers a somewhat more difficult question. However, it has been held, under section 23(e)(3), that an automobile wreck may be a casualty in closest analogy to shipwreck. *Shearer v. Anderson*, 16 Fed. (2) 995, and Regulations 103, section 19,23(e)-1, approves as a deductible item loss occasioned by damage to an automobile and resulting from the faulty driving of the taxpayer or another operating the automobile, or from the faulty driving of another automobile colliding with it. In *Anderson v. Commissioner*, 81 Fed. (2d) 457, it is held, under section 23 (e)(3), that losses arising from ordinary highway mishaps may be deducted even though caused by the negligence of the taxpayer. Conversely, losses sustained through the action of termites have

[5] Kipp v. Bingler, 64-2 USCT ¶ 9711 (W. D. Pa. 1964).

[6] 3 T.C. 1 (1944), *acq.* 1944 CUM. BULL. 8.

been held not to be deductible under the heading of casualty. *United States v. Rogers,* 120 Fed. (2d) 244; *Charles J. Fay,* 42 B.T.A. 206; *aff'd* 120 Fed. (2d) 753. It thus appears that a proper definition of the term casualty does not exclude the intervention of human agency, such as involved in setting off the blast involved in this case, and the prime element is that of suddenness as opposed to some gradually increasing result. The blast being considered here, though set off by human agency, was sudden and unusual in violence. The fact that ordinary blasts had been occurring, without complaint from the petitioners, from day to day, the fact that such ordinary blasts caused no damage and that much damage was caused by this particular blast, resulting in complaint by the petitioners, all indicate that the occurrance was unusual in its results.

B. *Events Constituting a Casualty*

The Tax Court and Federal courts treat various types of casualties in different ways; their disposition of the cases differ (1) in recognizing the losses and (2) in determining the amounts thereof. The following events (involving both natural causes and human intervention) have been held to constitute "casualties" within the meaning of section 165(c)(3): accident,[7] blasting,[8] bomb explo-

[7] See, *e.g.,* Samual Abrams, 23 CCH Tax Ct. Mem. 1546 (1964) (piece of furniture dropped 16 floors by movers while being moved from one apartmeent to another); I.T. 2231, IV-2 CUM. BULL. 53 (1925), *modified on other grounds,* G.C.M. 16255, XV-1 CUM. BULL. 115 (1936) (bursting of hot water boiler in residence caused by an air obstruction in the pipes which prevented the water from properly coming in contact with the boiler and flowing through the system); The Wellston Co., 24 CCH Tax Ct. Mem. 306 (1965) (collapse of roof due to faulty construction). An automobile owned by the taxpayer, whether used for business purposes or maintained for recreation or pleasure, may be the subject of a casualty loss, including losses caused by nature or the intervention of man. Treas. Reg. § 1.165-7(a)(3) (1960); Helvering v. Owens, 305 U.S. 468 (1939); Francis L. Davis, 9 CCH Tax Ct. Mem. 306 (1950); Nat Lewis, 13 CCH Tax Ct. Mem. 1167 (1954); G.C.M. 16255, XV-1 CUM. BULL. 115 (1936). Thus, a casualty loss occurs when an automobile owned by the taxpayer is damaged and when (1) the damage results from the faulty driving of the taxpayer or other person operating the automobile but is not due to the willful act or willful negligence of the taxpayer or one acting in his behalf; or (2) the damage results from the faulty driving of the operator of the vehicle with which the automobile of the taxpayer collides. Treas. Reg. § 1.165-7(a)(3) (1960). It makes no difference that the automobile was operated by an unauthorized person. Shearer v. Anderson, 16 F.2d 995 (2nd Cir. 1927). However, the taxpayer is not entitled to deduct as a casualty loss, damages (personal injury or property) including costs incident thereto paid to another for injury to the other party's property or person if the injury was not in connection with the taxpayer's trade or business. See cases cited, *infra* notes 49 and 52. However, the damages and costs are deductible if the vehicle was being operated in the ordinary course of a trade or business. Anderson v. Commissioner, 81 F.2d 457 (10th Cir. 1935); M. L. Rose Co., 13 CCH Tax Ct. Mem. 213 (1954), *but cf.* Freedman v. Commissioner, 301 F.2d 359 (5th Cir. 1962), *affirming* 35 T.C. 1179 (1961) (accident occurred while taxpayer was en route from his place of employment to a place of business in which he was a partner).

[8] Ray Durden, 3 T.C. 1 (1944, *acq.* 1944 CUM. BULL. 8 (damage to residence).

sions and bombardment,[9] damage in storage and transit,[10] damage to automobile mechanism, caused by child,[11] damage to septic tank and water line when lot was plowed,[12] drought,[13] earthquake,[14] fire,[15]

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[9] I.T. 2037, III-1 CUM. BULL. 146 (1924), *modified* by I.T. 35119, 1941-2 CUM. BULL. 96 (home of the taxpayer damaged as the result of the explosion of a bomb placed on his front porch); I.T. 3519, *supra* (taxpayer lost certain personal property located in a residence which was destroyed in 1940 as a result of bombardment of a city in France).

[10] See, Latimore v. United States, 63-1 USCT ¶ 9845 (N.D. Calif. 1963) (art objects in storage either smashed, missing, soiled or crushed beyond restoration); Harry M. Leet, 14 CCH Tax Ct. Mem. 39 (1955), *aff'd* 230 F.2d 845 (6th Cir. 1956) (goods stolen and damaged in transit, loss denied because claimed in incorrect year); Leland D. Webb, 1 B.T.A. 759 (1925), *acq.* IV-1 CUM. BULL. 3 (1925) (personal property in transit aboard naval transport). *But cf.* Guy I. Rowe, 3 B.T.A. 1228 (1926); Bercaw v. Commissioner, 165 F.2d 521 (4th Cir. 1948), *affirming* 6 CCH Tax Ct. Mem. 27 (1947); Mildred Bauman, 10 CCH Tax Ct. Mem. 31 (1951).

[11] Hary M. Leet, 14 CCH Tax Ct. Mem. 39 (1955), *aff'd* 230 F.2d 845 (6th Cir. 1956) (taxpayer's auto did not have a mechanism which automatically disengaged the starter when the motor was running; a child pressed the starter button and damaged the starter).

[12] Harry M. Leet, 14 CCH Tax Ct. Mem. 39 (1955), *aff'd* 230 F.2d 845 (6th Cir. 1956).

[13] Winters v. United States, 58-1 USCT ¶ 9205 (N.D. Okla. 1958), *rev'd on other grounds* 261 F.2d 675 (10th Cir. 1958), *cert. denied* 359 U.S. 943 (1959) (damage to landscaping); Rev. Rul. 54-85, 1954-1 CUM BULL. 58 (damage to residential property — soil shrinkage during period of drought). *But cf.* Kemper v. Commissioner, 269 F.2d 184 (8th Cir. 1959), *affirming* 30 T.C. 546 (1958) (evidence was insufficient to establish the trees died of drought or any other casualty); Buttram v. Jones 87 F. Supp. 322 (W.D. Okla. 1943) (damage to landscaping loss denied for failure to show change in value); Louis Broido, 36 T.C. 786 (1961) (taxpayer failed to show a difference in value before and after the drought); Dick H. Woods, 19 CCH Tax Ct. Mem. 388 (1960) (damage to residence — soil settled causing foundation to crack — loss denied for failure to show loss in value); Rev. Rul. 55-367, 1955-1 CUM. BULL. 25 ("the drying up of a well resulting from prolonged lack of rain is not such an unusual or unexpected happening and involves no such sudden, identifiable event fixing a point at which a loss can be measured as to constitute a casualty loss. . . .").

[14] A.R.R. 4725, III-1 CUM. BULL. 143 (1924) (damage to plant).

[15] INT. REV. CODE of 1954 § 165(c)(3); see, United States v. Koshland, 208 F.2d 636 (9th Cir. 1953); Miree v. United States, 62-2 USCT ¶ 9756 (N.D. Ala. 1962) (apartment houses); Sears v. United States, 59-1 USCT ¶ 9302 (N.D. Ohio 1959); Virgil R. Williams, 19 CCH Tax Ct. Mem. 106 (1960) (warehouse, carpentry shop and hotel); Melvin Mailloux, 20 CCH Tax Ct. Mem. 942 (1961), *rev'd on other grounds,* 320 F.2d 60 (5th Cir. 1963) (household furnishings and equipment); Ticket Office Equipment Co., 20 T.C. 272 (1953), *acq.* 1953-2 CUM. BULL. 6 *aff'd per curiam on other grounds,* 213 F.2d 318 (2nd Cir. 1954) (Plant and contents including machinery, supplies and inventory items); Bernard L. Shackleford, 7 CCH Tax Ct. Mem. 694 (1948) (house and furnishings); J. H. Anderson, 7 CCH Tax Ct. Mem. 811 (1948) (house and furnishings); Lorraine Turpentine Co., 20 B.T.A. 423 (1930) (distillery); Fred Frazer, 10 B.T.A. 409 (1928) (apartment house); George B. Friend, 8 B.T.A. 712 (1927), *acq.* VII-2 CUM. BULL. 14 (1928).

flood,[16] freeze,[17] high waves,[18] hurricane,[19] lightning,[20] rain,[21] snow

[16] See, Ferguson v. Commissioner, 59 F.2d 893 (10th Cir. 1932), *reversing* 23 B.T.A. 364 (1931) (farmland flooded); Hutchings v. Glenn, 41-2 USTC ¶ 9673 (W.D. Ky. 1941) (architect's plans and drawing destroyed by flood); Smith, Trustee v. Commissioner, 19 F. Supp. 377 (D.N.H. 1937) (flood washed away bank necessitating repair to a penstock); Harris Hardwood Co., 8 T.C. 874 (1947), *acq.* on this issue, 1947-2 CUM. BULL. 2 (damage to plant used in manufacture of hardwood flooring); Doyle E. Collup, 21 CCH Tax Ct. Mem. 128 (1962) (inundation of lake front property including house); Frank R. Hinman, 12 CCH Tax Ct. Mem. 1347 (1953) (flash flood washing away top soil). *But see* J. G. Boswell Co., 34 T.C. 539 (1960) *aff'd* 302 F.2d 682 (9th Cir. 1962), *cert. denied* 371 U.S. 860 (1962); Citizens Bank of Weston v. Commissioner, 252 P.2d 425 (4th Cir. 1958) *affirming* 28 T.C. 717 (1957); Central Arizona Ranching Co., 23 CCH Tax Ct. Mem. 1304 (1964).

[17] United States v. Barret, 202 F.2d 804 (5th Cir. 1953) (destruction of landscaping; the case also involved the question of when the actual injury and hence the "loss" occurred); Ferris v. United States, 62-1 USTC ¶ 9448 (D. Vt. 1962) (unusual conditions of precipitation, freezing and thawing, and temperature caused garage wall to collapse); Stanley Kupiszewski, 223 CCH Tax Ct. Mem. 1559 (1965); Donald G. Graham, 35 T.C. 273 (1960), *acq.* 1961-2 CUM. BULL. 4 (destruction of exotic plants); Robert H. Montgomery, 6 CCH Tax Ct. Mem. 77 (1947) (destruction of rare and exotic palm trees); Seward City Mills, 44 B.T.A. 173 (1941), *acq.* 1941-1 CUM. BULL. 9 (ice jam on river damaged foundation of a mill); I.T. 3921, 1948-2 CUM. BULL. 32 (partial damage to trees held in trade or business); O.D. 1076, 5 CUM. BULL. 138 (1921) (damage to flooring and furniture caused by freezing and bursting of water pipes in a residence). *But cf.* Dean L. Phillips, 9 CCH Tax Ct. Mem. 501 (1950) (automobile motor frozen); Samuel Greenbaum, 8 B.T.A. 75 (1927) (a water pipe in the cellar froze and burst, causing a flood in the cellar; the court disallowed the deduction — "a frozen water pipe is a common occurrence").

[18] Ferst v. Edwards, 129 F. Supp. 606 (D. Ga. 1955) (beach home collapsed after sand was washed away); Rev. Rul. 53-79, 1953-1 CUM. BULL. 41 (physical damage to buildings, boathouses, docks, seawalls on Great Lakes as a result of their being battered by wave action). *But cf.* Edward W. Banigan, 10 CCH Tax Ct. Mem. 561 (1951) ("The alleged loss by damage to the automobile by salt water is not due to casualty. . . .").

[19] Biddle v. United States, 175 F. Supp. 203 (E.D. Pa. 1959) (damage to residential property); Graham M. Brush, 21 CCH Tax Ct. Mem. 649 (1962) (damage to residential property); Philip Allen, 1 CCH Tax Ct. Mem. 14 (1962) (damage to residential property); Jay W. Howard, 18 CCH Tax Ct. Mem. 413 (1959) (damage to residential landscaping); Western Products Co., 28 T.C. 1196 (1957), *acq.* 1958-1 CUM. BULL. 6 (damage to landscaping); Oceanic Apartments, Inc., 13 CCH Tax Ct. Mem. 944 (1954) (damage to resort hotel); Gilbert J. Kraus, 10 CCH Tax Ct. Mem. 1071 (1951) (damage to beach house); Carl A. Haslacher, 9 CCH Tax Ct. Mem. 314 (1950) (damage to residential landscaping); Isabelle B. Krome, 9 CCH Tax Ct. Mem. 178 (1950); Mary F. Cary, 7 CCH Tax Ct. Mem. 724 (1948) (damage to residential landscaping); G.C.M. 21013, 1939-1 CUM. BULL. 101 (damage to landscaping); I.T. 3304, 1939-2 CUM. BULL. 158 (damage to residence).

[20] S. F. Horn, 18 CCH Tax Ct. Mem. 177 (1959) (damage to trees); Harry M. Leet, 14 CCH Tax Ct. Mem. 39 (1955), *aff'd* 230 F.2d 845 (6th Cir. 1956) (damage to tree).

[21] Clapp v. Commissioner, 321 F.2d 12 (9th Cir. 1963), *affirming* 36 T.C. 905 (1961) (artificial beach washed away by unprecedented rain); Kipp v. Bingler, 64-2 USTC ¶ 9711 (W.D. Pa. 1964) (involving a mud slide); Schirmer v. United States, 59-2 USTC ¶ 9572 (N.D. Calif. 1959) (extraordinary rain caused soil slide); Delbert P. Hesler, 13 CCH Tax Ct. Mem. 972 (1954) (drought followed by unusual rainfall caused soil to subside and produce cracks in foundation); Clarence E. Stewart, 12 CCH Tax Ct. Mem. 921 (1953) (rain storm flooded basement); A. J. Coburn, 12 CCH Tax Ct. Mem. 275 (1953) (damage to residential property). *But cf.* Rupert Stuart, 20 CCH Tax Ct. Mem. 938 (1961) (mere presence of water damage is not sufficient to show that it was the result of a casualty).

and ice storm,[22] sonic boom,[23] squall,[24] sudden subsidence of soil, cave-in or slide,[25] thunderstorm,[26] vandalism,[27] wind (tornado).[28]

The following events (involving both natural causes and human intervention) have been held not to constitute "casualties" within the meaning of section 165(c)(3): damage caused by

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[22] Whipple v. United States, 25 F.2d 520 (D. Mass. 1928); Mary Cheney Davis, 16 B.T.A. 65 (1929), *acq.* VIII-2 CUM. BULL. 13 (1929) (damage to landscaping); John S. Hall, 16 B.T.A. 71 (1929), *acq.* VIII-2 CUM. BULL. 21 (1929) (damage to landscaping). *But cf.* Paul E. Jackson, 13 CCH Tax Ct. Mem. 1175 (1954) (damage to residential and rental property).

[23] Rev. Rul. 60-329, 1960-2 CUM. BULL. 67 (compared to wind damage).

[24] Ralph Walton, 20 CCH Tax Ct. Mem. 653 (1961) (severe squall from Lake Erie — destruction of trees).

[25] Tank v. Commissioner, 270 F.2d 477 (6th Cir. 1959), *reversing* 29 T.C. 677 (1958) (damage to residence located on river bank due to subsidence of the bank caused apparently by dredging operations conducted in the river); Stowers v. United States, 169 F. Supp. 246 (S.D. Miss. 1958) (damage caused by slide or cave-in of a bluff upon which taxpayer's residence was situated which while it did not damage the house did block the access to the house); Harry Johnston Grant, 30 B.T.A. 1028 (1934), *acq.* XIII-2 CUM. BULL. 8 (1934) (surface began to sink when substratum "sticky clay or quick sand and clay" was set in motion); Rev. Rul. 57-524, 1957-2 CUM. BULL. 141 (damage to residence caused by a "mine cave," *i.e.,* the collapse of mine excavations beneath the surface). *But cf.* Kipp v. Bingler, 64-2 USTC ¶ 9711 (W.D. Pa. 1964); Daniel F. Ebbert, 9 B.T.A. 1402 (1928). See also, Delbert P. Hesler, 13 CCH Tax Ct. Mem. 972 (1954). *But see,* Schirmer v. United States, 59-2 USTC ¶ 9572 (N.D. Calif. 1959) (gradual erosion of soil by action of the wind or water is not a casualty); Texas and Pacific Ry. Co., 1 CCH Tax Ct. Mem. 863 (1943); I.T. 1567, II-1 CUM. BULL. 90 (1923); Rev. Rul. 53-79, 1953-1 CUM. BULL. 41.

[26] David W. Murray Jr., 212 CCH Tax Ct. Mem. 1302 (1961) (destruction of trees); Andrew A. Maduza, 20 CCH Tax Ct. Mem. 1302 (1961) (rain caused taxpayer's property to flood, destruction of trees and shrubs).

[27] Charles Gutwirth, 40 T.C. 666 (1963) (vandalism and theft in residence occupied by troops); Burrell E. Davis, 34 T.C. 586 (1960), *acq.* in result only, 1963-2 CUM. BULL. 4 (vandals broke into a house being constructed for petitioners and damaged certain new appliances owned by the petitioneers and placed by them on the premises). *But cf.* Edward W. Banigan, 10 CCH Tax Ct. Mem. 561 (1951) (damage by "small boys" to hot water heater, hen coop, fence, and platform trailer; the court holding "the law does not recognize loses due to vandalism nor can any of the losses be allowed under the casualty section").

[28] Barry v. United States, 175 F. Supp. 308 (W.D. Okla. 1958) (windstorm which blew away approximately 4 inches of top soil in 36 hours); David W. Murray Jr., 21 CCH Tax Ct. Mem. 7 (1962) (strong wind caused retaining wall to collapse); Louis A. Edwards, 19 CCH Tax Ct. Mem. 925 (1960) (damage to trees); Richard E. Stein, 14 CCH Tax Ct. Mem. 191 (1955) (destruction of a barn); William O. Lindley, 11 CCH Tax Ct. Mem. 355 (1952) (damage to trees and shrubbery on residential site); Rev. Rul. 53-79, 1953-1 CUM. BULL. 41 (damage to buildings, boathouses, docks, seawalls, etc. on the Great Lakes as a result of their being battered by wind). *But cf.* Maude T. Fearing, 21 CCH Tax Ct. Mem. 800 (1962), *aff'd on other grounds,* 315 F.2d 495 (8th Cir. 1963) (destruction of tree and water damage but taxpayer failed to show difference in market values before and after the wind storm); Philip Handelman, 20 CCH Tax Ct. Mem. 878 (1961) (destruction of yacht sails but failure to prove cost or whether loss was compensated by insurance).

household pets,[29] damage done by moths or rodents,[30] death of livestock from disease, or old age,[31] dismissal from employment,[32] insect damage to and disease of trees and plants,[33] ordinary wear and tear or usual deterioration from use and age,[34] property lost or misplaced,[35] routine breakage of household or personal items,[36]

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[29] J. Raymond Dyer, 20 CCH Tax Ct. Mem. 705 (1961) ("the breakage of ordinary household equipment such as china or glassware through negligence of handling or by a family pet is not a 'casualty loss' under section 165(c)(3) in our opinion." The fact that "the breakage of the vase was not occasioned by the cat's ordinary perambulations on the top of the particular piece of furniture, but by its extraordinary behavior there in the course of having its first fit" makes no difference).

[30] Edward W. Banigan, 10 CCH Tax Ct. Mem. 561 (1951) (rats); Rev. Rul. 55-327, 1955-1 CUM. BULL. 25 (moths).

[31] Rev. Rul. 61-216, 1961-2 CUM. BULL. 134; I.T. 3696, 1944 CUM. BULL. 241, modified by Rev. Rul. 59-102, 1959-1 CUM. BULL. 200; see INT. REV. CODE of 1954 § 1033(e); Treas. Reg. § 1.1033(e)-1 (1957); INT. REV. CODE of 1954 § 1231; Treas. Reg. § 1.1231-1(e) (1957).

[32] Evelyn R. Marks, 22 CCH Tax Ct. Mem. 1128 (1963) (dismissal as a teacher and loss of unused sabbatical and sick leave).

[33] Appleman v. United States, 338 F.2d 729 (7th Cir. 1964), *cert. denied*, 380 U.S. 956 (1965); Burns v. United States, 174 F. Supp. 203 (N.D. Ohio 1959), *aff'd per curiam*, 284 F.2d 436 (6th Cir. 1960); Internal Revenue Service Field Release No. 56, 5 CCH 1957 STAND. FED. TAX REP. ¶ 6668; Rev. Rul. 57-599, 1957-2 CUM. BULL. 142. See also, Matheson v. Commissioner, 54 F.2d 537 (2nd Cir. 1931), *affirming* 18 B.T.A. 674 (1930), *acq.* IX-2 CUM. BULL. 38 (1930) (pilings exposed by action of storms and eaten by worms). The rule may be different with respect to timber held in a trade or business. Orono Pulp & Paper Co. v. United States, 34 F.2d 714 (D. Me. 1929) (damage to pulp wood timber over a two-year period by spruce bud worm); Oregon Mesabi Corporation, 39 B.T.A. 1033 (1939) *acq.* 1944 CUM. BULL. 22.

[34] Clinton H. Mitchell, 42 T.C. 953 (1964) (tire blow-outs caused by overloading a trailer); Charlie L. Wilson, 22 CCH Tax Ct. Mem. 914 (1963) (casualty loss claimed for two automobile tires and damages to interior of home caused by leaky roof); Emil A. Wold, 22 CCH Tax Ct. Mem. 732 (1963) (breakdown of automobile engine); Henry W. Rice, 15 CCH Tax Ct. Mem. 1350 (1956) (engine ruined due to break in oil line of automobile which permitted all the oil to escape); Harry M. Leet, 14 CCH Tax Ct. Mem. 39 (1955), *aff'd* 230 P.2d 845 (6th Cir. 1956) (damage to fuel pump and muffler allegedly "sustained from flying stones while driving over the temporary road. . . .").

[35] Keenan v. Bowers, 91 F. Supp. 771 (E.D.S.C. 1950) (ring accidentally flushed down toilet); O.D. 526, 2 CUM. BULL. 130 (1920); Emily Marx, 13 T.C. 1099 (1949), *acq.* 1950-1 CUM. BULL. 3; Edgar F. Stevens, 6 CCH Tax Ct. Mem. 805 (1947) (ring lost while hunting). *Cf.* William Fuerst, 10 CCH Tax Ct. Mem. 208 (1951) (diamond bracelet apparently misplaced rather than stolen).

[36] J. Raymond Dyer, 20 CCH Tax Ct. Mem. 705 (1961) (vase broken by cat); Robert M. Diggs, 18 CCH Tax Ct. Mem. 443 (1959), *aff'd* 281 F.2d 326 (2nd Cir. 1960), *cert. denied* 364 U.S. 908 (1960) (glassware and china" . . . accidentally broken in the course of ordinary handling, by domestic help in the course of cleaning or by the family cat."); E. M. Taylor, 11 CCH Tax Ct. Mem. 651 (1952) ("During the calendar year 1948 he dropped his watch on the sidewalk in front of his home and expended $8.50 as the cost of repair. . . . It clearly does not constitute a casualty loss. . . ."); Willard I. Thompson, 15 T.C. 609 (1950) *acq.* this issue, 1951-1 CUM. BULL. 3, *rev'd on other grounds*, 193 F.2d 586 (10th Cir. 1951) ("As to the breakage of watch: This was a personal expense and the breakage does not partake of the nature of fire, storm, or shipwreck. . . ."); Charles J. Voigt, 8 CCH Tax Ct. Mem. 662 (broken glasses).

seizure of nonbusiness property by Police or other government officers,[37] termite,[38] and dry rot damage.[39]

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[37] Charles K. Richter, 24 CCH Tax Ct. Mem. 461 (1965); William J. Powers, 36 T.C. 1191 (1961) (seizure of automobile by officials in East Germany); A. Gilbert Formel, 9 CCH Tax Ct. Mem. 782 (1950) ("The loss of money through seizure by the customs officers of a foreign country in the course of their execution of their official duties is not a loss from a casualty. . . . Again, even if the seizure were an illegal seizure . . . that is not a 'casualty' within the meaning of the statutory provision."); Thomas F. Gurry, 27 B.T.A. 1237 (1933) (fee paid to attorney for services rendered in recovering award compensating taxpayer for seizure of private automobile during WWI); Fred J. Hughes, 1 B.T.A. 944 (1925) (seizure of private stock of liquors by police officers); I.T. 4086, 1952-1 CUM. BULL. 29; Rev. Rul. 62-197, 1962-2 CUM. BULL. 66. A special exception to the above rule applies in cases of losses arising from confiscation of property by the Cuban government (any political subdivision thereof, or any agency or instrumentality of the government). INT. REV. CODE OF 1954 § 165(i)(1)(A) (1964); The Revenue Act of 1964, § 238, 78 Stat. 19. The loss is treated as a casualty loss, INT. REV. CODE of 1954 § 165(i)(1), but applies only to property (1) not used in a trade or business; and (2) not held for the production of income. INT. REV. CODE of 1954 § 165(i)(1)(B). Business property is governed by the general rules under section 165(i). The following requisites must be satisfied before the loss may be deducted: (1) the taxpayer claiming the loss must have been a citizen of the United States or resident alien, on December 31, 1958; (2) seizure must have taken place before January 1, 1964; (3) if the property involved is *tangible,* it must have been held and been located in Cuba on December 31, 1958. INT. REV. CODE of 1954 § 165(i)(1)(A)-(B). In connection with (3), *intangible* property may have been acquired after December 31, 1958. Thus, the special relief provided does not apply to: (1) business property; (2) tangible personal property acquired after December 31, 1958, and (3) losses incurred after December 31, 1963, or before December 31, 1958. The loss is deemed to have occurred on October 14, 1960, unless it is established that the loss was sustained on some other day. INT. REV. CODE of 1954 § 165(i)(2)(A). In determining the amount of loss, the fair market value of property held by the taxpayer on December 31, 1958, is treated as the market value of the seized asset regardless of the date when the expropriation actually took place. Intangible property acquired after December 31, 1958, the date of taking, is used for value purposes. INT. REV. CODE of 1954 § 165(i)(2)(B). Regardless of the time limits applicable generally to refund claims, a refund or credit of any overpayment attributable to a certain confiscation loss may be made as allowed if the claim is made before January 1, 1965. No interest is allowed on any refund or credit for any period from February 26, 1964. INT. REV. CODE of 1954 § 165(i)(3). See Rev. Rul. 65-87, 1965-1, CUM. BULL. 111 (repossession of household furniture because of default on the loan is not a casualty); Aaron F. Vance, 36 T.C. 547 (1961).

[38] United States v. Rogers, 120 F.2d 244 (9th Cir. 1941); Fleinstein v. United States, 173 F. Supp. 893 (E.D. Mo. 1954); Leslie C. Dodge, 25 T.C. 1022 (1956):

> It is thus seen that the weight of authority is to the effect that generally, termite damages does not give rise to a deductible casualty loss. This is for the reason that it does not occur suddenly, unexpectedly or from an unusual cause; it is rather in the nature of a gradual erosion or deterioration of property.

Charles J. Fay, 42 B.T.A. 206 (1940), *aff'd* per curiam, 120 F.2d 253 (2nd Cir. 1941); Rogers v. United States, *supra.* Only in exceptional cases where the invasion and measurable damage have occurred within a relatively short period of time has the loss been held deductible as a casualty loss. Rosenberg v. Commissioner, 198 F.2d 46 (8th Cir. 1952); Shopmaker v. United States, 119 F. Supp. 705 (E.D. Mo. 1953); Rev. Rul. 63-232, 1963-2 CUM. BULL. 97. For taxable years beginning after November 12, 1963, the Internal Revenue Service will disallow casualty loss deductions for any termite damage — "fast" termite damage not excepted. Rev. Rul. 63-232, *supra.* For taxable years beginning prior to November 12, 1963, a casualty loss deduction will be allowed by the Internal Revenue Service only in those situations where the damage caused by he termites extended over a period of 15 months or less. Rev. Rul. 59-277, 1959-2 CUM. BULL. 73 (*revoked by* Rev. Rul. 63-232, *supra.*) Rosenberg v. Commissioner, 198 F.2d 46 (8th Cir. 1952), *reversing* 16 T.C. 1360 (1951) (house inspected in April 1946 and found free of termites, termite damage discovered in April 1947); Shopmaker v. United States, 119 F. Supp. 705 (E.D. Mo. 1953) (house inspected in December 1949, termites discovered on February 8, 1951, the court treating the invasion or swarming of the termites as the casualty event); Buist v. United States, 164 F. Supp. 218 (E.D.S.C. 1958)

(summer cottage inspected and found free of termites in September 1953, termite damage discovered in June 1954); E. G. Kilroe, 32 T.C. 1304 (1959), *acq.* 1960-1 CUM. BULL. 4 (house inspected by bank in May 1953, thereafter by exterminating company on January 9, 1954, and January 19, 1955, the court stating:

> Bearing in mind the fact that an inspection had been made in 1953 when the house was purchased and that annual inspections were made on the premises each year thereafter, the last having been made in January 1955 — about 3 months before the discovery of the termite damage in question — plus the fact that there had been no exterior evidence of termite activity and that there were 'fresh channels' in the kitchen wall and floor, we are persuaded that the time within which the damage or loss occurred was within a relatively short time prior to discovery in 1955. From the record as a whole, we conclude that there was not termite activity in petitioners' house between May 1953 and January 1955, and that the petitioners are entitled to a casualty loss deduction for the damage in question.

Henry F. Cate, Jr., 21 CCH Tax Ct. Mem. 1146 (1962) (infestation existed for approximately six months); Allan M. Winsor, 18 CCH Tax Ct. Mem. 383 (1959), *aff'd* 278 F.2d 634 (1st Cir. 1960) (damage in the house had taken place in about a year and a half). No deduction is or was allowable for any year where the termite infestation and subsequent damage occurred over periods of several years. Rev. Rul. 59-277, *supra* (*revoked by* Rev. Rul. 63-232). Although the Internal Revenue Service has changed its position, there is no indication that the courts will not permit the deduction for a casualty loss arising from damage caused by the "fast termite." See Leslie C. Dodge, 25 T.C. 1022 (1956); E. G. Kilroe, 32 T.C. 1304 (1959), *acq.* 1960-1 CUM. BULL. 4; Hale v. Welch, 38 F. Supp. 754 (D. Mass. 1941).

[39] United States v. Rogers, 120 F.2d 244 (9th Cir. 1941); Rudolf L. Hoppe, 42 T.C. 820 (1964):

> Section 165(c)(3) speaks of losses arsing from "fire, storm, shipwreck, or other casualty . . . ." And the term "casualty" has been interpreted to mean "an accident, a mishap, some sudden invasion by a hostile agency; it exludes the progressive deterioration of property through a steadily operating cause." Fay v. Helvering, 120 F.2d 253 (C. A. 2); United States v. Rogers, 120 F.2d 244, 246 122 F.2d 485 (C. A. 9); Matheson v. Commissioner, 54 F.2d 537, 539 (C. A. 2); Leslie C. Dodge, 25 T. C. 1022, 1026. Thus, the foregoing cases have denied deductions for losses due to such causes as termites, dry rot, and rust.
>
> An exception to this rule appears to have developed in recent years in the case of the "fast termite," where it has been held that termite damage may qualify as a casualty loss if it occurs within a realtively short period of time. Rosenberg v. Commissioner, 198 F.2d 46 (C. A. 8); Joseph Shopmaker v. United States, 164 F. Supp. 218 (E.D.S.C.). And this Court has undertaken to follow this line of cases in E. G. Kilroe, 32 T. C. 1304, 1306, 1307 (1959) stating that the "term 'suddenness' is comparative, and gives rise to an issue of fact," noting that the claimed deductions for termite losses were disallowed in some cases while allowed in others.
>
> The alleged casualty before us involves dry rot rather than termites, but we do not understand either of the parties to suggest that anything here turns upon this difference. Accordingly, the question before us under Kilroe is the factual one whether the dry rot discovered in petitioners' house in November 1959 was of comparatively recent origin so as to qualify for the requisite degree of "suddenness." Petitioners' position in substance is that the fungus infestation began as the result of the unusually heavy rains in January, February, March and April of 1958; that the ensuing damage occurred over the following period of some 18 to 22 months; and that such period is sufficiently short to justify classifying the loss as characterized by the necessary "suddenness" to qualify as a "casualty."
>
> We might well hesitate to say that a period of some three months that we approved in Kilroe may be expanded to some 18 to 22 months without subjecting the whole theory of "comparative suddenness" to a reductio ad absurdum, but we do not reach that point because we cannot find that the dry rot in question had its beginning at the time of those rains in the first part of 1958 rather than at some substantially earlier date. Petitioners' contention that the fungus infestation began with those rains is based upon the assumption that their house was free of dry rot after the September 1956 inspection and repair of the property as recommended in the inspection report. Although we had the impression at the time of the trial that there might be a basis for that assumption, a careful study of the record has satisfied us that the assumption is without foundation.

C. *Burden of Proof*

The above list of casualty events is an "open end" list, *i.e.,* other events may constitute casualties within the meaning of section 165(c)(3) if the taxpayer can demonstrate an identifiable event (act of man or nature) which was sudden, unexpected or of an unusual nature. Of course, the taxpayer may lose the deduction, even if the identifiable event is one well established within the casualty class, if he fails to show the other requisites, *i.e.,* the sudden, unexpected or unusual nature[40] of the event.

III. Necessity of Actual Loss in Value

As with any claimed loss, the taxpayer must have actually parted with something of value, the loss of which was not only the result of actual physical damage to his property but also a loss in value which can be measured with reasonable accuracy.

Cast in terms of negligence law, the taxable event is a combination of a "trauma" (actual physical damage to taxpayer's property) resulting from a "cause" (storm, fire, collision, etc.) which was the "probable" cause of the damage.[41]

In short, there must be an event (the casualty) which directly culminates in actual physical damage, *i.e.,* a loss which is both immediate and measurable.[42] Thus a prospective loss or an economic loss without actual physical damage is not sufficient for tax pur-

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[40] Kipp v. Bingler, 64-2 USTC ¶ 9711 (W.D. Pa. 1964) (failure to show that a slide was caused by rain storm and not excavation); Clyde v. Jackson, 24 CCH Tax Ct. Mem. 309 (1965); Rudolph L. Hoppe, 42 T.C. 820 (1964) (failure to show that dry rot occurred with sufficient suddenness to qualify as a casualty loss); Jane V. Elliott, 40 T.C. 304 (1963), *acq.* 1964-1 INT. REV. BULL. 5; Maude T. Fearing, 21 CCH Tax Ct. Mem. 800 (1962), *aff'd on other grounds,* 315 F.2d 495 (8th Cir. 1963); Rupert Stuart, 20 CCH Tax Ct. Mem. 938 (1961) (water damage shown, but failed to show evidence of a sudden or destructive force, or an identifiable event in the nature of a casualty); Henry M. Leet, 14 CCH Tax Ct. Mem. 39 (1955), *aff'd* 230 F.2d 845 (6th Cir.1956).

[41] INTERNAL REVENUE SERVICE, U.S. DEP'T OF TREASURY, DOC. NO. 5174, DISASTERS, CASUALTIES AND THEFTS, p. 3 (March 1964): "The reduction in value of property because it is in or near a disaster area and there is the possibility that the area might again have a similar disaster is not a casualty loss. A loss is allowed only for the actual physical damage to your property resulting from the casualty." See Kemper v. Commissioner, 269 F.2d 184 (8th Cir. 1959), *affirming* 30 T.C. 546 (1958). Actual damage does not include a "reserve" for repairs; James I. Goski, 24 CCH Tax Ct. Mem. 828 (1965). The damage or loss must be the immediate and direct result of the casualty, *i.e.,* a result directly connected with and following the casualty event. For example, a loss resulting from the sale of a taxpayer's residence to a conservancy district under condemnation proceedings, was not deductible as a casualty loss although the district was created as part of a flood prevention program initiated because of a flood in the area. II-1 CUM. BULL. 92 (1923). Philip Allen, 1 CCH Tax Ct. Mem. 14 (1942). *But cf.* INT. REV. CODE § 1033(f) and Treas. Reg. § 1.1033(f)-1 dealing with the sale or exchange of livestock solely on account of drought.

[42] The casualty event is the identifiable event fixing the onset of the damage and the physical injury closes the transaction. See Ferguson v. Commissioner, 59 F.2d 893 (10th Cir. 1932); Louis Broido, 36 T.C. 786 (1961); J. G. Boswell Co., 34 T.C. 539 (1960), *aff'd* 302 F.2d 682 (9th Cir. 1962), *cert. denied* 371 U.S. 860 (1962).

poses. For example, although the taxpayer's farm land was in fact flooded, no loss deduction was allowed for an alleged loss due to a reduction in cotton "history," *i.e.,* the possibility that the taxpayer might suffer a reduction in his acreage allotment for the planting of supported cotten due to his inability to plant cotton while the land was flooded. Since there in fact had been no reduction of the acreage in the year the loss was claimed, the loss was at best speculative and prospective.[43]

In *Leonard J. Jenard,*[44] involving the destruction of a taxpayer's residence by fire, the taxpayer claimed he was entitled to a loss deduction of $13,622.60 — an amount achieved by subtracting from the amount of the alleged difference in the fair market value of the residence before and after the fire ($32,000) the insurance recovery of $18,377.40. Although it was stipulated as a fact that a contractor engaged by the taxpayer restored the building to its condition immediately before the fire (at a cost of $23,782.47) the taxpayer, nevertheless, maintained that he suffered a loss by reason of the fire which was more than the cost of restoring the house to the condition it was in before the fire. This additional loss was based upon the argument that:

> [A] burned building suffers a loss in market value, over and above the cost of restoring it to its condition before the fire; . . . a loss of value results because a prospective buyer in the market for a house would, upon learning of the fire, fear that there may have been latent structural weaknesses caused by the fire which were not repaired; and, therefore, the very occurrence of the fire serves

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[43] Central Arizona Ranching Co., 23 CCH Tax Ct. Mem. 1304 (1964); J. G. Boswell Co., 34 T.C. 539 (1960), *aff'd* 302 F.2d 682 (9th Cir. 1962), *cert. denied* 371 U.S. 860 (1962).

[44] Leonard J. Jenard, 20 CCH Tax Ct. Mem. 346 (1961). See also Clarence A. Peterson, 30 T.C. 660 (1958), *appeal dismissed,* involving a claimed casualty loss arising from rainstorms. The Court noted:

> Each of petitioners' expert witnesses was of the opinion that immediately preceding the rainstorm here involved, the fair market value of the petitioner's property was equal to its cost to that time, or $87,053. One of the witnesses was of the opinion that the fair market value of the property immediately after the rainstorm was between $50,000 and $60,000 and the other thought such value was approximately $65,000. The foregoing opinions were based in part on the amount of physical damage to the property and in part on what the witnesses considered would have been an almost complete lack of prospective purchasers for or demand for the property. Neither of the witnesses stated the portion of the decline in value testified to by him which he attributed to physical damage or the portion which he attributed to lack of demand. Each of the witnesses expressed the opinion that petitioners' property has returned to the value it had immediately prior to the rainstorm and one of them was of the opinion that it had returned to that value by March 1954.
>
> From the foregoing we think it is apparent that petitioners in claiming a loss of $25,000 are not only seeking a deduction on account of the physical damage to the property but also are seeking a deduction for a fluctuation in the value of the property which they have continued to own and which they have continued to occupy as a residence since March 1, 1952.

to decrease the fair market value in an amount in excess of repair costs.

While the Tax Court did allow a deduction of $5,405.07 difference between the cost of repair ($23,782.47) and the insurance recovery ($18,377.40), it rejected any contention that a loss resulted from the prospect that potential purchasers might discount the value of the house because of the fire, stating:

> Ascertaining the fair market value before and after the fire is merely the tool used for measuring the extent of the casualty loss. When the property suffers a repairable loss, the loss is measured by the difference between the fair market value immediately befor the fire and the fair market value immediately after the fire in its partially damaged state. Obviously, the fair market value of such property in its damaged state amounts to no more than an estimate or determination of what it will cost to repair the damage and restore it to its former condition and subtracting that sum from the fair market value before the fire. Here that sum is stipulated and now allowed as the extent of petitioner's casualty loss. He is not entitled to more because the property must bear the stigma of having once been damaged by fire, and this fact alone might make prospective future purchaser wary of buying. Fair market value is determined by elements of value that inhere in the property and not the groundless fears of prospective buyers.
>
> A complete answer to petitioner's contention is found in that portion of the statute excluding losses covered by insurance. Clearly a taxpayer whose casualty damaged property is restored to its prior condition by insurance funds, suffers no deductible loss under the statute. And yet the full force of petitioner's argument here would mean that if he had insurance coverage that paid the entire repair bill for restoring the property to its former state, in the sum of $23,782.47, he would still have a casualty loss in the sum of $8,217.53. That the statute intended no deducation for a fully insured casualty loss is too clear for argument.

Based on the same theory the IRS, In *I.T. 1567*,[45] refused to allow a deduction because of a loss allegedly sustained through depreciation in the value of a residence situated adjacent to the sea on account of the action of the sea on such property during storms.

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[45] II-1 CUM. BULL. 90 (1923); See also Frank P. Kendall, 17 CCH Tax Ct. Mem. 809 (1958) (wherein the taxpayer claimed a casualty loss in the amount of the difference betwen what he believed the beach cottage was worth and the amount he received from its sale alleging that a storm in that year frightened away prospective purchasers). The Court in denying the loss stated:

> . . . even if we assume, *arguendo*, a loss in the fair market value of the property occurring in 1953, the record affirmatively indicates that such a loss in value was not the result of physical damage caused by a storm or storms in that year but was the result of fear on the part of prospective buyers of damages that might be sustained in future years as a result of storms, contemplated as possible and even probable, but which had not yet occurred and which might never occur. Obviously such a fear on the part of prospective buyers was not caused by a history of storm damages extending over a period of several, and probably many, years.

But cf. Bank of American Nat'l Tr. & Savings Ass'n Exr. v. United States 51-1 USTC ¶ 9110 (S.D. Calif. 1950).

The IRS noted that the taxpayer had not been compelled to spend any money in repairing the damage done by the storms and that it had not been necessary to move the residence on account of its exposure to the action of the sea and ruled that the alleged loss was only conjectural or indeterminable and did not represent a closed and completed transaction.

Similarly in *Citizens Bank of Weston v. Commissioner*,[46] the taxpayer was denied a casualty loss deduction for the value of basement storage space which the bank claimed had lost its usefulness due to the history of floods and the threat of future floods in the area. The court found that the flood had not materially altered the physical condition of the basement and that, although the bank officers had testified that the bank had permanently abandoned the basement, it still retained dominion over the basement and could, upon future reconsideration, again use the space.[47]

Finally, not only must there be an event which results directly in actual physical damage, but the damage must be to property belonging to the taxpayer. For example, a shareholder is not entitled to claim the casualty loss resulting to property owned by the corporation even though the shareholder is assessed by the corporation for the cost of repairs.[48] Nor is the taxpayer entitled to deduct as a casualty loss damages paid to another for injury to the other party's property or person unless the damage resulted from an accident arising in the course of business.[49] Thus, where the taxpayer is involved in an accident not arising in the course of business, he is entitled to claim only his damage as a casualty loss and he may

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[46] Citizens Bank of Weston v. Commissioner, 252 F.2d 425 (4th Cir. 1958), *affirming* 28 T.C. 717 (1957).

[47] The Court of Appeals recited the following with respect to the Tax Court's holding, Citizens Bank of Weston v. Commissioner, 252 F.2d 425, 427 (4th Cir. 1958):

> The Tax Court held that the fear of a future loss furnishes no basis for a current deduction; and even if such fear diminished the market value — a fact not found by the Tax Court — this would be a mere fluctuation, for which no deduction may be made until a loss is actually realized by the sale or other disposition of the property.

[48] West v. United States, 163 F. Supp. 739 (E.D. Pa. 1958), *aff'd* per curiam, 259 F.2d 704 (3rd Cir. 1958); Earl S. Orr, 19 CCH Tax Ct. Mem. 789 (1960); Estate of Myrtle P. Dodge, 20 CCH Tax Ct. Mem. 1811 (1961) (taxpayer sold the property in 1956 to one Link who apparently rented it to one Recupero who severely damaged the building and stole some of the fixtures; taxpayer discovered the abandonment in December 1957 but did not foreclose until sometime in 1958; *held*, taxpayer "offered no satisfactory evidence that he actually owned the premises in 1957." Thomas J. Draper, 15 T.C. 135 (1950) (parents not entitled to claim a casualty loss for the destruction by fire of clothing belonging to an adult daughter although the daughter was still being supported by the parents.).

[49] Stern v. Carey, 119 F. Supp. 488 (N.D. Ohio 1953); C. W. Stoll, CCH Tax Ct. Mem. 731 (1946); Luther Ely Smith, 3 T.C. 696 (1944) *acq.* this issue, 1944 CUM. BULL. 26 (amount paid to library for damage to book inadvertently left on a bus); B. M. Peyton, 10 B.T.A. 1129 (1928); Samuel E. Mulholland, 16 B.T.A. 1331 (1929); L. Oransky, 1 B.T.A. 1239 (1925). See, 4 CUM. BULL. 159 (1921) indicating that the costs expended in defending a damage suit are not deductible as a casualty loss.

not deduct any amount paid to the other party involved by way of settlement or on a judgment.

A life tenant is entitled to deduct the full amount of the casualty loss (not merely that portion of the loss theoretically attributable to the life interest) for injury to property subject to the life estate.[50] In a lease situation, the party bearing the risk of the loss is entitled to the deduction.[51] Thus, if the lessee is bound by a covenant in the lease to restore and replace the leased buildings if they are destroyed, or if he is required to surrender the property to the lessor upon expiration of the lease "in as good order and condition as reasonable use and wear thereof will permit," then the risk is upon the lessee and he will be allowed the deduction.[52] If, on the other hand, the lessee is under no obligation to repair the damage or to make replacements, then the lessee is not entitled to deduct the full amount of the loss. In this case, since the casualty loss affects the value of both the lessee's interest and the lessor's reversion, the loss must be apportioned between them.[53] Similarly, a taxpayer committed to bear the risk of loss by a contract to purchase property is entitled to the casualty loss deduction.[54]

IV. Amount of Casualty Loss

A. *Introduction*

The discussion which follows sets forth the rules applicable to computing the amount of the loss. As in the preponderance of tax matters, the amount of loss is a question of proof. In short, a taxpayer seeking a casualty loss deduction must establish three facts: (1) that he suffered a loss, (2) the amount of the loss,[55] and (3) that his loss was caused by a "casualty."

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[50] Bliss v. Commissioner, 256 F.2d 533 (2nd Cir. 1958), 27 T.C. 770 (1957); Lena L. Steinert, 33 T.C. 447 (1959), *acq.* 1960-1 CUM. BULL. 6; INT. REV. CODE of 1954 § 611(b)(2).

[51] See generally, Camp Wolters Land Co. v. Commissioner, 160 F.2d 84 (5th Cir. 1947), *reversing* on this issue, 5 T.C. 336 (1945), *acq.* 1945 CUM. BULL. 2.

[52] I.T. 2150, IV-1 CUM. BULL. 147 (1925); I.T. 3850, 1947-1 CUM. BULL. 20.

[53] Bonney v. Commissioner, 247 F.2d 237 (2nd Cir. 1957), *affirming* 24 T.C. 199 (1955), *acq.* 1956-2 CUM. BULL. 5, *cert. denied* 355 U.S. 923 (1957).

[54] Collins v. United States, 193 F. Supp. 602 (D. Mass. 1961), *aff'd and rev'd on other grounds,* 300 F.2d 821 (1st Cir. 1962), 303 F.2d 142 (1st Cir. 1962).

[55] Buttram v. Jones, 87 F. Supp. 322 (W.D. Okla. 1943); Leonard P. Tomlinson, 22 CCH Tax Ct. Mem. 662 (1963) (auto accident, taxpayer only produced a check issued for auto body work which was in an amount less than the claimed loss and was dated prior to the date of the accident); William S. Herreshoff, 22 CCH Tax Ct. Mem. 667 (1963); Jane U. Elliott, 40 T.C. 304 (1963), *acq.* 1964-2 CUM. BULL. 5; Maude T. Fearing, 21 CCH Tax Ct. Mem. 800 (1962), *aff'd on other grounds,* 315 F.2d 495 (8th Cir. 1963); Oceanic Apartments, Inc., 13 CCH Tax Ct. Mem. 944 (1954); Estate of R. D. McDaniel, 20 CCH Tax Ct. Mem. 1551 (1961); Benjamin J. Checkoway, 19 CCH Tax Ct. Mem. 1174 (1960); Paul E. Jackson, 13 CCH Tax Ct. Mem. 1175 (1954); Clarence E. Stewart, 12 CCH Tax Ct. Mem. 921 (1953); Philip Allen, 1 CCH Tax Ct. Mem. 14 (1942).

The Tax Guide For Small Business[56] gives the following summary of the proof necessary to substantiate the loss deduction:

> Proof of Casualty Loss. A deduction is allowed only for damages to or losses of property owned by you. You must substantiate the amount of any casualty loss. You should be prepared to submit evidence when it occurred:
>
> 1. Nature of casualty and when it occurred;
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> 2. Loss was the direct result of the casualty;
>
> 3. That you were the owner of the property at the time of the loss;
>
> 4. Cost of other adjusted basis of the property, supported by purchase contract, checks, receipts, etc.;
>
> 5. Depreciation allowed or allowable, if any;
>
> 6. Values before and after casualty (pictures and appraisals before and after the casualty are pertinent evidence); and
>
> 7. The amount of insurance or other compensation received, including the value of repairs, restoration, and cleanup provided without cost of relief agencies.

In outline form, the following are the elements of proof necessary to demonstrate qualification for a casualty loss deduction:

(a) An identifiable event which reflects the constituent elements of a casualty, viz., the sudden, unexpected, or unusual nature of the event;[57] the year in which the event occurred,[58] and if the event itself merely opened the loss transaction, the year in which the loss transaction was closed should also be included;[59] and finally, the causal connection between the event and injury.[60]

(b) Taxpayer is the person or entity entitled to claim the loss.[61]

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[56] INTERNAL REVENUE SERVICE, U.S. DEP'T OF TREASURY, PUB. NO. 334, TAX GUIDE FOR SMALL BUSINESS, p. 93 (1965).

[57] See cases cited at note 40, *supra.*

[58] Jane U. Elliott, 40 T.C. 304 (1963), *acq.* 1964-2 CUM. BULL. 5; Paul E. Jackson, 13 CCH Tax Ct. Mem. 1175 (1954).

[59] United States v. Barret, 202 F.2d 804 (5th Cir. 1953); Nourse v. Birmingham, 73 F. Supp. 70 (S.D. Iowa 1947); Williard T. Burkett, 10 CCH Tax Ct. Mem. 948 (1951).

[60] Rev. Rul. 59-102, 1959-1 CUM. BULL. 200. A mere showing that the identifiable event present in your case is similar to that approved in other cases as a "casualty," does not necessarily establish the existence of a "casualty" in your case. *Compare* O.D. 1076, 5 CUM. BULL. 138 (1921), *with* Samuel Greenbaum, 8 B.T.A. 75 (1927), the former allowing a loss arising from the freezing and bursting of water pipes; the latter disallowing the loss.

[61] The person or persons entitled to deduct the loss is determined by how title to the property is held. For example, if the property is held by a husband and wife as tenants by the entirety, and separate returns are filed, each spouse is entitled to deduct one-half the loss. Gilbert J. Krause, 10 CCH Tax Ct. Mem. 1071 (1951). *But see* I.T. 3304, 1939-2 CUM. BULL. 158 holding that although the property was held as tenants by the entirety, if the husband defrayed all the expenses in repairing the property, the husband was entitled to claim the full loss, assuming, of course, that, if he claimed the entire deduction, his wife does not attempt to claim any deduction on her return.

(c) A description of the property sufficient to establish that it is the property which sustained the injury.[62]

(d) The cost or adjusted basis of the property.[63]

(e) The fair market value of the property immediately before and after the casualty event.[64]

(f) The amount of salvage value,[65] insurance proceeds or other compensation recovered.[66]

Failure to establish salvage value and/or the amount of the insurance recovery, if any, or particularly that there was no insurance recovery is a common failure.[67] This blunder in the handling of the case may be one which cannot be corrected.[68]

B. *Business Property*

(a) Amount of Loss

In the case of property used in a trade or business or held for the production of income, the amount of the loss arising from partial injury or destruction of the property is the LESSER of either (1) the difference in the fair market value of the property immediately preceding and immediately after the casualty event; or (2) the amount of the adjusted basis for determining the loss from the sale

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[62] David W. Murray, Jr., 21 CCH Tax Ct. Mem. 7 (1962); Benjamin J. Checkoway, 19 CCH Tax Ct. Mem. 1174 (1960); Richard E. Stein, 14 CCH Tax Ct. Mem. 191 (1955); Gilbert J. Kraus, 10 CCH Tax Ct. Mem. 1071 (1951); Isabelle B. Krome, 9 CCH Tax Ct. Mem. 178 (1950); Benard L. Shackleford, 7 CCH Tax Ct. Mem. 694 (1948); Greenwood Packing Plant, 46 B.T.A. 430 (1942), *acq.* 1942-1 CUM. BULL. 8, *rev'd on other grounds,* 131 F.2d 787 (4th Cir. 1942).

[63] Including date of acquisition and if appropriate, the allocation of basis if the property destroyed or damaged is comprised of several types of property. Philip Handelman, 20 CCH Tax Ct. Mem. 878 (1961); Melvin Mailloux, 20 CCH Tax Ct. Mem. 942 (1961), *rev'd on other grounds,* 320 F.2d 60 (5th Cir. 1963); Benjamin J. Checkoway, 19 CCH Tax Ct. Mem. 1174 (1960); Virgil R. Williams, 19 CCH Tax Ct. Mem. 106 (1960) (allocation); John W. Snyder, 14 CCH Tax Ct. Mem. 1218 (1955); Paul E. Jackson, 13 CCH Tax Ct. Mem. 1175 (1954); Nat Lewis, 13 CCH Tax Ct. Mem. 1167 (1954).

[64] Schirmer v. United States, 59-2 USTC ¶ 9572 (N.D. Calif. 1959); Samuel Abrams, 23 CCH Tax Ct. Mem. 1546 (1964); William S. Herreshoff, 22 CCH Tax Ct. Mem. 667 (1963); Maude T. Fearing, 21 CCH Tax Ct. Mem. 800 (1962), *aff'd on other grounds,* 315 F.2d 495 (8th Cir. 1963); Isabelle B. Krome, 9 CCH Tax Ct. Mem. 178 (1950).

[65] Except where salvage value is used to determine the market value immediately after the fire, or other casualty.

[66] Hubinger v. Commissioner, 36 F.2d 724 (2d Cir. 1929), *affirming* 13 B.T.A. 960 (1928), *cert. denied* 281 U.S. 741 (1929); Ferst v. Edwards, Adm'r, 129 F. Supp. 606 (D. Ga. 1955); John W. Snyder, 14 CCH Tax Ct. Mem. 1218 (1955); I.T. 4032, 1950-2 CUM. BULL. 21; Treas. Reg. § 1.165-1(c) (1960).

[67] *E.g.,* Philip Handelman, 20 CCH Tax Ct. Mem. 878 (1961); Emanuel Hollman, 38 T.C. 251 (1962).

[68] *See,* Goodman v. Commissioner, 200 F.2d 681 (2nd Cir. 1953), affirming the Tax Court's denial of a motion for rehearing filed because the taxpayer, claiming medical expenses, neglected to show that such expenses were "not compensated for by insurance or otherwise."

or other disposition of the property involved.[69] The amount thus determined is then adjusted ". . . for any insurance or other compensation received."[70]

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[69] Treas. Reg. § 1.165-7(b)(1) (1960); INTERNAL REVENUE SERVICE, U.S. DEP'T OF TREASURY, DOC. NO. 5174, DISASTERS, CASUALTIES, AND THEFTS, p. 7 (March 1964). Practically speaking the adjusted basis of the property is the measure of the loss, *see* United States v. Koshland, 208 F.2d 636 (9th Cir. 1953), Frank R. Hinman, 12 CCH Tax Ct. Mem. 1347 (1953); and, if there is no cost basis, there is no deduction, Belcher v. Patterson, 1960-2 USTC ¶ 9733 (N.D. Ala. 1960). Unfortunately, the regulations are silent on what is meant by "immediately" after the casualty event. Obviously the property has no value when the flood waters are washing through the premises, or the building is in the grip of the conflagration. Is the value measured when the flood subsides or the embers cool? The question is in a sense academic since the statute is aimed at "permanent" loss in value (*see* Jenard, *supra* note 44 and Citizens Bank of Weston, *supra* note 46. Presumably the practical approach would be to consider the property's worth immediately after the event (when the fire burned out, the flood subsided, etc.) which in all likelihood is salvage or residual value (depending, of course, on how severely the casualty affected the property) and then discount that loss of value for factors which would occur or are likely to occur within a "reasonable" time after the casualty event. The taxpayer, of course, is allowed a deduction for his clean-up expense, either as a separate item (ordinary business expense) or as part of his decrease in value, so that this is not a major consideration. It is, of course, difficult to foretell what events are likely to occur and to measure or fix a "reasonable" time. Nonetheless, it would appear that "immediately after" value should take into consideration what the property will sell for after the property is repaired, the debris removed, the damage assessed or clearly marked for the buyer to see (so that the buyer can determine how much he would discount the purchase price in order to pay for the rebuilding) and after the immediate shock has worn off in the public's mind. This approach is not based on the casualty loss regulations but is suggested by the general approach to value found in the Code. For example, Treas. Reg. § 20.2031-1(b), speaking to the general valuation rules, states: "The fair market value of a particular item of property includible in the decedent's gross estate is not to be determined by a *forced sale* price." (emphasis added), and Treas. Reg. § 20.2031-2(e), concerning the valuation of stock, states: "If the executor can show that the block of stock to be valued is so large in relation to the actual sales on the existing market that it could not be liquidated in a *reasonable time* without depressing the market, the price at which the block could be sold as such outside the usual market . . . may be a more accurate indication of value than market quotations." (emphasis added). These regulations indicate that as a practical matter the IRS will not accept as the loss in value the amount determined at the height of the casualty event. *See* J. G. Boswell Co., *supra* note 43.

[70] Treas. Reg. § 1.165-1(c) (1960); INTERNAL REVENUE SERVICE, U.S. DEP'T OF TREASURY, DOC. NO. 5174, DISASTERS, CASUALTIES AND THEFTS, p. 7 (March 1964), *and see, e.g.,* Miree v. United States, 1962-2 USTC ¶ 9756 (N.D. Ala. 1962); Ticket Office Equipment Co., 20 T.C. 272 (1953), *acq.* 1953-2 CUM. BULL. 6, *aff'd per curiam on other grounds,* 213 F.2d 318 (2nd Cir. 1954); Gilbert J. Kraus, 10 CCH Tax Ct. Mem. 1071 (1951). Salvage value is used only in a complete destruction situation wherein the adjusted basis alone is used as the measure of the loss. In other words if the difference in market values is used to determine the amount of loss, then salvage value is a part of the "after" value of the property and is not again deducted from the difference and this is so even if the adjusted basis is lower, all that is allowable as a deduction is the amount of the basis. For example, if the fair market value of an item is $1,000, the basis $900, and salvage value of "after" casualty value is $50, the economic loss is $950, but because the amount deductible is the "lesser" amount between market values and basis, only $900 is deductible. Salvage value of $50 is *not* again deducted from the $900 to reduce the loss to $850, Sears v. United States, 59-1 USTC ¶ 9302 (N.D. Ohio 1959). Salvage value, of course, remains an element of proof to establish the loss. Hubinger v. Commissioner, 36 F.2d 724 (2nd Cir. 1929), *affirming* 13 B.T.A. 960 (1928), *cert. denied* 281 U.S. 741 (1929); Frances L. Davis, 9 CCH Tax Ct. Mem. 306 (1950).

If the property is totally destroyed, and if the fair market value of such property immediately before the casualty is less than the adjusted basis of such property, the amount of the adjusted basis of such property is treated as the amount of the loss.[71] The amount deductible, of course, is decreased by salvage value, insurance, or other recovery.[72]

An example demonstrating the computation of the allowable loss deduction where the property is completely destroyed, is as follows:[73]

> *Example*: You owned a building used in your business which had an adjusted (depreciated) basis of $20,000, exclusive of land, at the time it was completely destroyed by a hurricane. Its fair market value just before the hurricane was only $15,000. Since this was business property, and since it was completely destroyed, your deductible loss is your adjusted basis of $20,000, decreased by salvage value, insurance, or other recovery.

(b) "Single Property" Rule

A loss incurred in a trade or business or in any transaction entered into for profit is determined under the rules set forth in paragraph (a) above by reference to the single identifiable property damaged or destroyed.[74] The regulations give this example:

> Thus, for example, in determining the fair market value of the property before and after the casualty in a case where damage by casualty has occurred to a building and ornamental or fruit trees used in a trade or business, the decrease in value shall be measured by taking the building and trees into account separately, and not together as an integral part of the realty, and separate losses shall be determined for such building and trees.[75]

Another example is *United States v. Koshland*,[76] involving these

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[71] Treas. Reg. § 1.165-7(b)(1) (1960) as amended, T.D. 6786, 1965-1 CUM. BULL. 107; INTERNAL REVENUE SERVICE, U.S. DEP'T OF TREASURY, DOC. NO. 5174, DISASTERS, CASUALTIES AND THEFTS, p. 7 (March 1964).

[72] Treas. Reg. § 1.165-1(c) (1960); I.T. 4032, 1950-2 CUM. BULL. 21. Salvage value in this situation must be deducted in computing the amount of the loss since it has not yet been considered in the computation. Insurance "or other recovery" includes replacement property, etc., as well as cash. For example, in Ray Durden, 3 T.C. 1 (1944), *acq.* 1944 CUM. BULL. 8, to arrive at the deduction, the court subtracted the insurance proceeds and the value of the driveway laid down by the county in settlement of damage caused to the taxpayer's house by blasting. Obviously, if the taxpayer has made up the loss by repairs the cost of which were deducted as business expenses, he is not entitled to a casualty loss deduction. J. G. Boswell Co., 34 T.C. 539 (1960), *aff'd* 302 F.2d 682 (9th Cir. 1962), *cert. denied* 371 U.S. 860 (1962); Central Arizona Ranching Co., 23 CCH Tax Ct. Mem. 1304 (1964).

[73] INTERNAL REVENUE SERVICE, U.S. DEP'T OF TREASURY, DOC. NO. 5174, DISASTERS, CASUALTIES AND THEFTS, p. 7 (March 1964).

[74] Treas. Reg. § 1.165-7(b)(2) (1960); United States v. Koshland, 208 F.2d 636 (9th Cir. 1953). The "single property" rule raises the importance of a proper allocation of purchase price among various properties acquired in a single transaction. See, *e.g.*, Virgil R. Williams, 19 CCH Tax Ct. Mem. 106 (1960); Stanley Kupiszewski, 23 CCH Tax Ct. Mem. 1559 (1964).

[75] Treas. Reg. § 1.165-7(b)(2) (1960).

[76] 208 F.2d 636 (9th Cir. 1953).

facts: Taxpayer and her husband purchased a hotel in 1925 for the sum of $185,000 plus accrued real property taxes. For depreciation purposes, $53,000 was allocated to the building. By 1946, taxpayer had been allowed a total of $52,684 as depreciation for the hotel building and had made improvements of $2,092.16. On May 20, 1946, the hotel building was destroyed by fire. The taxpayer received proceeds of the fire incurance policies on the hotel property in the amount of $45,000. In December 1946, she sold the land, in the condition it had been left by the fire, for $50,000. The taxpayer claimed that, under section 165 she sustained a deductible fire loss of $43,166 in 1946, this being the difference between the adjusted basis of the land and building at the time of the fire ($138,166) and the sum of the market value of the property after the fire ($50,000) and the insurance proceeds ($45,000). The court, relying upon the "single property" rule, held that the "property" destroyed in this case was the hotel building and since at the time of the fire the building had an adjusted basis of $1,408, the insurance proceeds ($45,000) more than compensated for the loss.[77]

An example demonstrating the computation of the allowable loss deduction under the "single property" rule, is as follows:[78]

> *Example (2)*: In 1958 A purchases land containing an office building for the lump sum of $90,000. The purchase price is allocated between the land ($18,000) and the building ($72,000) for purposes of determining basis. After the purchase A planted trees and ornamental shrubs on the grounds surrounding the building. In 1961 the land, building, trees, and shrubs are damaged by hurricane. At the time of the casualty the adjusted basis of the land is $18,000 and the adjusted basis of the building is $66,000. At that time the trees and shrubs have an adjusted basis of $1,200. The fair market value of the land and building immediately before the casulty is $18,000 and $70,000, respectively, and immediately after the casulty is $18,000 and $52,000 respectively. The fair market value of the trees and shrubs imme-- diately before the casualty is $2,000 and immediately after the casualty is $400. In 1961 subject to section 1231 and §1.1231-1. The amount of the deduction allowable under section 165(a) with respect to the building for the taxable year 1961 is $13,000, computed as follows:
>
> | | |
> |---|---|
> | Value of property immediately before casualty ..... | $70,000 |
> | Less: Value of property immdeiately after casualty ..... | 52,000 |
> | Value of property actually destroyed ..... | 18,000 |

[77] The facts set forth in the *Koshland* case indicate that the taxpayer might have had a gain. To the extent that insurance proceeds or other compensation, exceeds the depreciated cost or other adjusted basis of the property destroyed or damaged, the difference is a gain from an involuntary conversion. INT. REV. CODE of 1954 §§ 1033, 1245 and 1250.

[78] Treas. Reg. § 1.165-7(b)(3) (1960), *Example (2)*.

Loss to be taken into account for purposes of section 165(a):	
Lessor amount of property actually destroyed ($18,000) or adjusted basis of property ($66,000)	$18,000
Less: Insurance received	5,000
Deduction allowable	13,000

The amount of the deduction allowable under section 165(a) with respect to the trees and shrubs for the taxable year 1961 is $1,200, computed as follows:

Value of property immediately before casualty	$ 2,000
Less: Value of property immediately after casualty	400
Value of property actually destroyed	1,600
Loss to be taken into account for purposes of section 165(a) Lessor amount of property actually destroyed ($1,600) or adjusted basis of property ($1,200)	1,200

Prior to the adoption of the final version of Treasury Regulation § 1.165-7(b)(2), the loss in a partial loss situation was ". . . the proportion of the adjusted basis determined under section 1011 which the value of the destroyed property bears to the value of the entire property, reduced by any insurance or other compensation received in respect of the property."[79] Proposd Treasury Regulation § 1.165-3(c)(1) gives the following example of the computation:

> *Example.* A purchased an automobile for $4,200 on January 1, 1955, and at once devoted it to business use. The expected life of the automobile was 6 years. On January 1, 1957, the automobile sustained damages through casualty. The value of the automobile immediately before the casualty was $2,000. The value of the automobile immediately after the casualty is $1,500. A is compensated by insurance in the amount of $300. The amount of the allowable deduction to A is $400 (loss of $700 less insurance of $300), computed as follows:

Cost	$4,200
Less: Depreciation for 1955 and 1956 at $700 per year	1,400
Adjusted basis at time of casualty	2,800
Value before casualty	2,000
Value after casualty	1,500
Value of destroyed property	500
Allowable loss $\frac{(\ 500\ )}{(\$2,000)} \times \$2,800$	700
Less: Insurance received	300
Allowable deduction	$ 400

The above stated method of computing the amount of the loss has the sanction of several court decisions[80] although it was ques-

[79] Proposed Treas. Reg. § 1.165-3 (c)(1), 21 Fed. Reg. 4925 (1956).

[80] G.C.M. 6122, VIII-2 CUM. BULL. 115 (1929); Fred Fazer, 10 B.T.A. 409 (1928); Bessie Knapp, 23 T.C. 716 (1955).

tioned in *Alcoma Association, Inc. v. United States.*[81] It may still have some validity in rare situations where the taxpayer is unable to allocate any basis to the separate properties acquired for a single purchase price. It should be noted that the former rule gives a higher deduction than that afforded by the rule applicable under the final regulations (lesser of market value or adjusted basis) where the adjusted basis of the asset is in excess of its market value before the casualty.[82]

(c) Inventory

The *Tax Guide for Small Business* (1964),[83] p. 83, sets forth the following rules for the treating of casualty losses with respect to inventory.[84]

> LOSS OF INVENTORY. The manner of reporting your casualty or theft loss of inventory or items held for sale to customers will depend upon whether you have received or will recover any part of your loss from insurance or other reimbursement. If no recovery or other reimbursement is anticipated, the loss will be automatically reflected in cost of goods sold where your opening and closing inventories are properly reported. This loss should not be claimed again as a casualty loss. If you wish to show the loss separately, an offsetting credit either to opening inventory or to purchases is required.
>
> Insurance proceeds received in the year of the loss must be included in gross income if you reflect the loss in closing inventory. However, the recovery should not be included in gross income if you show the loss separately and offset the insurance against the loss. The insurance must be accounted for in your return. If the insurance is not received by the end of the year, you must remove the amount of the loss from cost of goods sold.
>
> Should your creditors forgive, in the year of the loss, part of what you owe them because of your inventory loss, such amounts must be taken into account as income, or you must make appropriate adjustments to your cost of goods sold.
>
> If suppliers replace damaged or destroyed inventory items in the year of loss at no cost to you, no adjustments should be made.

(d) Converted Property

In the case of property which originally was not used in a trade or business or held for income-producing purposes and which

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[81] 239 F.2d 365 (5th Cir. 1956).

[82] See, *e.g.*, Barry v. United States, 175 F. Supp. 308 (W.D. Okla. 1958). *Cf.* Frank R. Hinman, 12 CCH Tax Ct. Mem. 1347 (1953).

[83] INTERNAL REVENUE SERVICE, U.S. DEP'T OF TREASURY, PUB. NO. 334, p. 83 (1964).

[84] See also Treas. Reg. § 1.165-7(a)(4) (1960); INTERNAL REVENUE SERVICE, U.S. DEP'T OF TREASURY, DOC. NO. 5174, DISASTERS, CASUALTIES AND THEFTS, p. 7 (March 1964). *But see,* Ticket Office Equipment Co., 20 T.C. 272 (1953), *acq.* 1953-2 CUM. BULL. 6, *aff'd* per curiam *on other grounds,* 213 F.2d 318 (2nd Cir. 1954); Lorraine Turpentine Co., 20 B.T.A. 423 (1930), *acq.* this issue, X-1 CUM. BULL. 39 (1931).

12.	Loss sustained on furnishings (lesser of 10 or 11)	$ 500
13.	Less: estimated insurance recovery	None
14.	Casualty loss on furnishings	$ 500
15.	Total loss (7 plus 14)	$4,500
16.	Less $100 reduction	100
17.	Casualty loss deduction	$4,400

(i) *"From Each Casualty"*

Congress has indicated that the determination of whether the loss arises from a single or multiple casualty is to be liberally made[92] in favor of a single casualty. Events closely related in origin generally give rise to a single casualty.[93] Examples illustrating the determination of whether the incident gave rise to a single event include the following:[94]

> *Example 1.* Thieves broke into your home in January 1964 and stole a diamond ring and a fur coat. You sustained a loss of $150 on the ring and $200 on the coat. This is a single theft, and the $100 limitation is applied to the total amount of your loss of $350. Your deductible loss from the theft is the excess over $100, or $250.
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> *Example 2.* Your family car was damaged in an accident in January 1964 and the amount of your loss, after insurance recovery, was $75. In February 1964 your car was damaged in another accident and this time your loss after insurance recovery was $90. The $100 limitation must be applied to each separate casualty loss, and since neither accident resulted in a loss of over $100, you are not entitled to any deduction for these accidents.
>
> *Example 3.* In March 1964 hurricane winds blew the roof from your residence and caused flood waters that further damaged your house and demolished your furniture and personal automobile. This is considered to be a single casualty and the $100 limitation is applied against the total loss sustained as the result of the wind and flood waters. You do not have to compute separately the amount of loss caused by the wind and the amount caused by the water, nor do you compute separately the loss sustained on your house, your furniture, and your automobile in applying the $100 limitation.

Individual taxpayers other than husband and wife are subject to a separate $100 floor with respect to each casualty, even though property of other persons is damaged in connection with the same event.[95] For example, if fire damages a house and household goods of the owner, as well as the property of a visiting relative which

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[92] H.R. Rep. No. 749, 88th Cong., 1st Sess., p. A46 (1963); *See,* Treas. Reg. § 1.165-7(b)(4)(ii) (1960), as amended, T.D. 6786, 1965-1 CUM. BULL. 107.

[93] *Ibid.*

[94] INTERNAL REVENUE SERVICE, U.S. DEP'T OF TREASURY, DOC. NO. 5174, DISASTERS, CASUALTIES AND THEFTS, p. 5 (March 1964). Example 3 as quoted in the text is based on the example given in H.R. Rep. No. 749, *supra* note 92, at A46.

[95] Treas. Reg. § 1.165-7(b)(4)(iii) (1960), as amended, T.D. 6786, 1965-1 CUM. BULL. 107; H.R. Rep. No. 749, *supra* note 92, at A46.

is in the same house, the owner is subject to one $100 floor and the visiting relative is subject to a separate $100 floor.[96]

(ii) *Jointly Owned Property — Joint Returns*

As indicated above, where two or more individuals (other than husband and wife) suffer losses from the same casualty, the $100 reduction is applied separately to each and this is so whether or not the property is held jointly or in some other form of common ownership.[97] For example, if two brothers jointly own a house in which both live, and a fire destroys the house, each brother would be entitled to one-half of the loss and each would be required to apply a separate $100 reduction to his share of the loss.

For purposes of applying the $100 floor, a husband and wife filing a joint return for the taxable year in which the loss is allowed as a deduction are treated as one individual. If a husband and wife file a joint return, only one $100 floor applies for each casualty regardless of whether the loss is sustained with respect to jointly owned or separately owned property. If a husband and wife file separate returns, each is subject to a $100 floor for each casualty, regardless of whether the property damaged is owned jointly or separately.[98] For example, if a loss from fire to their personal residence is sustained by a husband and wife who own their home jointly, a single $100 reduction is applied to such loss in determining the amount deductible on their joint return. However, if they file separate returns, the loss must be split equally between them and each must apply a separate reduction of $100 to his or her share of that loss.[99]

(iii) *Floor Applies in Year of Deduction*

The $100 — deductible rule applies to all losses sustained after December 31, 1963, in taxable years ending after that date.[100] Thus, the rule applies if the loss occurred in 1964 even though under Int. Rev. Code of 1954 § 165 (h) the taxpayer deducted the loss on his 1963 return.[101] The IRS has indicated, however, that

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[96] See, *ibid.*

[97] Treas. Reg. § 1.165-7(b)(4)(iii) (1960), as amended, T.D. 6786, 1965-1 CUM. BULL. 107; INTERNAL REVENUE SERVICE, U.S. DEP'T OF TREASURY, DOC. NO. 5174, DISASTERS, CASUALTIES AND THEFTS, p. 6 (March 1964).

[98] Treas. Reg. § 1.165-7(b)(4)(iii) (1960), as amended, T.D. 6786, 1965-1 CUM. BULL. 107; H.R. Rep. No. 749, *supra* note 92, at A46.

[99] INTERNAL REVENUE SERVICE, U.S. DEP'T OF TREASURY, DOC. NO. 5174, DISASTERS, CASUALTIES AND THEFTS, p. 6 (March 1964).

[100] Treas. Reg. § 1.165-7(b)(4)(i) (1960), as amended, T.D. 6786, 1965-1 CUM. BULL. 107.

[101] *Ibid.*; INTERNAL REVENUE SERVICE, U.S. DEP'T OF TREASURY, DOC. NO. 5174, DISASTERS, CASUALTIES AND THEFTS, p. 6 (March 1964).

even if the casualty event occurred in 1963 or prior years, but the loss could not be claimed because of an expectation of reimbursement or recovery, the $100 reduction applies to any part of the loss deducted in years after December 31, 1963.[102] The theory being that the loss is not actually sustained until the prospect of recovery is ended.

(iv) *Property Used Partly in Business*

In the case of a casualty loss of property used partially for business and partially for personal purposes, the $100 floor applies only to the net loss attributable to the portion of the property used for personal purposes. For example, if a casualty causes damage in the amount of $1000 to a taxpayer's automobile having an adjusted basis of $2000, which is used 50 percent for business and 50 percent for personal purposes, and the taxpayer's insurance recovery with respect to the casualty is $900, the taxpayer has a net loss of $100. Fifty percent of this loss, or $50, is considered a business loss, and is fully deductible. The remaining $50 of loss is personal, and is nondeductible because of the $100 floor.[103]

(c) Agregation Rule

In determining the amount of a casualty loss involving real property and improvements thereon not used in a trade or business or in any transaction entered into for profit, the improvements (such as buildings and landscaping) to the property damaged or destroyed are considered an integral part of the property and no separate basis need be apportioned to such improvements.[104]

(d) Reimbursement in Later Year

If the taxpayer is reimbursed for his loss (assuming that the prospect of recovery in the year of the casualty event did not warrant postponing the deduction) in a year or years after the loss had been deducted, the recovery is included in income in the later year under the rules provided in Internal Revenue Code of 1954 § 111.[105]

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[102] INTERNAL REVENUE SERVICE, U.S. DEP'T OF TREASURY, DOC. NO. 5174, DISASTERS, CASUALTIES AND THEFTS, p. 6 (March 1964).

[103] Treas. Reg. § 1.165-7(b)(4)(iv) (1960), as amended, T.D. 6786, 1965-1 CUM. BULL. 107.

[104] Buttram v. Jones, 87 F. Supp. 322 (W.D. Okla. 1943); Louis A. Edwards, 19 CCH Tax Ct. Mem. 925 (1960); Dick H. Woods, 19 CCH Tax Ct. Mem. 388 (1960); William O. Lindley, 11 CCH Tax Ct. Mem. 355 (1952); Western Products Co., 28 T.C. 1196 (1957), *acq.* 1958-1 CUM. BULL. 6; G.C.M. 21013, 1939-1 CUM. BULL. 101; Treas. Reg. § 1.165-7(b)(2)(ii) (1960), as amended, T.D. 6786, 1965-1 CUM. BULL. 107; Treas. Reg. § 1.165-7(b)(3) (1960), *Example 3.*

[105] INTERNAL REVENUE SERVICE, U.S. DEP'T OF TREASURY, PUB. NO. 334, TAX GUIDE FOR SMALL BUSINESS, p. 83 (1964); Treas. Reg. § 1.111-1(a)(1) (1956).

V. MEASURE OF DAMAGES

A. *Introduction*

As indicated above, the major factor in determining the amount of the casualty loss is the amount by which the asset has decreased in value, i.e., in general terms, the decrease in relative market values.[106] Obviously, this calls for a demonstration of the decrease or, in other words, proof of the loss by the application of acceptable standards for measuring the damages. To achieve the desired result, the taxpayer must adopt a method of valuation.

The regulations issued pursuant to section 165 seemingly indicate that there are two equally acceptable methods of reflecting the amount of loss, first, appraisals and, secondly, cost of repairs and replacements.[107] The taxpayer, however, must not be misled and lose sight of the theory involved, viz., the loss is measured by the difference in *market values* of the asset before and after the casualty event.[108] Hence, proof of the cost of repairs is not sufficent to show the amount of loss absent evidence clearly demonstrating that the cost of repairs is indicative and corroborative of the difference in market values.[109] This principle is illustrated by the fact that the taxpayer is entitled to deduct the amount of his loss (the difference in market values) irrespective of whether this amount exceeds or is less than the cost of repairs.[110] The taxpayer should not forget that a sale of the property after the casualty, though not essential to reflect the loss, is one of the best indications of the amount of the loss, and, for example, if the asset is sold for a price equal to or more than adjusted basis (if higher) or market value of the property before the casualty, taxpayer has no loss regardless of the testimony of his appraisers and the cost of repairs.[111] Finally, the taxpayer, in proving his case, must keep in mind the type of property involved (business or nonbusiness) and whether the "separate property" or aggregation rules apply. Thus, if the aggregation rule

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[106] See Helvering v. Owens, 305 U.S. 468 (1939).

[107] Treas. Reg. § 1.165-7(a)(2) (1960).

[108] Helvering v. Owens, *supra* note 106.

[109] Hubinger v. Commissioner, 36 F.2d 724 (2nd Cir. 1929) *affirming* 13 B.T.A. 960 (1928), *cert. denied* 281 U.S. 741 (1929); Paul E. Jackson, 13 CCH Tax Ct. Mem. 1175 (1954); Robert H. Montgomery, 6 CCH Tax Ct. Mem. 77 (1947); Ray Durden, 3 T.C. 1 (1944), *acq.* 1944 CUM. BULL. 8; George B. Friend, 8 B.T.A. 712 (1927), *acq.* VII-2 CUM. BULL. 14 (1928). *But cf.* Clarence E. Stewart, 12 CCH Tax Ct. Mem. 921 (1953).

[110] A.R.R. 4725, III-1 CUM. BULL. 143 (1924); Miree v. United States, 62-2 USTC ¶ 9756 (N.D. Ala. 1962); Graham M. Brush, 21 CCH Tax Ct. Mem. 649 (1962). *But cf.* Clapp v. Commissioner, 321 F.2d 12 (9th Cir. 1963), *affirming* 36 T.C. 905 (1961). Taxpayers are well advised to consider appraisals as the major element of proof since the difference in market values may in some instances exceed repairs.

[111] *E.g.*, Dick H. Woods, 19 CCH Tax Ct. Mem. 388 (1960).

is thereafter converted to either of these uses, the loss is treated in the same way as the loss from any other business property, except that if the fair market value of the property on the date of conversion is less than the adjusted basis of the property at that time, the fair market value is used as the basis for determining the amount of loss.[85] Where the property is held partly for nonbusiness purposes and partly for business purposes or for the production of income, the casualty loss deduction must be computed as though two separate pieces of property were involved — one business and the other personal.[86]

C. *Nonbusiness Property*

(a) Amount of Loss

In the case of nonbusiness property, I.T. 4032,[87] sets forth the following rule:

> It is held that the amount of loss which is deductible . . . in the case of depreciable nonbusiness property, is the difference between the value of the property immediately preceding the casualty and its value (including salvage value) immediately after the casualty, but not in excess of an amount equal to the adjusted basis of the property, reduced by any insurance or compensation received. In other words, the amount of insurance or other compensation received must be applied to the amount of the loss otherwise determined, whether measured by the difference between the value of the property immediately before and immediately after the casualty, or limited to the adjusted basis of the property . . . .

This is the same rule applicable to business property except that it does not include the business property provision dealing with the total destruction of the asset.[88]

An example demonstrating the computation of the allowable loss deduction in a situation where nonbusiness property is partially destroyed is as follows:[89]

Example (1). In 1956 B purchases for $3,600 an automobile

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[85] Treas. Reg. § 1.165-7(a)(5) (1960) as amended T.D. 6712, 1964-1 (Part 1) CUM. BULL. 107; Treas. Reg. § 1.165-9(b) (1960), as amended, T.D. 6712, 1964-1 (Part 1) CUM. BULL. 107.

[86] G.C.M. 8628, IX-2 CUM. BULL. 112 (1930), Rev. Rul. 286, 1953-2 CUM. BULL. 20; INTERNAL REVENUE SERVICE, U.S. DEP'T OF TREASURY, DOC. NO. 5174, DISASTERS, CASUALTIES AND THEFTS, p. 8 (March 1964).

[87] 1950-2 CUM. BULL. 21; Gilbert J. Kraus, 10 CCH Tax Ct. Mem. 1071 (1951); Rev. Rul. 54-85, 1954-1 CUM. BULL. 58; Rev. Rul. 79, 1953-1 CUM. BULL. 41; Treas. Reg. § 1.165-7(b) (1960), as amended T.D. 6786 1965-1 CUM. BULL. 107.

[88] *See also,* Helvering v. Owens, 305 U.S. 468 (1939); Buttram v. Jones, 87 F. Supp. 322 (W.D. Okla. 1943); J. H. Anderson, 7 CHH Tax Ct. Mem. 811 (1948); G.C.M. 21013, 1939-1 CUM. BULL. 101 G.C.M. 16255, XV-1, CUM. BULL. 115 (1936); Treas. Reg. § 1.165-7(a) (1960), as amended, T.D. 6786, 1965-1 CUM. BULL. 107.

[89] Treas. Reg. § 1.165-7(b)(3) (1960), as amended, T.D. 6786, 1965-1 CUM. BULL. 107, *Example (1).*

which he uses for nonbusiness purposes. In 1959 the automobile is damaged in an accidental collision with another automobile. The fair market value of B's automobile is $2,000 immediately before the collision and $1,500 immediately after the collision. B receives insurance proceeds of $300 to cover the loss. The amount of the deduction allowable under section 165(a) for the taxable year 1959 is $200, computed as follows:

Value of automobile immediately before casualty	$2,000
Less: Value of automobile immediately after casualty	1,500
Value of property actually destroyed	500
Loss to be taken into account for purposes of section (165a): Lessor amount of property actually destroyed ($500) or adjusted basis of property ($3,600)	500
Less: Insurance received	300
Deduction allowable	200

(b) $100 - Deductible Provision

Pursuant to section 165(c)(3)[90] a casualty loss described in (c)(3) ("loss of property not connected with a trade or business") which arises after December 31, 1963, is deductible only to the extent that the amount of the loss to the taxpayer arising from each casualty exceeds $100.

An example demonstrating the inclusion of the $100 deductible provision in the computation of the allowable loss, is as follows:[91]

Example. Mr. Lee's home, which cost him $4,000, including land, was partially destroyed by a flood following a storm in March 1964. The value of the property (building and land) immediately before the storm was $7,500 and the value immediately after the storm was $2,500. His household furnishings were completely destroyed. They cost him $1,250 but had a fair market value before the storm of $500. His insurance did not cover this type of damage and he estimated no recovery. His casualty loss is $4,500, but his deduction is limited to $4,400, computed in the following manner:

1.	Value of property before storm	$7,500
2.	Value of property after storm	2,500
3.	Decrease in value of property	$5,000
4.	Adjusted basis of property (Cost in this case)	4,000
5.	Loss sustained on property (lesser of 3 or 4)	$4,000
6.	Less: estimated insurance recovery	None
7.	Casualty loss on property	$4,000
8.	Value of furnishings before storm	$ 500
9.	Value of furnishings after storm	None
10.	Decrease in value of furnishings	$ 500
11.	Adjusted basis of furnishings (cost)	1,250

[90] Revenue Act of 1964 § 208, 78 Stat. 19; Treas. Reg. § 1.165-7(b)(4) (1960), as amended, T.D. 6786, 1965-1 CUM. BULL. 107.

[91] INTERNAL REVENUE SERVICE, U.S. DEP'T OF TREASURY, DOC. NO. 5174, DISASTERS, CASUALTIES AND THEFTS, p. 5 (March 1964).

applies, taxpayer has failed his burden of proof if he proves only the market value of one of the units of property involved as, for example, showing the value of trees and shrubs, but not the value of the entire property.[112]

B. *Appraisals — Expert Witnesses*

Treasury Regulation § 1.65-7(a)(2)(i) provides:

> In determining the amount of loss deductible under this section, the fair market value of the property immediately before and immediately after the casualty shall generally be ascertained by competent appraisal. This appraisal must recognize the effects of any general market decline affecting undamaged as well as damaged property which may occur simultaneously with the casualty, in order that any deduction under this section shall be limited to the actual loss resulting from damage to the property.

The Internal Revenue Service has also indicated that "[a]ppraisals should be made by an experienced and reliable appraiser. The appraiser's knowledge of sales of comparable property, conditions in the area, his familiarity with your property before and after the casualty, and the method used by him are important elements in proving a casualty loss.[113]

In deciding to secure expert assistance in determining the amount of the loss, the taxpayer should keep these practical considerations in mind:

(a) As is obvious but bears repeating, the more competent and skilled the appraiser, the more likely it is that the taxpayer will succeed in his burden of proof.[114] Since the appraisal fee may be deducted as an expense of determining tax liability if the taxpayer itemizes his deductions, the taxpayer should not lose sight of the fact that the government is paying part of the expense. The usual compulsion to proceed as cheaply as possible should not, therefore, be the only factor considered particularly when the cost of a skilled appraiser may reap larger ordinary income deductions.

(b) The taxpayer should keep in mind that the government (i) instead of producing expert testimony on its behalf, may rely solely on the presumption of correctness in which case the taxpayer will

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[112] Western Products Co., 28 T.C. 1196, 1218 (1957), *acq.* 1958-1 CUM. BULL. 6. *Cf.* Mary Cheney Davis, 16 B.T.A. 65 (1929), *acq.* VIII-2 CUM. BULL. 13 (1929).

[113] INTERNAL REVENUE SERVICE, U.S. DEP'T OF TREASURY, DOC. NO. 5174, DISASTERS, CASUALTIES AND THEFTS, p. 8 (March 1964); INTERNAL REVENUE SERVICE, U.S. DEP'T OF TREASURY, PUB. NO. 334, TAX GUIDE FOR SMALL BUSINESS, p. 92 (1965).

[114] Mary F. Cary, 7 CCH Tax Ct. Mem. 724 (1948) (hurricane damage to trees; taxpayer relying on the testimony of a real estate appraiser to show decrease in market value and a forest engineer and former park commissioner to show cost of replacement, was allowed the full deduction claimed.); Graham M. Brush, 21 CCH Tax Ct. Mem. 649 (1962) (Tax Court relied on taxpayer's experts.).

ordinarily prevail if his expert has some degree of competence;[115] or (ii) the Service may rely on its own valuation engineer who will suffer, by comparison with a local expert, for lack of familiarity with the local conditions.[116]

(c) While the Court will be the final arbiter of the witnesses' qualifications,[117] any witness familiar with the property is better than no witness, even if the witness called is the taxpayer himself,[118] and the taxpayer is likely to be allowed some part of his deduction even if his expert is held less qualified than the Service's witness.[119]

(d) In preparing to give testimony or supplying background information to the appraiser, the taxpayer should not overlook such facts as the assessed value for real estate tax purposes, value fixed for insurance coverage, and after the casualty, the amount of insurance claim and insurance settlement, prior listing of the property

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[115] Royal Little, 31 T.C. 607 (1958), *acq.* 1959-1 CUM. BULL. 4, *aff'd on other grounds,* 273 F.2d 746 (1st Cir. 1960) (taxpayer relying on the deposition of a local realtor and appraiser, prevailed on the full amount of the deduction claimed since the Commissioner offered no evidence in opposition and the Tax Court found taxpayer's expert adequately qualified to value the property before and after the storm.).

[116] Biddle v. United States, 175 F. Supp. 203 (E.D. Pa. 1959) (The Court relied more heavily on taxpayer's expert although he had seen the property two years before the storm and rendered his appraisal after seeing the property more than four years after the storm, than upon the Internal Revenue Service's witness who had visited the property two years after the storm and had not seen it before the storm.). *But cf.* William O. Lindley, 11 CCH Tax Ct. Mem. 355 (1952) and Ralph Walton, 20 CCH Tax Ct. Mem. 653 (1961) where the court relied on the Internal Revenue Service's experts as being more qualified than taxpayer's witnesses.

[117] *E.g.,* J. H. Anderson, 7 CCH Tax Ct. Mem. 811 (1948); Donald G. Graham, 35 T.C. 273 (1960), *acq.* 1961-2 CUM. BULL. 4.

[118] Nat Lewis, 13 CCH Tax Ct. Mem. 1167 (1954) (taxpayer was sustained on his own uncontradicted testimony); Carl A. Haslacher, 9 CCH Tax Ct. Mem. 314 (1950) (taxpayer, trying his own case, testified for himself, his testimony being based on what he learned from speaking with others. The IRS called an expert who had not seen the property until three years after the storm. The Tax Court, commenting that the taxpayer's own testimony was not as strong as it might have been if he called experts more knowledgeable and experienced than himself, did allow a deduction of $1,300, an amount between the taxpayer's high of $1,800 and the government's low of $750.). *Cf.* Melvin Mailloux, 20 CCH Tax Ct. Mem. 942 (1961), *rev'd on other grounds,* 320 F.2d 60 (5th Cir. 1963) (The Tax Court sustained the government because the taxpayer was (1) not an expert appraiser; (2) the items lost were listed from memory; (3) no attempt to find their depreciated value; and (4) no description of the lost items.); Bernard L. Shackleford, 7 CCH Tax Ct. Mem. 694 (1948) (Tax Court while considering taxpayer's testimony relied more heavily on the testimony of expert called by the taxpayer.).

[119] S. F. Horn, 18 CCH Tax Ct. Mem. 177 (1959) (taxpayer claiming $10,000 was allowed $5,000); Jay Howard, 18 CCH Tax Ct. Mem. 413 (1959) (taxpayer claimed $1,275, the IRS allowed $192, and Tax Court sustained a deduction of $750 after discounting the taxpayer's expert's testimony for lack of familiarity with the property); Doyle E. Collup, 21 CCH Tax Ct. Mem. 128 (1962) (the Tax Court after considering the testimony, lowered the value of the property as appraised before the storm from $29,000 to $26,000 but accepted the appraised value for the property after the storm); Ralph Walton, 20 CCH Tax Ct. Mem. 653 (1961) (taxpayer claimed $3,000; the IRS allowed $1,460; and the Tax Court $2,000); William O. Lindley, 11 CCH Tax Ct. Mem. 355 (1952) (taxpayer claimed $25,000 but the Tax Court allowed $7,500 by weighing the testimony of the witnesses on both sides).

for sale, other attempts to sell the property and other similar facts which have the effect of "pegging" value.[120]

(e) The taxpayer should not forget the value of demonstrative evidence, i.e., photographs, diagrams, etc., in proving the amount of loss particularly as corroborative of the testimony of witnesses. The cost of producing this type evidence is treated in the same manner as the cost of appraisals.[121]

C. *Repairs and Replacement Cost*

Treasury Regulation § 1.165-7(a)(2)(ii) provides:

> The cost of repairs to the property damaged is acceptable as evidence of the loss of value if the taxpayer shows that (a) the repairs are necessary to restore the property to its condition immediately before the casualty, (b) the amount spent for such repairs is not excessive, (c) the repairs do not care for more than the damage suffered, and (d) the value of the property after the repairs does not as a result of the repairs exceed the value of the property immediately before the casualty.

Included in such costs are clean-up expenses.[122] Whatever the "sanctity" of the Service's regulations, taxpayers should remember that in court they must satisfy the market value tests propounded by *Owens* and may well fail their burden unless they tie the cost of repairs into market value.[123] This is not to say that the cost of repairs and replacements cannot be relied upon in dealing with the Service or that in some cases the courts do not consider these costs as a more reliable indicator of the loss in value than the testimony of experts.[124] Indeed, in some reported decisions the courts appear to rely solely upon the cost of repairs.[125] But as indicated in discussing appraisals, some evidence is better than no evidence and

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[120] Gilbert J. Kraus, 10 CCH Tax Ct. Mem. 1071 (1951); Ferst v. Edwards, 129 F. Supp. 606 (D. Ga. 1955) (the Court relied upon the value found by a real estate appraisal when the property was listed for sale). *But cf.* Andrew A. Maduza, 20 CCH Tax Ct. Mem. 1302 (1961) which stated that the listing of the property for sale does not rise to the dignity of an appraisal of its fair market value.

[121] INTERNAL REVENUE SERVICE, U.S. DEP'T OF TREASURY, DOC. NO. 5174, DISASTERS, CASUALTIES AND THEFTS, p. 8 (March 1964).

[122] *Ibid.*

[123] See cases cited, *supra* note 109.

[124] Clapp v. Commissioner, 321 F.2d 12, 13 (9th Cir. 1963), *affirming* 36 T.C. 905 (1961).

> Petitioners contend that they had a right to a deduction for the market value of the sand lost; not for the cost of its replacement. The court, however, did not purport to allow the deduction as one for the cost of replacement. It looked to the cost of replacement as evidence of market value before loss. This method of ascertaining the amount of the loss is sanctioned by Treasury Regulation § 1.165-7(a)(2)(ii), and the court did not err in employing it here. . . . But, for the reasons which we have already stated, the court could well have determined that the appraisal offered was not competent and that replacement cost was the most reliable evidence.

Andrew W. Maduza, 20 CCH Tax Ct. Mem. 1302 (1961).

the taxpayer, if he introduces evidence of the cost of repairs and replacements, is likely to succeed in at least a part of the deduction claimed.[126]

The taxpayer would be well advised to consider proving his case from both points of view, first, expert testimony on the relative market values, and second, proof of the cost of repairs or replacements. In point of fact, a review of the decisions dealing with the casualty losses indicates that both elements of proof were present in most cases in which the taxpayer was sustained by the court in the full amount of the deduction claimed.[127] Evidence of cost of repairs and replacements may also be used to support a shaky or less qualified witness.

D. *Automobiles*

The Internal Revenue Service has indicated in several sources[128] that: "The so-called bluebooks issued periodically by various automobile organizations are useful in determining the value of motor vehicles. The amount offered for your vehicle as a trade-in on a new vehicle is not usually a measure of the true value of the vehicle." The Service, however, has sanctioned the use of "trade-in" value in situations where there are appraisals of the "trade-in" value of the automobile both before and after the casualty.[129] Clearly, taxpayers may not rely upon the appraisal of the "trade-in" value to establish the fair market value of the automobile before the casualty and the actual price at which the auto is sold on the open market after the accident as evidence of market value after the casualty.[130]

VI. MISCELLANEOUS MATTERS

A. *Relationship to Section 1231 of the Internal Revenue Code.*

The Commissioner's original position on the integration of

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[125] Schirmer v. United States, 59-2 USTC ¶ 9572 (N.D. Calif. 1959); Winters v. United States, 58-1 USTC ¶ 9205 (N.D. Okla. 1958), *rev'd on other grounds,* 261 F.2d 675 (10th Cir. 1958), *cert. denied* 359 U.S. 943 (1959); Smith v. Commissioner, 19 F. Supp. 377 (D.N.H. 1937); Jane U. Elliott, 40 T.C. 304 (1963), *acq.* 1964-1 (Part 1) CUM. BULL. 4.

[126] David W. Murray, Jr., 21 CCH Tax Ct. Mem. 7 (1962); Richard E. Stein, 14 CCH Tax Ct. Mem. 191 (1955).

[127] *E.g.,* Mary F. Cary, 7 CCH Tax Ct. Mem. 724 (1948); Mary Cheney Davis, 16 B.T.A. 65 (1929), *acq.* VIII-2 CUM. BULL. 13 (1929).

[128] INTERNAL REVENUE SERVICE, U.S. DEP'T OF TREASURY, DOC. NO. 5174, DISASTERS, CASUALTIES AND THEFTS, p. 8 (March 1964); INTERNAL REVENUE SERVICE, U.S. DEP'T OF TREASURY, PUB. NO. 334, TAX GUIDE FOR SMALL BUSINESS, p. 92 (1965).

[129] G.C.M. 16255, XV-1 CUM. BULL. 115 (1936); Gus S. Caras, 23 CCH Tax Ct. Mem. 1103 (1964) (dicta).

[130] Gus S. Caras, *supra* note 129. Ordinarily, if the taxpayer has $50 or $100 deductible collision insurance on an automobile, the amount of loss would be the $50 or $100, but under the new rules concerning $100 deductible floor, no loss would be allowable.

Int. Rev. Code of 1954 § 1231 (Section 117(j) of the 1939 Code) and 165 (Section 23(e) and (f) of the 1939 Code) was set forth in Treasury Regulation 118, Section 39.117(j)-1(a)(2):

> For the purpose of this section, the "involuntary conversion" of property is the conversion of such property into money or other property as a result of destruction in whole or in part, theft or seizure, or an exercise of the power of requisition or condemnation or the threat or imminence thereof. Losses upon the destruction in whole or in part, theft or seizure, requisition or condemnation of property are treated as losses upon an involuntary conversion whether or not there was a conversion of the property into money or other property. For example, if a capital asset held for more than six months, with an adjusted basis of $400, is stolen, and the loss from this theft is not compensated for by insurance or otherwise, the $400 loss is included in the computations under section 117(j).

Substantially the same language was incorporated in the initial regulations adopted under Int. Rev. Code of 1954 § 1231.[131] The Commissioner's position, however, has not gone without challenge. In *Maurer v. United States*,[132] and *Oppenheimer v. United States*,[133] both decided under the original regulation, the courts held that uninsured losses arising from the destruction (drought, windstorm) of ornamental trees and shrubs on residential property were deductible in full as casualty losses under Int. Rev. Code of 1954 § 165 and did not have to be first applied against Int. Rev. Code of 1954 § 1231 gains.

To alleviate the hardship of the Commissioner's interpretation,[134] Congress amended Int. Rev. Code of 1954 § 1231 (section 49 of the Technical Amendments Act of 1958) as follows:

> (a) TREATMENT AS ORDINARY LOSS. — Section 1231(a) (relating to property used in the trade or business and involuntary conversions) is amended by adding at the end thereof the following new sentence: "In the case of any property used in the trade or business and of any capital asset held for more than 6 months and held for the production of income, this subsection shall not apply to any loss, in respect of which the taxpayer is not compensated for by insurance in any amount, arising from fire, storm, shipwreck, or other casualty, or from theft."
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> (b) EFFECTIVE DATE. — The amendment made by subsection (a) shall apply to taxable years beginning after December 31, 1957.

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[131] See Treas. Reg. § 1.1231-1(e), 1957-2 CUM. BULL. 547, 550.

[132] 284 F.2d 122 (10th Cir. 1960), *reversing* 178 F. Supp. 223 (D. Kan. 1959). In Rev. Rul. 61-54, 1961-1 CUM. BULL. 398, the IRS announced that it will not follow the *Maurer* Case.

[133] 220 F. Supp. 194 (W.D. Mo. 1963).

[134] See S. Rep. No. 1983, 85th Cong., 2nd Sess. 74-75 (1958) 203-204.

Based upon the legislative history of the section,[135] the Commissioner amended Treasury Regulation § 1.1231-1(e)[136] to provide that section 1231 does not apply to losses arising with respect to ". . . both property used in the trade or business and any capital asset held for more than 6 months and held for the production of income, which losses arise from fire, storm, shipwreck, or other casualty, or from theft, and which are not compensated for by insurance in any amout. . . ."

In short, casualty losses arising from the destruction of capital assets held for personal uses (e.g., residential property) or assets used in trade or business or held for production of income which were partially insured must still be applied first to section 1231 gains.[137] This interpretation of the 1958 amendment has not, however, been accepted by the courts.[138]

B. *Personal Expenses Incident to Casualty*

The expenditure by a taxpayer of amounts for temporary hotel or apartment accommodations for the period during which his home was without heat, light, and/or other utilities or of amounts for the cost of temporary lights, fuel, and moving expenses, constitute personal expenses and may not be deducted as part of the casualty loss.[139] Amounts received through insurance for reimbursement of

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[135] S. Rep. No. 1983, 85th Cong., 2nd Sess. 203-204 (1958):

> . . . The amendment applies with respect to, for example, loss incurred as the result of the destruction of a taxpayer's oil tanks which he used for oil storage in his trade or business, but on which he was unable to obtain insurance. On the other hand, the amendment does not apply to loss arising from the destruction of theft of the taxpayer's uninsured personal automobile. The amendment is intended to benefit business taxpayer who, because of the special hazards of their business or for other reasons, carry their own insurance. . . .

[136] T.D. 6394, 1959-2 CUM. BULL. 186, 187.

[137] J. H. Anderson, 7 CCH Tax Ct. Mem. 811 (1948); INTERNAL REVENUE SERVICE, U.S. DEP'T OF TREASURY, DOC. NO. 5174, DISASTERS, CASUALTIES AND THEFTS, p. 15 (March 1964). See also Treas. Reg. § 1.1231-1(e) (1957), as amended, T.D. 6394, 1959-2 CUM. BULL. 186, 187.

[138] Morrison v. United States, 230 F. Supp. 989 (E.D. Tenn. 1964); Killebrew v. United States, 234 F. Supp. 481 (E.D. Tenn. 1964); Hall v. United States, 64-2 USTC ¶ 9770 (E.D. Tenn. 1964). In view of the favorable judicial outlook, taxpayers should claim all casualty losses in full as regular section 165 losses. See also H.R. 7502, 89th Cong., 1st Sess. (1965), which would amend INT. REV. CODE of 1954 § 1231(a) by adding this sentence:

> In the case of any involuntary conversion of property . . . which is attributable to a storm, flood, fire, or other casualty designated by the President of the United States as a major disaster . . . this subsection shall not apply to such involuntary conversion whether resulting in gain or loss, if during the taxable year, the recognized losses from such conversion exceed the recognized gains from such conversions.

See also H.R. Rep. No. 556, 89th Cong., 1st Sess. (1965), and Senate Finance Committee Amendments to H.R. 7502, 7 CCH 1965 STAND. FED. TAX REP. ¶ 6161B.

[139] Rev. Rul. 59-398, 1959-2 CUM. BULL. 76; INTERNAL REVENUE SERVICE, U.S. DEP'T OF TREASURY DOC. NO. 5174, DISASTERS, CASUALTIES AND THEFTS, p. 3 (March 1964); Richard A. Dow, 16 T.C. 1230 (1951) (cost of providing the household with water during four-month period when the well was polluted was not deductible).

family living expenses due to the loss of the use of a residence are taxable income and are not offset against the allowable amount of the casualty loss.[140]

C. *Computation of Net Operating Loss*

Casualty losses, whether or not involving business property, are treated as attributable to a trade or business for the purpose of computing the net operating loss for carryback and carryover purposes.[141] However, the $100 nondeductible portion of the loss must be excluded in the computation. As stated in H. R. Rep. No. 749:[142]

> Under section 172(d)(4)(C) of the code a personal casualty or theft loss is not treated as a nonbusiness expense for purposes of computing a net operating loss. The $100 floor applies in the computation of the net operating loss, but the net operating loss carried back or carried over is not again reduced in the year to which carried.

Losses arising from expropriations by the Cuban Government are treated as regular casualty losses for net operating loss purposes and not as expropriation losses under section 172(k).[143]

D. *Cleanup Expense*

If the taxpayer is relying upon the cost of repairs or replacements as evidence of the decrease in the market value of the property after the casualty, the cost figure used should include the expense incurred in cleaning up the debris.[144] On the other hand, if the taxpayer is relying on the testimony of experts to establish the relative market values, he should insure that the amount of diminution in fair market value testified to by his witnesses is measured just after the loss has taken place and before cleanup has begun. The expense of cleaning up should be added to this permanent loss in value.[145] If a taxpayer does not actually incur any expense in cleaning, as where, for example, he sells the property as is, presumably he should add to the permanent loss in value an estimate for cleanup expense. This is so because the price the taxpayer could

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[140] Rev. Rul. 59-360, 1959-2 CUM. BULL. 75, INTERNAL REVENUE SERVICE, U.S. DEP'T OF TREASURY, DOC. NO. 5174, DISASTERS, CASUALTIES AND THEFTS, p. 7 (March 1964).

[141] Treas. Reg. § 1.165-7(d) (1960); INT. REV. CODE of 1954 § 172(d)(4)(c); Treas. Reg. § 1.172-3(a)(3)(iii) (1956); INTERNAL REVENUE SERVICE, U.S. DEP'T OF TREASURY, DOC. NO. 5174, DISASTERS, CASUALTIES AND THEFTS, p. 10 (March 1964).

[142] H.R. Rep. No. 749, 88th Cong., 1st Sess., p. A47 (1963); see also S. Rep. No. 830, 88th Cong., 2nd Sess., p. 210 (1964).

[143] INT. REV. CODE of 1954 § 165(i)(2)(c).

[144] INTERNAL REVENUE SERVICE, U.S. DEP'T OF TREASURY, DOC. NO. 5174, DISASTERS, CASUALTIES AND THEFTS, p. 8 (March 1964).

[145] Ralph Walton, 20 CCH Tax Ct. Mem. 653 (1961); David W. Murray, Jr., 21 CCH Tax Ct. Mem. 7 (1962).

receive for the property immediately after the casualty would be its bargained-for value less the cost of cleaning up the damage.[146]

E. *Rehabilitation Payments — Disaster Relief*

Amounts received by the taxpayer from his employer or from disaster relief agencies, in the form of cash or property for the purpose of restoring or rehabilitating property lost or damaged in a disaster, reduces the amount of the deductible loss.[147] If the reimbursement exceeds the taxpayer's basis in the property prior to the casualty, the amount of the excess cannot be used to increase the basis of the property,[148] but such payments do not come within the concept of gross income and should not be included in the gross income of the recipients for income tax purposes.[149] Such amounts are deductible by the employer as business expenses.[150]

Disaster relief received in the form of food, medical supplies, and other forms of subsistence received by the taxpayer which are not replacements of lost or destroyed property do not reduce the amount of the casualty loss deduction and do not represent taxable income.[151] The same rule applies to cash gifts used to repair the property but not restricted to that purpose.[152]

F. *Use and Occupancy Insurance*

Use the occupancy insurance proceeds are not proceeds from casualty, to the extent that such proceeds are reimbursemnt for actual loss of net profit in the business. Such proceeds are income and are taxed in the same manner as the profits for which they are substituted would have been taxed.[153]

G. *Basis Adjustments*

The *Tax Guide for Small Business*[154] sets forth the following explanation of the adjustments which must be made to the basis of the property after a casualty:

> The basis of property damaged or destroyed by a casualty must be reduced by the allowable loss deduction. The basis must be

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146 Ralph Walton, *supra* note 145.

147 INTERNAL REVENUE SERVICE, U.S. DEP'T OF TREASURY, DOC. NO. 5174, DISASTERS, CASUALTIES AND THEFTS, p. 7 (Mafch 1964); Rev. Rul. 53-131, 1953-2 CUM. BULL. 112.

148 *Ibid.*

149 *Ibid.*

150 *Ibid.*

151 *Ibid.*

152 Rev. Rul. 64-329, 1964-2 CUM. BULL. 58.

153 INTERNAL REVENUE SERVICE, U.S. DEP'T OF TREASURY, DOC. NO. 5174, DISASTERS, CASUALTIES AND THEFTS, p. 7 (March 1964).

154 INTERNAL REVENUE SERVICE, U.S. DEP'T OF TREASURY, PUB. NO. 334, TAX GUIDE FOR SMALL BUSINESS, p. 92 (1965). See, *e.g.*, Ferst v. Edwards, 129 F. Supp. 606 (D. Ga. 1955).

further reduced by the amount of any insurance or other compensation which you receive.

Example 1. Your truck is involved in an accident and, after appraisals have been made, you determine the loss to be $200. You carry $50 deductible insurance and receive $150 from the insurance company. Your deductible casualty loss is $50 ($200 less $150 insurance recovered). The basis of your truck must be reduced by the amount of your casualty loss, $50; it must further be reduced by the $150 of insurance received.

Example 2. Your building, which is partially destroyed by fire, has a basis of $15,000. Its value was $30,000 just before the fire and $20,000 immediately after, and you collected $10,000 insurance. You have no casualty loss deduction since your recovery was equal to the value of the destroyed portion. The basis of your building is reduced by $10,000, the amount of recovery.

Of course, amounts which are not business expenses paid or incurred to replace or restore property damaged or destroyed as a result of a casualty are capital expenditures and should be added to the remaining basis of the property. These adjustments are required to determine your adjusted basis of the property.