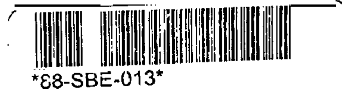

88-SBE-013

BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
) No. 86R-1426-KP
BARNEY C. RUBEN AND ESTATE OF)
ELEANOR RUBEN, DECEASED)

For Appellants: Dickinson Thatcher
Attorney at Law

For Respondent: Phillip Farley
Counsel

O P I N I O N

This appeal is made pursuant to section 19057, subdivision (a),[1] of the Revenue and Taxation Code from the action of the Franchise Tax Board in denying the claim of Barney C. Ruben and Estate of Eleanor Ruben, Deceased, for refund of personal income tax in the amount of $23,467.31 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 issue presented by this appeal is whether the Franchise Tax Board improperly rejected the majority of appellants' claimed casualty loss.

In August 1962, appellants acquired property upon which they built their residence. On September 26, 1981, appellants' residence-was partially damaged by fire. Subsequently, appellants rebuilt their home at a cost of $371,370.34. After deducting various amounts from this figure, including improvements on the property, appellants determined 'that their loss from the fire amounted to $345,000. Although appellants insured their property, the insurance reimbursement consisted of only $171,500. On their tax return for 1981, appellants deducted the balance of the claimed loss, $173,400 (less the $100 statutory exclusion), as a casualty loss.

Upon review, the Franchise Tax Board (FTB) requested substantiation of the claimed loss. After examining all of the records provided by appellants,, the FTB determined that Mr. and Mrs. Ruben failed to document their claimed deduct&n. Specifically, the FTB decided that appellants had failed to properly distinguish the necessary repair work from the improvements on the property. Appellants protested. The FTB's subsequent review determined that even if all of appellants' claims were accurate, appellants would still be unable to take the entire amount of their claimed deduction since the proper measure of deductible loss was the difference between the insurance proceeds appellants received and their adjusted basis in the property. Under this latter formula, the FTB allowed a deduction of $18,617. An assessment was issued, which appellants paid. Thereafter, appellants filed the present claim for refund, which the FTB denied. This appeal followed.

Section 17206, subdivision (a), of the Revenue and Taxation code allows a deduction for a loss sustained during the taxable year if the loss was not compensated for by insurance or otherwise. In the case of an individual taxpayer, such a deduction is limited to the loss of property due to fire, storm, shipwreck, or other casualty, or from theft. (Rev. and Tax. Code, § 17206, subdivision (c).) Both parties agree that a deductible loss under section 17206 occurred. Their dispute arises as to the proper method of evaluating that loss.

Treasury Regulation section 1.165-7 (1977) states:

Casualty Losses. (a) In general

* • *

> (b) Amount deductible - (1) General rule. In the case of any casualty loss ... the amount of the loss to be taken into account for purposes of section 165(a) shall be the lesser of either -
>
> (i) The amount which is equal to the fair market value of the property immediately before the casualty reduced by the fair market value of the property immediately after the casualty; or (ii) the amount of the adjusted basis prescribed in § 1.1011-1 for determining the loss from the sale or other disposition of the property involved. (Emphasis added.)

Consequently, regardless of what method is used to determine the amount of loss, a taxpayer is barred from deducting more than the adjusted basis of the damaged property. That deduction is further diminished by any compensation derived from insurance or otherwise. (See Helvering v. Owens, 305 U.S. 468 [83 L.Ed. 292] (1939); Tank v. Commissioner, 29 T.C. 677, 690 (1958); Appeal of Costa-y, Cal. St. Bd. of Equal., Dec. 3, 1987.)

In determining appellants' loss, the FTB decided that appellants' basis in the property was $190,217. As appellants' received $171,500 in insurance proceeds, the FTB allowed as a casualty loss deduction the difference between the adjusted basis and the sum of the insurance recovery plus the $100 statutory limitation, $18,617.

Appellants argue that the regulation's formula does not take into account the increased value in the damaged property. Appellants contend that the proper measure of determining a casualty loss is the measure of the necessary costs expended to restore the property to its original condition. This method, they contend, would take into account the effect of inflation upon the replacement cost of. the house. In effect, appellants' argument would replace the two-pronged test set.forth in Treasury Regulation section 1.165-7 with a single "cost of replacement" test. To agree with this argument would require the repudiation of settled tax law.

The "cost of repairs" test is an alternative only where the taxpayer is unable to provide evidence of the fair market value of the property before and after the casualty. (Tank v. Commissioner, supra, 29 T.C. at 692; see also Kielts v. Commissioner, ¶ 81,329 T.C.M. (P-H) (1981).) The taxpayer's adjusted basis in the property remains as the maximum allowable casualty loss. (See Conner v. United States,

439 F.2d 974 (5th Cir. 1971); Tank v. Commissioner supra; see also Kielts v. Commissioner, supra; Felix and Annabelle Chappellet, Cal. St. Bd. of Equal., June 2, 1969.)

Since appellants' adjusted basis in the property is the maximum allowable casualty loss, and as respondent has already allowed the appropriate deduction based upon that limit less the sum of the insurance proceeds plus the statutory limitation, appellants' claim for refund was properly denied. Accordingly, respondent's action in this matter must be sustained.

Appeal of Barney C. Ruben and Estate of Eleanor Ruben, Deceased

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 19060 of the Revenue and Taxation Code that the action of the Franchise Tax Board in denying the claim of Barney C. Ruben and Estate of Eleanor Ruben, Deceased, for refund of personal income tax in the amount of $23,467.31 for the year 1981, be and the same is hereby sustained.

Done at Sacramento, California, this 3rd day of May 1988, by the State Board of Equalization, with Board Members Mr. Dronenburg, Mr. Carpenter and Mr. Collis present.

Ernest J. Dronenburg, Jr., Chairman

Paul Carpenter, Member

Conway H. Collis, Member

__________ Member

__________, Member