

STATE OF ALABAMA
DEPARTMENT OF REVENUE,

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STATE OF ALABAMA
DEPARTMENT OF REVENUE
ADMINISTRATIVE LAW DIVISION

§

v.

§

DOCKET NO. INC. 87-217

STEVEN F. JACOBS
Route 2, Box 702
Union Grove, AL 35175,

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§

Taxpayer.

§

FINAL ORDER

The Revenue Department partially denied a refund of income tax claimed by Steven F. Jacobs ("Taxpayer") on his 1985 Alabama income tax return. The Taxpayer appealed to the Administrative Law Division and a hearing was conducted on November 2, 1988. The Taxpayer represented himself. Assistant counsel Duncan Crow appeared for the Department. Based on the evidence and arguments presented by the parties, the following recommended findings of fact and conclusions of law are hereby made and entered.

FINDINGS OF FACT

The Taxpayer purchased thirty-three acres of land in Huntsville, Alabama in 1983 for \$40,100.00. The property was undeveloped and included a large number of trees. The Taxpayer intended to develop the property as a tree nursery. The Taxpayer prepared for the nursery during 1983 and 1984 by clearing some of the land, trimming and labeling a number of the trees, and planting a few smaller trees.

In early 1985, the Taxpayer discovered that the property had been bulldozed and that a number of trees had been destroyed. Upon

investigation, the Taxpayer discovered that the damage was done by the City of Huntsville for the purpose of disbursing large flocks of roosting birds. The City considered the birds a health hazard to the area residents.

No birds or bird damage had been observed by the Taxpayer prior to the City's action. Further, the Taxpayer was not notified by the City prior to the destructive event.

The Taxpayer sued the City for damages and eventually settled in June, 1986 for \$4,000.00.

The Taxpayer subsequently filed a 1985 Alabama income tax return and claimed the following:

(a) A casualty loss deduction of \$22,400.00. The loss was based on a tree damage appraisal of \$12,700.00 and an estimated cleanup appraisal of \$9,800.00.

(b) A farm expense deduction of \$5,764.00. The farm expenses were incurred in preparation for the opening and operation of the tree nursery.

(c) interest expense of \$3,943.00 relating to the financing of the subject property.

The Department disallowed the casualty loss because (1) the destructive event was not in the nature of a "fire, storm, shipwreck or other casualty" within the purview of Code of Ala. 1975, §40-18-15(6); and (2) the Taxpayer failed to establish a cost basis in the destroyed property.

The farm expenses were disallowed in full. The Department's position is that the cost of starting a new business must be capitalized and cannot be fully deducted in the current year.

Interest expense of \$3,943.00 was included as part of the farm expenses and was thus disallowed. However, the Department allowed the full amount claimed as an itemized deduction, plus an additional amount of \$4,473.00, or a total of \$8,416.00.

CONCLUSIONS OF LAW

1. The Casualty Loss Issue

Alabama law provides a deduction for losses "arising from fires, storms, shipwrecks or other casualties . . .11, see Code of Ala. 1975, §40-18-15(a)(6). That section is modeled after the federal statute on point, 26 U.S.C. §165.

The IRS defines a casualty loss as the "complete or partial destruction of property resulting from an identifiable event of a sudden, unexpected and unusual nature". Rev. Rul. 72-592, 1972-2C.B.101. That same regulation defines an "unusual" event as one that is "extraordinary and non-reoccurring, one that does not commonly occur during the activity in which the taxpayer was engaged when the destruction or damage occurred, and one that does not commonly occur in the ordinary course of day-to-day living of the taxpayer".

It is not necessary that the destructive event must be a natural

disaster. Rather, losses from "man-made" calamities have been allowed as deductible casualty losses in a number of instances. A house damaged by a distant quarry explosion qualified as a deductible loss in Durden, 3 T.C.1, Dec. 13,672. Damage to a septic tank caused by a tractor was allowed in Harry M. Lett, 14 T.C.M. 39 Dec. 20,826, aff'd 230 F.2d 847. Damage caused by vandalism was allowed in B. E. Davis, 34 T.C. 586, Dec. 24,246, and J. L. Pickering, 37 T.C.M. 1765 Dec. 35,485, cert. denied 100 S. Ct. 654. Finally, a tree chopped down by a neighbor qualified as a casualty loss in A.T. Butson, 43 T.C.M. 557, Dec. 38,795. (Although the loss was eventually disallowed because no proof was established that the tree was on the taxpayer's property.)

The destructive event in the present case was the bulldozing of the Taxpayer's property by the City. Certainly that action was sudden, unexpected and unusual from the standpoint of the Taxpayer. Accordingly, a casualty loss should be allowed.

A casualty loss is measured by the difference between the value of the property immediately preceding the destructive event and its value immediately following, but limited to the adjusted cost basis of the property and reduced by any reimbursement or compensation received. Helvering v. Owens, 59 S.Ct. 26, 305 U.S. 468.

In the present case, there is no evidence as to the before and after value of the subject property. However, the Taxpayer did provide independent appraisals concerning the value of the

destroyed trees and the cost of cleaning up the damage. The damage estimates were less than the Taxpayer's basis in the property. However, there was no evidence that the amount claimed as cleanup expenses was actually spent by the Taxpayer. Accordingly, a deduction should be allowed based on the tree damage appraisal of \$12,700.00. That amount should be reduced by the \$4,000.00 received as compensation by the Taxpayer in his lawsuit with the City. The Taxpayer is hereby given 30 days from the date of this Order in which to provide evidence that the cleanup expenses were actually incurred, at which time the amount actually incurred for cleanup will be allowed as part of the casualty loss deduction.

2. The Farm Expense Issue

The Taxpayer also deducted various expenses incurred in preparing to open the tree nursery. However, business entry expenses incurred prior to the opening of a business must be capitalized and deducted over the life of the asset. Deputy v. Dupont, 306 U.S. 488; Richard Television Corp. v. U.S., 345 F.2d 901. Accordingly, the Department properly disallowed a full deduction in the subject year.

3. The Interest Issue

The Taxpayer incorrectly claimed an interest deduction as part of the farm expenses discussed above. However, the Department properly allowed the amount claimed plus an additional interest discovered per the audit as an itemized deduction pursuant to Code

of Ala. 1975, §40-18-15(a)(2).

The Taxpayer's liability should be recomputed based on the above findings, and any refund due the Taxpayer should thereafter be granted, subject to the substantiation of the cleanup expense above. This Order shall constitute the final order for purposes of judicial review according to the provisions of §41-22-20, Code of Alabama 1975,

Done and ordered this the 10th day of January, 1989.