STATE OF ALABAMA DEPARTMENT OF REVENUE,	§ §	STATE OF ALABAMA DEPARTMENT OF REVENUE ADMINISTRATIVE LAW DIVISION
v.	§	DOCKET NO. INC. 86-237
SAMUEL D. & MARCY H. PUCKETT 161 South Hawk Drive Gadsden, AL 35901,	§ §	
Taxpayers.	§	

ORDER

This case involves a disputed casualty loss deduction claimed by Samuel D. and Marcy H. Puckett (Taxpayers) per their Alabama income tax return for the year 1984. A hearing was conducted in the matter on March 26, 1987 at the Revenue Department's Taxpayer Service Center in Birmingham. The Taxpayers were represented by certified public accountant, Luther D. Abel. Assistant counsel Mark Griffin appeared on behalf of the Department. Based on the evidence submitted at said hearing, the following findings of fact and conclusions of law are hereby made and entered.

FINDINGS OF FACT

In 1980, the Taxpayers built a swimming pool at their residence in Gadsden, Alabama, along with a surrounding patio and brick and cedar wall. The total cost for the improvements was $23,580.00.

In July, 1984, a severe thunderstorm caused flooding throughout the Taxpayer's neighborhood. After the storm, the Taxpayers noticed surface cracks and settling in the patio deck and pool area. The Taxpayers filed an insurance claim and received

$900.00 ($1,000.00 less $100.00 deductible), the maximum allowed under their policy. The Taxpayers also attempted to repair the structure at a cost of $2,238.80. During the repair attempt, further extensive damage was discovered and the Taxpayers hired an engineering firm to investigate.

The engineer's report revealed that the soil beneath the deck and pool was loose due to failure by the pool contractor to properly prepare and compact the fill dirt used in constructing the pool and surrounding improvements. As a result of the engineer's findings, the Taxpayers hired an attorney to sue the contractor. Because the pool builder had filed for bankruptcy, the attorney sought compensation through the builder's bonding agent. The bonding company offered the Taxpayers a $14,000.00 settlement, which the Taxpayers accepted and received in May, 1985.

The engineering fees associated with the pool were $2,200.00, attorney fees were $2,500.00, and the Taxpayers paid $2,000.00 to have the pool and enclosure demolished.

On their 1984 Alabama return, the Taxpayers claimed a casualty loss deduction of $24,448.00 under the provisions of Code of Ala. 1975, §40-18-15(6). The Taxpayers' return was audited by the Department and the casualty loss deduction was disallowed in full.

The Department auditor noted in her report that the damage resulted from (1) faulty construction, and (2) excessive rainfall. The auditor then concluded that the storm was the identifiable

event which caused the damage. However, the auditor disagreed with the Taxpayers as to the amount of the loss by concluding that the fair market value of the pool and enclosure immediately prior to the storm was equal to the $14,000.00 received by the Taxpayers from the pool builder's bonding agent. The auditor apparently offset the allowable $14,000.00 deduction by treating the $14,000.00 settlement as income received by the Taxpayers in 1984. Accordingly, no deduction was allowed.

Upon transmittal of the audit report to the Income Tax Field Section in Montgomery, the disallowance of the casualty loss was upheld, but the Field Section's justification for upholding the disallowance was based on the argument that the damage had been caused by the faulty construction, and not by the storm. Consequently, the Department based its case at the administrative hearing on the argument that the damage was not caused by a sudden and unforeseen event which would qualify as a casualty loss under §40-18-15(6).

CONCLUSIONS OF LAW

Section 40-18-15(6) provides a deduction for losses arising for such sudden and unforeseen events as fires, storms, shipwrecks, etc. The initial question raised in this case is whether the damage to the Taxpayers' property was caused by faulty construction, which would not give rise to a deduction, or by the thunderstorm, in which case a deduction would be allowable.

The pool, patio and surrounding fence were built in 1980 and existed for four years without apparent damage. Only after the sudden thunderstorm in 1984 did the damage in question occur. Accordingly, it is clear that the proximate cause of the settling and shifting of the pool and patio foundation was the thunderstorm that occurred in July, 1984. However, the underlying fact that the improvements had been negligently constructed would have a bearing on the fair market value of the property.

The measure of a casualty loss is the difference between the fair market value of the subject property immediately prior to the catastrophic event and its fair market value immediately after, but not to exceed the property basis. Helvering v. Owens, 59 S.Ct. 260, 305 U.S. 468; U.S. v. Koshland, 208 F.2d 636; Westvaco v. U.S., 639 F.2d 700. The original cost basis of the property is not a factor. Further, the burden of establishing the existence and amount of a casualty loss is on the taxpayer. Westvaco v. U.S., supra.

There is no dispute that the Taxpayers' cost in the pool and surrounding improvements was approximately $23,850.00. However, even a well-constructed pool, patio and fence would have been worth less than its original cost due to normal wear and tear. Add to that the fact that the construction was negligently performed, and the fair market value of the property at the time of the storm would obviously be a good deal less than the cost of the improvements. The only evidence introduced at the hearing which

could be used to establish a fair market value for the pre-storm property is the $14,000.00 settlement received by the Taxpayers from the bonding company. The value of the improvements after the storm was zero. Accordingly, as initially concluded by the Department's auditor, the Taxpayers should be allowed a $14,000.00 casualty loss in 1984 for the destruction of their pool, patio and surrounding fence.

The auditor allowed the loss, but offset the deduction by the proceeds received from the bonding company. However, the evidence shows that the loss was incurred in 1984, whereas the reimbursement was received by the Taxpayers in 1985. Under such circumstances it would be proper for the Taxpayers to take the allowable casualty loss deduction in 1984, and then report the amount received from the settlement, less expenses incurred in investigating and settling the matter, as income in 1985.

The above considered, the Revenue Department is hereby directed to recalculate the Taxpayers' liability as set out herein, and to thereafter submit the adjustments to the Administrative Law Division for entry of a subsequent final order.

Done this 24th day of April, 1987.

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BILL THOMPSON
Chief Administrative Law Judge