

ALABAMA TAX TRIBUNAL

MARY L. HAMMER,	§	
Taxpayer,	§	DOCKET NO. INC. 19-722-JP
v.	§	
STATE OF ALABAMA	§	
DEPARTMENT OF REVENUE.		

OPINION AND FINAL ORDER

Mary L. Hammer (Taxpayer) timely filed her 2016 Alabama individual income tax return, requesting a refund of \$2112. The Alabama Department of Revenue issued the refund, but later audited the return and adjusted certain amounts reported as income and deductions. After an administrative review with the Taxpayer, the Revenue Department agreed that a deduction for real estate tax paid was allowable but continued to dispute other deductions. Most notably, the Revenue Department disallowed deductions for expenses associated with a bed-bug infestation, because the Revenue Department claimed that such an infestation did not qualify as a deductible casualty loss. The Revenue Department entered a final assessment against the Taxpayer, which she appealed to the Alabama Tax Tribunal.

Question Presented

The dispositive question is whether the Taxpayer documented the fair market value of the affected property immediately before the bed-bug infestation and immediately after the infestation.

Law and Analysis

In Ala. Code § 40-18-15(a)(6), the legislature allows an income tax deduction for “[c]asualty and theft losses sustained during the taxable year of property not connected with the conduct of a trade or business or a transaction entered into for profit as determined in accordance with subsections (c)(3) and (h) of 26 U.S.C. § 165.” Subject to certain exceptions that are not relevant here, 26 U.S.C. § 165(c)(3) allows a deduction for “losses of property not connected with a trade or business or a transaction entered into for profit, if such losses arise from fire, storm, shipwreck, or other casualty, or from theft.”

To aid in interpreting 26 U.S.C. § 165, the following federal administrative rule was adopted:

(b) Amount deductible –

(1) General rule. In the case of any casualty loss whether or not incurred in a trade or business or in any transaction entered into for profit, the amount of 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. However, if property used in a trade or business or held for the production of income is totally destroyed by casualty, and if the fair market value of such property immediately before the casualty is less than the adjusted basis of such property, the amount of the adjusted basis of such property shall be treated as the amount of the loss for purposes of section 165(a).

26 C.F.R. § 1.165-7(b)(1)(i) and (ii).

Further, in calculating the fair market value of the property in question, the rule states:

(a) In general -

...

(2) Method of valuation.

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

26 C.F.R. § 1.165-7(a)(2)(i).

Here, both parties cited cases and presented arguments to support their respective positions that a bed-bug infestation does or does not qualify as a casualty loss for tax purposes. It is not necessary to decide that question, however, because the Taxpayer did not properly document the amount of her claimed loss.

Specifically, the Taxpayer did not establish, by competent appraisal or otherwise, the fair market value of the affected property immediately before or after the infestation. Nor did the Taxpayer establish the amount of her adjusted basis in the property. See 26 C.F.R. § 1.165-7(b)(1). Instead, the Taxpayer merely deducted the costs of replacement furniture and flooring and the expenses incurred for painting and for a pest-control treatment. Later, the Taxpayer submitted to the Tax Tribunal a self-prepared spreadsheet in an attempt to determine the fair market value of the property in question. However, the amounts on the spreadsheet were based on information that she found on the Salvation Army's website (or other sites) concerning items that the Taxpayer considered to be somewhat comparable to her items. The Taxpayer used that information to assign a condition to each item, such as

poor, fair, or good, and to then assign the Taxpayer's own assessment of fair market value, sometimes using assumptions and averages.

Although the Tax Tribunal appreciates the Taxpayer's efforts, her estimation does not meet the standard for documenting a loss that is set forth in 26 C.F.R. § 1.165-7(a) or (b). See *also* Ala. Code § 40-2A-7(a)(1), requiring taxpayers to "keep and maintain an accurate and complete set of records, books, and other information sufficient to allow the department to determine the correct amount of value or correct amount of any tax ... administered by the department ..." In fact, the Revenue Department's objection to the Taxpayer's estimation succinctly points out its deficiencies:

Importantly, this fair market value estimation is the Taxpayer's own, and reflects the fair market value of such items as they currently exist, not as they existed in 2016. More important, however, is the fact that this spreadsheet is the Taxpayer's own creation, using as reference data she retrieved from the Salvation Army regarding the probable value of items that are of unknown similarity to the Taxpayer's, and taking further as their guide the Taxpayer's own estimation of each item's condition.

The Taxpayer did not document the amount of her claimed loss. Therefore, it is unnecessary to decide whether a bed-bug infestation qualifies as a casualty loss.

The final assessment of 2016 income tax is upheld, except that the late-payment penalty is waived. Judgment is entered in favor of the Revenue Department and against the Taxpayer in the amount of \$2,528.50, plus additional interest that continues to accrue until the assessment is paid in full.

It is so ordered.

This Opinion and Final Order may be appealed to the appropriate circuit court within 30 days, pursuant to Ala. Code § 40-2B-2(m).

Entered July 1, 2021.

/s/ Jeff Patterson

JEFF PATTERSON

Chief Judge

Alabama Tax Tribunal

cc: Mary L. Hammer
Ralph M. Clements, III, Esq.