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Casualty and Theft Losses

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Since casualty and theft losses are of a serious and unpredictable nature, the principal reason for allowance of deductions therefor is to mitigate the effects of such losses. Because the deduction provisions afford protection in unfortunate situations, they have been characterized as serving the function of insurance or as a substitute for or supplement to insurance.[1]

In general, in order for casualty losses to be deductible, under section 165 of the Code, they must be evidenced by closed transactions, fixed by identifiable events, bona fide, and actually sustained during the taxable period for which allowed.[2] This applies to a loss arising from theft except that such a loss is allowable only for the taxable year in which the taxpayer discovers such loss.[3] Ordinarily, to be deductible, losses of these types must be of characters which permit definite ascertainment and measurement in money terms.[4]

It is well established that the burden of proving a casualty or theft loss and the amount thereof is upon the taxpayer.[5] This may be said to be a corollary to the statements repeatedly made by the courts that the deduction of losses is a privilege and not a right, and that deductions are a matter of legislative grace.[6]

One illustration of the failure of a taxpayer to carry the burden of proof was the McMorran case, decided in 1939 by the Board of Tax Appeals.[7] In that case it was held the loss arising from the death of a riding horse which occurred soon after the horse had swallowed a silk hat lining was not deductible because of failure to prove that death was due to this act, rather than to an illness.

Appraisals are of particular importance to a taxpayer in ascertaining and proving the decrease in value of property by reason of a casualty, and preferably should be made by one or more experienced and reliable appraisers. This may be illustrated by the 1958 Tax Court decision in the Tank case,[8] holding that a casualty loss was not deductible for damage to a new residence allegedly due to the vertical slippage of a river bank. In that case the taxpayer did not have an independent expert investigation made by a disinterested party to prove the facts. Instead, he relied primarily on the opinion of his architect that cracks in the ceilings and walls of the residence were the result of an unusual cause and not faulty construction. The Court emphasized that the taxpayer did not prove the proximate cause of the damage or that he sustained a loss. Where a taxpayer sustains a deductible casualty loss, the appraisal fees paid to establish such loss apparently are deductible under section 212(3) of the 1954 Code as expenses incurred in determining tax liability.[9]

One difficult problem throughout the years has been the interpretation as to what is meant by the words "other casualty," following the words fire, storm and shipwreck. For many years it was thought that such a deductible loss must be due to natural causes. However, court decisions and Revenue Service rulings have developed the present overall concept that the term "other casualty" refers to an identifiable event of a sudden, unexpected, or unusual nature, and that damage or loss resulting from progressive deterioration of property through a steadily operating cause does not constitute a casualty loss. Application of the overall concepts and limitations are well illustrated by Revenue Ruling 69, published in 1953, relating to losses sustained by individuals owning property on the Great Lakes, and making distinctions between losses directly resulting from a storm and other losses.[10]

The 1927 decision in the case of Shearer v. Anderson[11] may be said to have been of particular significance in the development of the present concept of a casualty loss, particularly with respect to losses resulting from automobile accidents. In that case, damage due to an accident attributable to the icy condition of a roadway and to the subsequent freezing of the motor was held deductible as a casualty loss. In so holding the court compared the automobile with a yacht, and an automobile accident with a shipwreck, and it seems first established the principle that a

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[1] *See statements of Prof. Melvin I. White, Brooklyn College, to Subcom. on Fed. Tax Policy, Joint Committee Rept., 11/9/55, pps. 362, 363 and 366.*

[2] *Sec. 28.15, Mertens Law of Federal Taxation.*

[3] *Sec. 165(e), IRC 1954.*

[4] *Sec. 28.50 of Mertens, supra.*

[5] *Burnet v. Houston, 5 S. Ct. 413 (1931); Rev. Rul. 57-524, C.B. 1957-1, 141.*

[6] *Sec. 28.01, Mertens, supra.*

[7] *B.T.A. Memo. Opp. (1939) Dec. 10,628-E.*

[8] *29 T.C. No. 77 (1958).*

[9] *Rev. Rul. 58-180, C. B. 1958-1, 154.*

[10] *C.B. 1953-1, 41.*

[11] *CCA-2, 16 Fed. (2d) 995 (Acq.); G.C.M. 1802 and I.T. 2363, C.B. VI-1, p. 219.*

deductible casualty loss does not have to result from natural physical forces.

Under the present concept, damage to an individual's automobile by collision or accident usually is deductible if due merely to faulty driving of the taxpayer or other person, but is not considered deductible if due to willful act or willful negligence of such a driver. Drunken driving, for example, is a case of willful negligence.[12] However, the allowable deduction does not extend to expenses in taking care of personal injuries, a payment in settlement of a personal injury claim resulting from an automobile accident, or to an amount paid because of liability for damage to another person's property.[13]

Another difficulty in the casualty loss area relates to such losses resulting from termite damages. The Service's position, as announced on March 13, 1959, is that it will follow certain court decisions[14] allowing deductions in cases where the infestation and subsequent damage were proved to have occurred in relatively short periods of time. However, in other cases where the termite infestation and damages occur over longer periods of time the Service will continue to follow other court decisions.[15]

With respect to the theft loss deduction provision a principal point is that such a loss results from the unlawful taking and removing of money or other property with the intent of depriving the owner of the property. This principle was involved in the Bonney case, holding that a claimed theft loss deduction for spending money and clothing which a taxpayer gave to his wife over a period of years before annulment of their marriage was not deductible, in the absence of proof of a criminal intent to deprive and defraud him of the property.[16]

[12] *IRS Pub. No. 155.*

[13] *IRS Pub. No. 155; sec. 28.58, Mertens, supra, Mulholland, 16 B.T.A. 1331; Peyton, 10, B.T.A. 1129.*

[14] *TIR-142: Buist v. U.S., 164 Fed. Supp. 218; Rosenberg v. Commissioner, 198 Fed. (2d) 46; and Shopmaker et al v. U.S., 119 Fed. Supp. 705.*

[15] *TIR-142; U.S. v. Betty Rogers et al., 120 Fed. (2d) 253; Fay et al v. Helvering, 120 Fed. (2d) 253; and Dodge et ux v. Commissioner, 25 TC 1022.*

[16] *Bonney v. Commissioner, 247 Fed. (2d) 237, cert. den. 355 U.S. 906.*

SELLS GOLD MEDAL WINNERS

For the first time in the history of the Elijah Sells award, the winner of a gold medal was a woman. Stepping on the toes of tradition, Mrs. Ellin McClarin Melohn of Mobile, Alabama, received the highest grades in the Uniform Examination for Certified Public Accountants at the May examination. She is shown above accepting the award from Mr. Richard H. Grosse, Chairman of the AICPA Board of Examiners. Mrs. Melohn is a senior accountant with Robert L. Godwin Associates in Mobile. Recipient of the same award for the November 1958 examination is Mr. Lee N. Abrams (right) of Chicago, Illinois, an attorney with Mayer, Friedlich, Spiess, Tierney, Brown & Platt of that city.

Embezzlement losses are classified as theft losses.[17] This classification is in accord with a decision of the Tax Court holding that a taxpayer was entitled to a deduction where a contractor absconded with part of the down payment which the taxpayer had made on the construction of a personal residence.[18]

However, the mere disappearance of money, jewelry, or other property, whether mislaid or lost, or the mere suspicion of theft may not be the subject of a theft deduction.[19] Misrepresentation by a real estate broker or vendor also does not result in a deductible theft loss.[20]

[17] *IRS Pub. No. 155.*

[18] *Miller, 19 TC 1046 (Acq.)*

[19] *Bakewell, Jr., 23 TC 803.*

[20] *IRS Pub. No. 115; Springer, T.C.M. 1957-232.*