

NETTIE ALEXANDER	§	STATE OF ALABAMA
P.O. Box 1197		DEPARTMENT OF
REVENUE		
Boaz, AL 35957,	§	ADMINISTRATIVE LAW
DIVISION		
	§	DOCKET NO. INC. 02-145
Taxpayer,		
	§	
v.		
	§	
STATE OF ALABAMA		
DEPARTMENT OF REVENUE		

OPINION AND PRELIMINARY ORDER

The Revenue Department disallowed a 1997 income tax refund claimed by Nettie Alexander (Taxpayer), and also reduced 1998 and 1999 refunds claimed by the Taxpayer. The Taxpayer appealed to the Administrative Law Division pursuant to Code of Ala. 1975, §40-2A-7(c)(5)a. A hearing was conducted on April 19, 2002 at the Department's Birmingham Taxpayer Service Center. The Taxpayer and her tax preparers, Betty Kirby and Tula Teal, attended the hearing. Assistant Counsel Keith Maddox represented the Department.

This is a casualty loss case. The Department concedes that the Taxpayer suffered a loss in 2000. The dispute concerns the amount of the loss.

The Taxpayer's house was destroyed by fire in early December 2000. The house and contents were a total loss. The Taxpayer claimed a gross casualty loss of \$66,074.49 (\$46,300 relating to the house, and \$19,774.49 relating to furniture, clothing, appliances, etc.) on her 2000 Alabama and federal income tax returns. The loss reduced her 2000 liability to zero. She also carried the loss back to 1997, 1998, and 1999 and claimed refunds in those years.

The Department disallowed the carryback to 1997 because effective May 1, 1998, the carryback period for losses was reduced to two years only. Code of Ala. 1975, §40-18-15.2(2). The Taxpayer does not contest that adjustment.

The Department also reduced the amount of the claimed loss. That resulted in reduced refunds due in 1998 and 1999. The Taxpayer appealed.

The Taxpayer testified extensively at the April 19 hearing concerning how she computed her basis in the house and the fair market value of the contents. The Taxpayer purchased the house in 1982 for \$30,000. Shortly thereafter, she added a fourth bedroom, new cabinets, a walk-in pantry, an extra bath, a new roof, and central air and heating. She also repaired and remodeled the house after a minor fire in 1998. She obtained information from businesses where she had purchased materials for the house, and calculated that the improvements cost at least \$16,300. She thus claimed a casualty loss relating to the house of \$46,300. The county tax assessor had appraised the house at \$55,000 for property tax purposes.

Concerning the furniture, clothing, kitchen appliances, and other household items destroyed in the fire, the Taxpayer visited the various businesses where she had purchased the items to determine their replacement cost. The total replacement cost was \$39,548.98. The Taxpayer deducted one-half of that amount, or \$19,774.49, as the fair market value of the items destroyed in the fire. The Taxpayer testified that since computing the fair market value of the household items, she has remembered numerous other items she forgot to list.

Alabama law allows a nonbusiness casualty loss to the same extent allowed by federal law at 26 U.S.C. §165(c)(3). See, Code of Ala. 1975, §40-18-15(a)(6). In such cases, federal case law and authority should control in

interpreting the Alabama statute. *State Dept. of Revenue v. Acker*, 636 So.2d 470 (Ala.Civ.App. 1994).

The allowable amount of a nonbusiness casualty loss is the difference between the fair market value of the property immediately before the casualty and its value immediately after the casualty, not to exceed the taxpayer's adjusted basis in the property. As with all deductions, taxpayers are generally required to establish by adequate records that they are entitled to a casualty loss. However, if a taxpayer's records are destroyed by fire, storm, or otherwise through no fault of the taxpayer, the taxpayer may reasonably reconstruct such records. *Hentges v. C.I.R.*, T.C. Memo 1998-244 (U.S. Tax Court 1998). Further, the rule established in *Cohan v. Commissioner*, 39 F.2d 540 (2nd Cir. 1930) is that if a taxpayer is entitled to a deduction, but is unable to prove the exact amount of the deduction, the taxpayer may reconstruct the amount using reasonable evidence.

In *Blass v. C.I.R.*, T.C. Memo 1977-254 (U.S. Tax Court 1977), the taxpayer claimed a \$35,000 casualty loss when his house was destroyed by fire. The taxpayer had no records showing his cost basis in the structure. The IRS allowed the taxpayer a \$5,000 loss. The Tax Court weighed the evidence and increased the amount to \$12,000.

Petitioner testified that he incurred \$35,000 of out-of-pocket costs in the construction of his self-built four room, one story, frame brick-veneer twelve hundred square feet house with no basement. The house was constructed in or around 1964. Petitioner presented no specific evidence of the cost of any of the materials and components. He testified that the house had ~~Aebony~~ shingles and oak floors. He submitted a photograph of the house under construction just before

the brick veneer was constructed. On the record, we are unable to accept his entirely unsubstantiated testimony that the materials for the house cost him \$35,000. The house was relatively small, with ordinary construction, and we believe that \$35,000 is a grossly inflated estimate of cost. On the other hand, we consider the \$5,000 cost determined by respondent (also unsupported by evidence) to be unrealistically low. Under the circumstances, and on a very unsatisfactory record, we believe it appropriate to apply the rule of *Cohan v. Commissioner*, 39 F.2d 540 (2d Cir. 1930). Weighing the facts against petitioner, who had the burden of proof, we are convinced the materials, components and appliances which went into the house cost not less than \$10 per square foot, or \$12,000, and we find \$12,000 to have been the basis for the house and the amount of the casualty loss.

Blass, T.C. Memo 1977-254.

In this case, the Taxpayer's records were destroyed when her house burned.¹ From photographs submitted by the Taxpayer, the house appears to have been a medium-size structure in relatively good repair before it burned. Allowing for inflation and the increased cost of construction since the Tax Court applied a \$10 per square foot cost in *Blass*, it is reasonable to conclude that the Taxpayer's house had a cost basis of at least the \$46,300 claimed by the Taxpayer. This is supported by the county tax assessor's fair market appraisal of \$55,000.

The fair market value of a person's clothes, kitchen items, furniture, etc. varies greatly from individual to individual. Clothing and other personal items are generally worth only a small fraction of their cost, perhaps 15 to 25 percent. On

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It is unclear what records were destroyed in the fire. However, most individuals normally do not keep purchase information concerning clothing, common household items, and even furniture. Consequently, it is usually necessary to reasonable estimate the fair market value of such items after a disaster.

the other hand, some furniture, especially antiques and artwork, may increase in value.

The Taxpayer in this case makes no claim that any antiques or other unusually valuable items were destroyed by the fire. Under the circumstances, it is reasonable to value the items overall at one-third of cost. Consequently, the Taxpayer should be allowed a \$13,182.99 loss for the house contents.

The Department is directed to recompute the Taxpayer's 1998 and 1999 refunds based on the above findings. A Final Order will then be entered.

This Opinion and Preliminary Order is not an appealable Order. The Final Order, when entered, may be appealed to circuit court within 30 days pursuant to Code of Ala. 1975, §40-2A-9(g).

Entered May 23, 2002.

BILL THOMPSON
Chief Administrative Law Judge

bt:dr

cc: Keith Maddox, Esq.
Nettie Alexander
Kim Herman