BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
) No. 86A-0613-VN
COSTA ZMAY)

For Appellant: Paul M. Pritchard
Certified Public Accountant

For Respondent: Philip M. Farley
Counsel

O P I N I O N

This appeal is made pursuant to section 18593[1/] of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Costa Zmay against a proposed assessment of additional personal income tax in the amount of $1,287 for the year 1981.

1/ Unless otherwise specified, all section references are to sections of the Revenue and Taxation Code as in effect for the year in issue.

The sole question presented for our decision is whether the Franchise Tax Board properly disallowed appellant's casualty loss deduction claimed in 1981.

On his personal income tax return for 1981, appellant claimed a $11,764 casualty loss deduction for one-half of the alleged $23,728 cost to repair his San Mateo home damaged by a rainstorm. On a statement that apparently accompanied his return, appellant noted that he was half-owner of a home substantially damaged by "the rainstorm of Jan[uary] 4, 1982," (Resp. Br., Ex. A) but since the home was located in a "federal disaster area," he was electing to deduct the casualty loss in 1981.[2/]

Two years later, in January 1984, the Franchise Tax Board requested that appellant provide further information about his casualty loss deduction, including the description of the damage to his house, the date of the casualty, and the fair market value of the property immediately prior to and after the casualty. Appellant replied that "[b]etween December 8th to December 18th" (Resp. Br., Ex. D) his hillside horde was damaged by

2/ Former section 17206.5, as in effect during the year at issue, provided that, where a taxpayer suffered a casualty loss attributable to a disaster occurring in an area subsequently determined by the President to warrant federal assistance under an applicable federal disaster act, the taxpayer may elect to deduct the casualty loss in the taxable year immediately preceding the taxable year in which the disaster occurred. The substantive language of section 77206.5 was identical to that of former section 165(h) of the Internal Revenue Code of 1954. The Internal Revenue Service annually publishes a list of disaster areas qualifying for federal assistance and only losses arising from these disasters qualified for special tax treatment under section 17206.5. (Appeal of Paul G. and Pearl M. Pilgrim, Cal. St. Bd. of Equal., Feb. 28, 1984.) Moreover, former section 17206.7 provided that any loss sustained in any county arising from storm, flooding; or other related casualty during the first week of January 1982 was deductible in the immediately preceding taxable year even though the loss occurred in an area that was not determined to warrant federal assistance under an applicable federal disaster act. Both sections 17206.5 and 17206.7 were repealed in 1983. (Stats. 1983, ch. 488, § 28, p. 1888.)

flooding, debris, and mud. As a result, he said he had to replace flooring and repair, walls. To protect his home from flooding again, appellant further indicated that he installed a pump, drainage lines, drain rock, gutters, and down spouts. With regard to fair market. values, appellant stated that the house was worth $160,000 before the **casualty** and $175,000 after the casualty.

In August 1984 the Franchise Tax Board asked appellant to demonstrate that he was the legal owner of the house and requested copies of appraisal reports to substantiate the fair market value of the house prior to and after the casualty as well as copies of invoices, receipts, and cancelled checks to substantiate the **cost** of repairing the flooring and walls. Appellant sent respondent a copy of a grant deed that showed appellant *was* the sole owner of the house. He also forwarded a copy of an appraisal report dated April 11, 1984, that estimated the market value of the house at $180,000 and a copy of a contractor's 'estimate and report.

In November 1984 respondent issued a proposed assessment of additional tax disallowing the casualty loss deduction in its entirety because respondent found appellant had not substantiated his cost of repair. Appellant filed a protest against the **deficiency** assessment, arguing that he had presented paid invoices substantiating his repair costs. Respondent subsequently advised appellant that, while it had been, furnished a contractor's report, it had not received copies of any cancelled checks, paid invoices, or receipts showing he had paid the repair costs. Appellant thereupon forwarded a copy of an undated invoice from one. European Construction of Burlingame indicating that appellant's house was damaged between "Dec. 1 and Dec. 8" and listing the repair and drainage work that appellant said had been performed on his house. The typed invoice showed a total labor and material cost of $11,764 and was signed "paid in full cash" by a Bans Burger who appellant stated was the owner **of** the construction company.

On further investigation, the Franchise Tax Board searched its files and found no evidence that tax returns had ever been filed by any European Construction **or** Hans Burger. Respondent also failed to find any telephone listing for the company or its owner during the period in question. Consequently, respondent denied appellant's protest and affirmed its disallowance of the

casualty loss deduction for "lack of substantiation." This appeal followed.

Section 17206, subdivision (a), allowed a deduction for "any loss sustained during the taxable year and not compensated for by insurance or otherwise." For individual taxpayers, subdivision (c)(3), in part, limited the deductible losses from property not connected with a trade or business to losses arising from fire, storm, shipwreck, or other casualty, or from theft. This section was substantially similar to and patterned after section 165 of the Internal Revenue Code of 1954, The interpretation and effect given the federal provision by the federal administrative bodies and courts are therefore persuasive in interpreting the California statute. (Meanley v. McColgan, 49 Cal.App.2d 203 [121 P.2d 451 (1942); see Appeal of John Z. and Diane W. Mraz, Cal. St. Bd. of Equal., July 26, 1976, and the cases cited therein.)

It is well settled that a taxpayer, in order to prove that he is entitled to a deduction for a casualty loss, must show that his property was damaged by a fire, storm, shipwreck, or other casualty, and the amount of the loss resulting from the casualty as distinguished from other causes. (Matheson v. Commissioner, 54 F.2d 937 (2nd Cir. 1931); Axelrod v. Commissioner, 56 T.C. 248 (1971).) Here, the Franchase Tax Board states almost incidentally that appellant has not proven that his house was physically damaged by flooding from a rainstorm, noting that appellant has given two dates for the alleged rainstorm. It is true that appellant has not presented any evidence of a storm nor given any reason for his differing statements. The record in this appeal also indicates, however, that respondent did not dispute the occurrence of a casualty during its audit and protest proceedings. Yet, even if we were to decide in appellant's favor on the existence of a loss by

casualty[3/], we find that appellant still would not be entitled to his claimed deduction due to his failure to establish the amount of any allowable casualty loss.

In general, the proper measure of a casualty loss is the difference between the fair market value of the property immediately before and its fair market value immediately thereafter, but not to exceed its adjusted basis. (Treas. Reg. § 1.165-7(b)(1)(i); Millsap v. Commissioner, 46 T.C. 751, 759 (1966) affd., 387 F.2d 420 (8th Cir. 1968).) The fair market values before and after the casualty must be "ascertained by competent appraisal." (Treas. Reg. § 1.165-7(a)(2)(i).) However, the cost of repairs to damaged property is also acceptable as evidence of the loss of value if the taxpayer can show 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.

(Treas. Reg. § 1.165-7(a)(2)(ii); Heinz v. Commissioner, 52 T.C. 41 (1969); Chichester v. United States, 22 A.F.T.R.2d (P-8) ¶ 68-5177 (1968).)

3/ Based on our own research, this board has reason to believe that appellant's home was, at least, located in an area beset by rainstorms. Under Revenue Ruling 81-306, 1981-2 C.B. 58, San Mateo County was one of several northern California counties determined to warrant federal disaster assistance for damage due to severe storms, mud slides, high tides, and flooding that occurred beginning on or about December 19, 1981. In addition, section 17206.7 was apparently enacted to provide favorable tax treatment to California taxpayers who suffered casualty losses from the storm and flooding that occurred in this state during the first week of January 1982 but were not entitled to federal disaster assistance.

The cost of repairs method of valuing a casualty loss applies only to repairs and expenditures actually made. (**Lamphere v.** Commissioner, 70 T.C. 391 **(1978).)** Any costs **incurred in** connection with remodeling or renovation work that does more than merely restore the property to its **pre-casualty** state are considered nondeductible **capital expenditures.** (Mayo **v. Commissioner, ¶** 78,424 **T.C.M.** (P-E) **(1978);** Dow **v.** Commissioner, 16 T.C. 1230 **(1951).)** Thus, **amounts expended** for the construction of protective **works,** such as **a** retaining wall, draining **system,** or **pump,** to prevent probable losses from future **storms** or flooding have been found to **constitute capital** expenditures not deductible as a casualty loss. (Appeal of Felix and Annabelle Chappellet, Cal. St. Bd. of Equal., June 2, 1969; Rev. Rul. **60-386, 1960-2 C.B.** 107; Rev. Rul. 79, 1953-1 C.B. 41.)

In the present **matter,** appellant has not carried his burden of proving what repairs were made to his home and the reasonable cost of those repairs. Appellant contends that the contractor's invoice shows that repair work was performed only to the extent necessary **to restore** his house to its pre-casualty **condition or** value. The problem with appellant's argument is that the invoice includes the cost of installing such flood protection measures such as drainage lines, gutters, and pump, which are in **the nature** of **nondeductible capital** expenditures, and fails to assign separate costs to what appear to be the necessary repair work of replacing flooring and walls damaged by flooding. While in prior instances we have estimated the amount of a taxpayer's casualty loss under the rule found in Cohan v. **Commissioner,** 39 **F.2d** 540 **(2d** Cir. **1930), we do** not believe this is a proper case for **such** approximation. (See, e.g., Appeal **of** George 0. and Alice **E.** Gullickson, Cal. **St.** Bd. of Equal., June 29, 1982.) The invoice indicates that the total cost of **the construction** work was $11,764, but we remind appellant that his return **first** stated that his repair costs **totalled** $23,728 and he was claiming only one-half of such cost as a casualty **loss.** In addition, appellant has given conflicting dates for the occurrence of the rainstorm and respondent has stated that it has not found any tax returns **or** telephone listing for the construction company or its owner to corroborate their existence. Under this set of circumstances, we cannot conclude that respondent erred in disallowing appellant's claimed casualty loss deduction. Respondent's action in this matter will be sustained.

Appeal of Costa **Zmay**

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 Costa **Zmay** against a proposed assessment of additional personal income tax in the amount of $1,287 for the year 1981, be and the same is hereby sustained.

Done at Sacramento, California, this 3th day of December, 1987, by the State Board of Equalization, with Board Members Mr. Collis, Mr. Dronenburg, Mr. Carpenter, and Ms. Baker present.

Conway H. Collis, Chairman

Ernest J. Dronenburg, Jr., Member

Paul Carpenter, Member

Anne Baker*, Member

_____, Member

*For Gray Davis, per Government **Code section** 7.9