BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
GEORGE 0. AND ALICE E. GULLICKSON)

Appearances:

For Appellants: George 0. and Alice E. Gullickson, in pro. per.

For Respondent: Michael E. Brownell Counsel

O P I N I O N

This appeal is made pursuant to section 18593 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of George 0. and Alice E. Gullickson against a proposed assessment of additional personal income tax in the amount of $1,895.00 for the year 1977.

On their joint California personal income tax return for 1977, appellants claimed a casualty loss deduction in the total amount of $8,681. The claimed deduction originally consisted of three items, only two of which are still in dispute: (i) an alleged loss of $551.80 resulting from automobile damage; and (ii) a claimed loss of $7,314.17 to appellants' yard, pool, and deck/patio purportedly caused by a mudslide.

Appellants originally explained that the $551.80 expense incurred with respect to their automobile was necessitated by collision damage and a repainting of their vehicle due to negligent repairs performed by a defunct company; these costs were not reimbursed by insurance. Upon consideration of the information supplied by appellants, respondent disallowed the $400 repainting job on the basis that it did not result from a casualty, but rather was due to negligence. Respondent did allow the remainder of the amount claimed by appellants as automobile damage, after the $100 exclusion provided for in Revenue and Taxation Code section 17206, thereby resulting in a casualty loss deduction in the amount of $51.80. This adjustment was incorporated in the subject notice of proposed assessment which was subsequently issued.

Appellants apparently accepted the correctness of respondent's disallowance of the cost incurred for repainting their automobile as an item of casualty loss; however, in their protest of respondent's action, they claimed that the same vehicle had been involved in a second collision. Appellants alleged that the damage caused by virtue of this collision resulted in damage in the amount of $1,604.26, of which only $1,016.83 was covered by their insurance. Accordingly, appellants argued, the remaining $587.43 in unreimbursed repairs should be allowed as a casualty loss, Upon consideration of their contentions, respondent concluded that appellants had failed to substantiate that the expense incurred had resulted from a casualty.

As previously noted, appellants' 1977 return also reflected a claimed casualty loss in the amount of $7,314.17 for yard damage purportedly caused by a mudslide resulting from unusually heavy rainfall. The $7,314.17 expense was primarily incurred by appellants as the result of erecting a retaining wall to prevent the reoccurrence of similar such damage. Appellants have noted that the damage caused by the mudslidc was significantly in excess of the above amount, but that

by purchasing many of the needed materials and supplying much of the labor they were able to repair the casualty damage and erect the wall for approximately $5,000 to $8,000 less than would otherwise have'been the case.

At the time of the audit, appellants assert, respondent's auditor proposed a settlement of this item, allowing a significant portion of the disputed loss sum as an estimated amount of the damage actually incurred by appellants as a result of the mudslide; respondent has not denied that its representative did propose such a settlement. Appellants rejected that settlement offer, arguing that the claimed amount was an accurate reflection of the damage suffered and should be allowed in its entirety. In its written arguments to this board with respect to the purported flood damage, respondent states that, upon review of all the relevant information, it concluded that appellants had failed to substantiate that they had in fact suffered a casualty; the subject notice-of proposed assessment was subsequently issued reflecting this determination. Upon review of appellants' protest of its action, respondent affirmed its proposed assessment, thereby resulting in this appeal.

The issue presented by this appeal is whether respondent properly disallowed all but $51.80 of the casualty loss deduction claimed by appellants on their 1977 return.

Revenue and Taxation Code section 17206 provides, in pertinent part, as follows:

> (a) There shall be allowed as a deduction any loss sustained during the taxable year and not compensated for by insurance or otherwise.
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> (c) In the case of an individual, the deduction under subsection (a) shall be limited to--
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> (3) Losses of property not connected with a trade or business, if such losses arise from fire, storm, shipwreck, or other casualty, or from'theft. A loss described in this paragraph shall be allowed only to the extent that the amount of loss to such individual arising from each casualty, or from each theft, exceeds one hundred dollars ($100).

During the year in issue, the regulations promulgated pursuant to this section (former Cal. Admin. Code, tit. 18, reg. 17206(g), subd. (1)(B), repealed March 23, 1979), provided, in relevant part, as follows:

> (i) In determining the amount of loss deductible under this regulation, 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 regulation shall be limited to the actual loss resulting from damage to the property.
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> (ii) 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.

It is well settled that deductions are a matter of legislative grace, and the burden of proving the right to a deduction is upon the taxpayer. (Deputy v. duPont, 308 U.S. 488 [84 L.Ed. 416] (1940); New Colonial Ice Company v. Helvering, 292 U.S. 435 [78 L.Ed. 1348] (1934).) Upon careful review of the record of this appeal, including appellants' testimony at the oral hearing on this matter, it is our belief that appellants have not established that they are entitled to a casualty loss deduction for automobile damage in an amount greater than that originally allowed by respondent. While we disagree with respondent's conclusion that the repairs to appellants' vehicle after its second collision in 1977 were not prompted by virtue of a. casualty, we believe, based upon appellants' testimony at the time'of the hearing conducted on this matter, that those repairs actually improved the automobile, and did not merely restore it to its pre-collision condition. There-fore, in accordance with the regulation quoted above, we find that respondent properly determined that

appellants were entitled to a casualty loss deduction for automobile damage in the amount of $51.80 ($151.80 as the result of the first collision less the $100 exclusion provided for in section 17206).

Eaving concluded our discussion of that portion of appellants' casualty loss deduction comprised of the unreimbursed automobile damage, we now turn to the remaining disputed item: the damage caused by the mudslide. As previously indicated, respondent disallowed the $7,314.17 claimed by appellants in its entirety because appellants had, in its view, failed to substantiate that a casualty had in fact occurred. Respondent concluded, based upon appellants' statements, that the mudslide had resulted from long term erosion, and therefore was not of a sudden or expected nature such as to qualify as a casualty, Finally, respondent determined that even if the damage had resulted from a casualty, appellants had failed to establish that the cost of constructing their retaining wall constituted a reasonable measure of the damage they had sustained. Based upon this board's decision in the Appeal of Felix and Annabelle Chappellet, decided June 2, 1969, as well as the authority c-therein, respondent concluded that by constructing the retaining wall, appellants were not restoring their property to its pre-casualty condition, but rather were improving the property's ability to withstand future heavy rains. Accordingly, respondent determined that the cost of the wall constituted a nondeductible capital expenditure.

Appellants concede that they have no competent appraisal evidencing the value of their residential property immediately before and after the 1977 storm damage. They contend, however, that their erection of the retaining wall merely restored their property to its pre-casualty value, and that the cost of that wall should therefore be'accepted as proof of the amount of their loss. At the oral hearing on this matter, respondent, when confronted with photographs of the work in progress on the retaining wall, which show a portion of the damage caused by the mudslide, tacitly acknowledged that appellants had in fact suffered a casualty, but retreated to its alternative'argument that the cost of the wall was not an accurate reflection of the amount of that loss.

In the Appeal of Felix and Annabelle Chappellet, supra, we summarized the case law and other authority pertinent to the issue presented here, i.e., the measure of a casualty loss on nonbusiness property, as follows:

> The general rule is that the measure of a casualty loss on nonbusiness property is the difference between the fair market value of the property immediately before and immediately after the casualty, but not in excess of the adjusted basis of the property. [Citations.] Furthermore, the loss of value must be the direct result of the actual physical damage to the property which was caused by the casualty,, [Citation.] A deductible loss is not incurred where . . . the loss of value is due to fear on the part of prospective buyers that future casualty damage might occur. [Citation.]
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> The taxpayer claiming a casualty loss deduction bears the burden of showing that the fair market value of his property decreased as a result of the casualty damage. Where a taxpayer is unable to produce competent appraisals, repair costs may be considered as evidence of loss of value, provided such expenditures were necessitated by the casualty, were reasonable in amount, and did not improve the property beyond its condition prior to the casualty. [Citations.]
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> Expenditures which improve the property beyond its condition immediately prior to the casualty are not a proper measure of the loss sustained, even though those expenditures may have been deemed advisable as a result of the casualty. [Citation.] Such expenditures which 'do more than merely restore the property to its pre-casualty state are in the nature of nondeductible capital expenditures. [Citations.]

While we were impressed both by the nature of appellants' testimony at the oral hearing, as well as by the evidence produced to demonstrate that their yard damage had been caused by a casualty, we cannot turn a blind eye to the well established principle that the taxpayer bears the burden of proving the right to a deduction. (Deputy v. duPont, supra.) While appellants have established that construction of the retaining wall was a prudent decision so as to prevent similar such damage, they have failed to establish that the entire cost of constructing that wall constitutes a reasonable measure of the casualty loss which they sustained. In this regard, we cannot overlook appellants' own statement that erection of the wall was necessary "to prevent a reoccurance [sic] of serious damage ...."

Notwithstanding the above, we are cognizant of the fact that appellants did suffer a casualty loss. We believe that this is a proper case for application of the so-called "Cohan rule" (Cohan v. Commissioner, 39 F.2d 540 (2d Cir. 1930)), which provides that, in cases of this type, where the taxing authority concedes that a casualty loss was sustained, but where the taxpayer has failed to prove the exact amount of that loss, an approximation of the casualty loss may be made. (See, e.g., Andrew A. Maduza, ¶ 61,249 P-H Memo. T.C. (1961).) In view of the damage caused to appellants' yard, pool, and deck/patio as a result of the mudslide in 1977, we believe, under the Cohan rule, that appellants' casualty loss was 50 percent of the $7,314.17 they claimed on their 1977 return. The remaining 50 percent, $3,657.08, constitutes a nondeductible capital expenditure.

For the reasons set forth above, respondent's action in this matter will be modified to allow appellants a casualty loss deduction in the amount of $3,708.89 (50 percent of the $7,314.17 claimed by appellants as yard damage plus $151.80 for automobile damage less the $100 exclusion provided for in section 17206).

O R D E R

Pursuant to the views expressed in the opinion of the board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section 18595 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of George 0. and Alice E. Gullickson against a proposed assessment of additional personal income tax in the amount of $1,895.00 for the year 1977, be and the same is hereby modified to allow a casualty loss deduction in the total amount of $3,708.89. In all other respects, the action of the Franchise Tax Board is hereby sustained.

Done at Sacramento, California, this 29th day of June, 1982, by the State Board of Equalization, with Board Members Mr. Bennett, Mr. Dronenburg, and Mr. Nevins present.

William M. Bennett, Chairman

Richard Nevins, Member

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