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7 **BOARD OF EQUALIZATION**
8 **STATE OF CALIFORNIA**

10 In the Matter of the Appeal of:) **HEARING SUMMARY**
11) **PERSONAL INCOME TAX APPEAL**
12 **JOHN M. CALLAGHAN AND**) Case No. 843533
13 **DORIS K. CALLAGHAN**)

14 _____
15 Year Proposed
16 2009 Assessment
17 \$6,335

17 Representing the Parties:

18 For Appellants: John M. Callaghan and Doris K. Callaghan
19 For Franchise Tax Board: Brian C. Miller, Tax Counsel III

21 QUESTION: Whether appellants have shown that they are entitled to a claimed casualty loss deduction
22 under Internal Revenue Code (IRC) section 165 for 2009.

23 HEARING SUMMARY

24 Background

25 Appellants filed a timely 2009 Form 540 return, reporting a federal and California
26 adjusted gross income (AGI) of \$166,565, claimed itemized deductions of \$148,093, taxable income of
27 \$18,472, and tax of \$275. After applying exemption credits of \$392, appellants reported a tax due of
28 zero. After applying withholding credits of \$1,834, appellants reported an overpayment of the same

1 amount. Appellants' claimed itemized deductions included a claimed casualty loss deduction of
2 \$99,500, which was reported on appellants' Schedule A. Appellants calculated the amount on a Form
3 4684, *Casualties and Thefts*, attached to their federal return. Appellants claimed a decrease in real
4 property value of \$100,000 in 2009, and reduced it by a \$500 deductible amount, leaving \$99,500 as a
5 casualty loss claim. (Resp. Op. Br., p. 1; Exs. A & B.)

6 Respondent examined appellants' return and disallowed the claimed casualty loss
7 deduction of \$99,500. Respondent issued a Notice of Proposed Assessment (NPA) on October 24,
8 2013, which increased appellants' taxable income by \$99,500, from \$18,472 to \$117,972 (i.e., \$18,472
9 + \$99,500). The NPA proposed an assessment of additional tax of \$6,335, plus interest.¹ (Resp. Op.
10 Br., pp. 1-2; Ex. C.)

11 Appellants protested the NPA. An FTB protest hearing officer examined documentation
12 that appellants made available and held a protest hearing. Thereafter, respondent affirmed the NPA and
13 issued a Notice of Action (NOA) on July 28, 2014. This timely appeal followed. (Resp. Op. Br., p. 2;
14 Ex. H.)

15 Contentions

16 Appeal Letter

17 Appellants contend that slippage occurred on their property on or about March 23-24,
18 2009. Appellants state that the property where the slippage occurred is contiguous to and below their
19 property and provides lateral support to their property. Appellants assert that the "slipped property" is
20 owned by the City of Agoura Hills, and not by appellants. Appellants assert that the slipped property is
21 not owned or controlled by them. Appellants contend that the slippage diminished the lateral support
22 provided to appellants' property and has permanently physically damaged their property. Appellants
23 contend that they have no right or ability to correct this slippage which exists. (Appeal Letter; p. 1.)

24 Appellants contend that the connection of the slipped property with and to appellants'
25

26 ¹ Appellants also claimed casualty loss deductions in 2008 and 2010. In 2008, appellants claimed on their federal and
27 California returns a casualty loss deduction of \$174,954 based on a claimed diminishment of \$200,000 in their home's value.
28 In 2010, appellants also claimed on their federal and California returns a casualty loss deduction of \$83,194 based on a
claimed diminishment of \$100,000 in their home's value. Respondent did not open an examination of appellants' 2008 and
2010 California returns, but respondent asserts that the salient facts from those returns provide context for the casualty loss
claim of 2009. (Resp. Op. Br., p. 1; Exs. D, E, F, & G.)

1 property makes this matter very different from the matter in *Pulvers v. Commissioner (Pulvers)* (9th Cir.
2 1969) 407 F.2d 838, as cited by the FTB in the NOA. Appellants state that, in *Pulvers*, the slipped
3 property was approximately 300 feet removed from the property claimed to be damaged, and there was
4 no claim of loss of lateral support and its associated injury in that case. Appellants argue that common
5 sense, as well as the enclosed photographic and appraisal documentation provided by appellants to the
6 FTB, establishes that appellants have suffered a deductible casualty loss in that their property has been
7 diminished in value. (Appeal Letter; p. 1.)

8 Appellants assert that the NOA stated that the loss must be “fixed by some identifiable
9 event, such as permanent physical damage”, which appellants contend is the loss of lateral support due
10 to the slippage in 2009 and the permanent physical damage caused thereby. Appellants argue that the
11 loss, acknowledged and uncontested by the FTB, of lateral support from contiguous property, which
12 appellants are incapable of correcting, is and includes, in and of itself, permanent physical damage.
13 (Appeal Letter; p. 1.)

14 Appellants contend that the FTB assessment is wrong in that it has chosen to focus on a
15 self-serving straw man argument that appellants have only raised a “stigma” issue, akin to the *Pulvers*
16 matter, and has gone to the lengths of adopting nuanced language in its NOA by describing the instant
17 matter as involving a “neighboring” land slippage, instead of the accurate, uncontested “contiguous”
18 land slippage which is truly at issue. Furthermore, appellants contend that the NOA features language
19 from the appraisal submitted by appellants that deals with the stigma issue, as if appellants, or its
20 appraiser, were required to turn a blind eye to the issue, or somehow distance appellants from it.
21 Appellants argue that, the fact is that the appraisal is a 37-page document that comprehensively
22 addresses the damages suffered by appellants, including the loss of lateral support, in and of itself.
23 Appellants state that the FTB has chosen to ignore the findings of that appraisal except for the stigma
24 language that it believes suits it. (Appeal Letter; p. 1.)

25 Appellants assert that it is worth noting that the FTB, by implication, is requiring, after
26 the fact, that appellants provide an even more comprehensive, more expensive, engineering report in
27 order to establish the obvious with particularity; i.e., to identify the specific damage to their property
28 associated with, and/or caused by, the loss of lateral support. Appellants argue that, said another way,

1 the FTB is requiring appellants to spend, not just the thousands of dollars in appraisal and associated
2 fees already spent, but tens of thousands of dollars for engineering studies and legal fees, in order to
3 address the so-called “noticeable damage” issues, in a matter that involves an approximately \$7,000
4 assessment. Appellants assert that such a requirement is unfair and inequitable, particularly in a
5 circumstance where the FTB failed to respond to appellants’ frequent requests for guidelines regarding
6 the scope of the appraisal evidence appellants needed to support their property damage claim. (Appeal
7 Letter; p. 2.)

8 Respondent’s Opening Brief

9 Respondent states that a slope on real property adjacent to appellants’ real property slid
10 during 2009. Respondent states that this slipped property, owned by the City of Agoura Hills, is
11 contiguous to and below appellants’ real property. Respondent states that appellants claim that the
12 slippage on this adjacent property has permanently physically damaged their property, which sits atop
13 the slipping hillside. Respondent asserts that appellants state that, because they do not own the slipped
14 property, they are unable to slow or stop its movement. (Resp. Op. Br., p. 2; Ex. I.)

15 Respondent states that appellants attach to their appeal letter an appraisal of their
16 property conducted in May 2014 to determine the property’s fair market value (FMV) in 2009.
17 Respondent asserts that this appraisal, attached to its opening brief as Exhibit J, states that the landslide
18 activity that occurred on the hillside just below the property would have to be disclosed to potential
19 buyers. Respondent asserts that the report notes that this condition is an adversity in the eyes of buyers,
20 who may choose instead a like home to avoid future legal battles or remediation costs. Respondent
21 asserts that the appraiser wrote that, because of this, the property “is said to suffer from a stigma.”
22 Respondent states that the appraiser wrote that appellants’ property suffers “from buyer’s perceptions of
23 the dangers of landslides near homes.” Respondent states that appellants told the appraiser that their
24 home has not suffered any noticeable cracks or damage due to the landslide activity. (Resp. Op. Br., p.
25 2; Ex. J, p. 13.)

26 Respondent asserts that the appraisal states that appellants’ property “is believed to
27 suffer in value due to the detrimental condition of the nearby landslide. The subject is believed to
28 suffer at least \$100,000 in value as a result.” Respondent states that the appraiser determined his

1 estimate of a \$100,000 loss by averaging the sale price of homes between January and March 2009, and
2 averaging the sale price of homes between April and June 2009, with the difference in value between
3 the two periods being \$101,900. Respondent states that the appraiser noted that “[n]ormal paired sales
4 analysis was not available as the ‘before and after-exact date’ of the landslide is difficult to ascertain.”
5 Respondent asserts that the appraisal does not state why the period between January and March 2009
6 and the period between April and June 2009 were compared to conclude their property value
7 diminished by \$100,000 in the taxable year ending December 31, 2009. (Resp. Op. Br., p. 2; Ex. J, p.
8 13.)

9 Respondent asserts that the appraisal also looked at market trends during 2009 to
10 ascertain market conditions in that year. Respondent states that the appraisal noted that there “was a
11 slight spike in value at the beginning of 2009 - and then the values declined by the end of 2009 and
12 continued until about 2012.” Respondent states that the downward market trend during 2009 was noted
13 by the appraisal on exhibit pages 32, 33, and 34, and the appraisal does not claim that the market decline
14 was caused by hillside slippage. Respondent asserts that this is probably a decline in value based on the
15 overall economic conditions during this period. (Resp. Op. Br., p. 3; Ex. J, p. 32.)

16 Respondent states that appellants also provided a January 2013 engineering report
17 during their protest. Respondent states that the report provided a technical analysis to the homeowners
18 association that managed the slope behind appellants’ property. Respondent states that the
19 homeowners association was in the process of determining the scope of repair to the slope. Respondent
20 states that the 2013 engineering report makes no mention of a slope failure in 2009, the taxable year at
21 issue in this appeal. Respondent asserts that appellants contend that there was slippage on/about
22 March 23 and 24, 2009, but without further documentation. (Resp. Op. Br., p. 3; Ex. K.)

23 Respondent asserts that the 2013 engineering report states that the slope failed after the
24 completion of tract grading in 1983 but before June 1992. Respondent notes that the engineering report
25 also states that there was a repair of the failed slope in 2000 and that the repaired slope failed again in
26 2005, but no further incidents are stated in the engineering report. Respondent asserts that, in other
27 words, the reality that the slope was an issue was evident to potential buyers as early as 1983, and the
28 slippage was not the isolated incident as described by appellants, and is not described in the engineering

1 report. (Resp. Op. Br., p. 3; Ex. K, p. 6.)

2 Respondent asserts that a deductible casualty loss requires actual damage to property,
3 and a loss of value due to stigma is not a deductible casualty loss. Respondent argues that a deduction
4 for a loss is allowed when the loss is sustained during the taxable year and is not compensated for by
5 insurance or otherwise, citing IRC section 165(a), as conformed to by California pursuant to Revenue
6 and Taxation Code (R&TC) section 17201. Respondent asserts that the burden of proving the casualty
7 loss and the amount is on the taxpayer, citing *Thornton v. Commissioner* (1966) 47 T.C. 1. (Resp. Op.
8 Br., pp. 3-4.)

9 Respondent asserts that a casualty loss is deductible if the loss arises from a fire, storm,
10 shipwreck, or other casualty, citing IRC section 165(c)(3) and R&TC section 17201. Respondent
11 asserts that, to define the term “other casualty”, courts look for characteristics similar to those of a fire,
12 storm, or shipwreck, citing *Maher v. Commissioner* (1981) 76 T.C. 593, affd. 680 F.2d 91. Respondent
13 contends that the specific losses stated in IRC section 165(c)(3) (i.e., fire, storm, or shipwreck) involve
14 physical damage or loss of the physical property, citing *Pulvers*. Respondent asserts that the amount of
15 the casualty loss is based on the cost of repairs, rather than on abstract theory and attenuated
16 hypotheses, citing *Pfalzgraf v. Commissioner* (1977) 67 T.C. 784. (Resp. Op. Br., p. 4.)

17 Respondent contends that appellants claim that the casualty loss is based on an alleged
18 reduction in their home’s value and, according to the appraiser, appellants’ home’s value decreased
19 based on the reluctance of a potential buyer to purchase property adjacent to a slipping hillside.
20 Respondent states that the appraiser did not recognize in his May 2014 appraisal report that the hillside
21 was slipping as far back as 1983, after grading work for the houses in appellants’ neighborhood.
22 Respondent contends that, in *Pulvers*, the court noted that the subject property value had decreased
23 because of concern that a landslide that damaged some nearby homes could attack their home next.
24 Respondent argues that the court held that the language of IRC section 165 required actual physical
25 damage, not hypothetical damage from a concern of a future casualty event. Respondent asserts that
26 the court also noted that Congress intended IRC section 165 to allow deductions for an actual loss, not
27 a hypothetical loss or a fluctuation in property value. (Resp. Op. Br., p. 4.)

28 Respondent asserts that appellants try to distinguish *Pulvers* from their case by noting

1 that the slippage in *Pulvers* was several hundred yards from the subject property, while the slippage in
2 their situation is adjacent to their land. Respondent contends that this distinction between *Pulvers* and
3 appellants' situation ignores the holding in *Pulvers* because *Pulvers* held that physical damage to a
4 taxpayer's property is a necessary element for a casualty loss deduction, and that the mere fluctuation in
5 market value does not constitute a casualty loss. Respondent asserts that the holding in *Pulvers* applies
6 directly to appellants' case because their property did not suffer any physical damage, as appellants
7 claim a casualty loss deduction based on a decline in market value. (Resp. Op. Br., p. 4.)

8 Respondent asserts that the Ninth Circuit held in another case that the loss of property
9 value based on a prediction of a future casualty is not deductible as a casualty loss, citing *Kamanski v.*
10 *Commissioner (Kamanski)* (1973) 477 F.2d 452. Respondent asserts that, in *Kamanski*, an earth slide
11 near the taxpayers' residence caused some wall cracking, and that the property value also declined due
12 to "buyer resistance," i.e., the reduction in market value due to a concern of a future earth slide.

13 Respondent states that the Internal Revenue Service (IRS) allowed a casualty loss for repairs of the
14 physical damage to the residence caused by the earth slide, but rejected the claim for a casualty loss
15 deduction due to buyer resistance, and the Tax Court upheld the IRS's decision. Respondent asserts
16 that, in *Kamanski*, the Ninth Circuit, in upholding the Tax Court's decision, noted that the loss in market
17 value was not due to damage caused by the casualty, but to buyer predictions that future casualties
18 would cause further damage, stating that "This may well be an accurate prediction but the claim of loss
19 must await the event." (Resp. Op. Br., pp. 4-5.)

20 Respondent asserts that the appraisal that appellants submitted notes that there was no
21 physical damage to their house, such as cracking. Respondent asserts that the appraisal concludes that
22 the property's value is diminished because of stigma. Respondent contends that an appraisal that
23 considers an economic theory, like market resistance or stigma, along with actual complementary, local
24 sales to conclude that the FMV of subject property is diminished after an event, does not establish a
25 deductible casualty loss for income tax purposes. Respondent asserts that, to be considered a deductible
26 casualty loss, the loss must be more than a "mere fluctuation in value," citing Revenue Ruling 66-242.
27 Respondent asserts that Revenue Ruling 66-242 explains that a decline and rise in market value due to
28 "psychological resistance" is usually short lived and "In such a case it does not represent an actual loss

1 resulting from damage to the property.” (Resp. Op. Br., p. 5.)

2 Respondent argues that the rationale for not allowing casualty loss deductions when
3 hypothetical buyer resistance reduces the value of property is that such a hypothetical loss in value
4 becomes fixed or real when the property is sold or disposed of and when the actual gain (or loss) is
5 determined, citing IRC section 1001 and R&TC section 18031. Respondent asserts that, if a loss were
6 allowed from current year earnings and the tax basis of the property were correspondingly reduced, then,
7 if the value of the property were to rise in a future year, a restoration of the deduction should be
8 required. Respondent contends that “The scheme of our tax laws does not, however, contemplate such a
9 series of adjustments to reflect the vicissitudes of the market, or the wavering values occasioned by a
10 succession of adverse or favorable developments”, citing *Citizens Bank of Weston v. Commissioner of*
11 *Internal Revenue* (1958) 252 F.2d 425. (Resp. Op. Br., p. 5.)

12 Furthermore, respondent contends that the Board has ruled on multiple occasions that a
13 deductible casualty loss is not incurred when a property value decreases because of buyer reluctance, or
14 stigma, attached to the property because prospective buyers fear that future casualty damage might
15 occur, citing the *Appeal of Henry H. and Diane A. Hilton (Hilton)*, 86-SBE-133, decided by the Board
16 on July 29, 1986, and the *Appeal of Charles McDaniel (McDaniel)*, 84-SBE-147, decided by the Board
17 on October 10, 1984.² Respondent states that, in *Hilton*, an appraisal of the taxpayers’ property
18 attributed a diminution in value to buyer reluctance or stigma because of the casualty, and the Board
19 found that the diminution in the property’s value, at least temporarily, was caused by the effect of the
20 casualty on the minds of hypothetical prospective buyers. Respondent asserts that the Board ruled in
21 *Hilton* that a hypothetical loss, based on a hypothetical buyer, is not a casualty loss because it reflects a
22 fluctuation in value and is not attributable to any actual physical damage. Respondent argues that the
23 Board stated that such a loss may be recognized on the sale or disposition of the property when there is
24 a real, not hypothetical, buyer. (Resp. Op. Br., p. 5.)

25 Respondent asserts that, in *McDaniel*, the taxpayer claimed a \$40,000 casualty loss due
26 to flooding and erosion which occurred during a Presidentially-declared natural disaster, and of the
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² Board of Equalization cases (designated “SBE”) may generally be found at: www.boe.ca.gov.

1 claimed \$40,000 casualty loss, \$28,000 was from “a decrease of market value.” Respondent states that
2 the Board allowed a casualty loss of \$2,200 which reflected actual physical damage, but rejected the
3 taxpayer’s claimed \$28,000 casualty loss stating that “[W]e have held before that to be a deductible
4 casualty loss the loss must be the result of actual physical damage. [A] deductible loss is not incurred
5 to the extent that property decreases in value merely because it is apparent that a casualty occurred, or
6 to the extent that it is due to fear of prospective buyers that future casualty damage might occur. . . As
7 appellant has proven no physical damage with respect to this additional \$28,000 (and beyond the
8 \$2,200 amount which has been allowed), we must also sustain respondent’s disallowance of that sum.”
9 (Resp. Op. Br., p. 6.)

10 Respondent contends that the loss of lateral support without physical damage is not a
11 casualty loss claim. Respondent argues that appellants contend that a loss of lateral support of their
12 property is a casualty loss and that they claimed during the docketed protest that there is a well-
13 established common law right to lateral support in adjoining land, and cited three cases. Respondent
14 states that appellants cited *Green v. Berge* (1894) 105 Cal. 52, which held that whoever deprives a
15 landowner of support of his land performs an unlawful act; *Peak v. Richmond Elementary School Dist.*
16 (1958) 161 Cal.Ap.2d 366, which involved whether a cause of action survives summary judgment
17 against architects whose work for a client damaged neighboring land; and *Empire Star Mines Co. v.*
18 *Butler* (1944) 62 Cal.App.2d 466, which involved whether a violation of the rights of lateral and
19 subjacent support give rise to an action for damages, among other underground mining issues.
20 Respondent asserts that the three cases that appellants cited appear to address whether appellants would
21 have a cause of action for a tort or another civil action against a neighboring landowner. Respondent
22 contends that the cases do not indicate that the facts of this appeal, where slippage on neighboring land
23 may have diminished lateral support of appellants’ land, are within the meaning of a casualty loss
24 deduction from taxable income. (Resp. Op. Br., p. 6.)

25 Respondent contends that appellants have no physical damage to their property and claim
26 a fluctuation in market value as a casualty loss deduction, which is not within the meaning of a casualty
27 loss deduction in California tax law. Also, respondent asserts that the IRS instructions to taxpayers on
28 casualties, disasters, and thefts instruct taxpayers that a decrease in the value of a taxpayer’s property

1 because it is in or near an area that suffered a casualty, or that might again suffer a casualty, is not to be
2 taken into consideration when calculating a casualty loss. Respondent asserts that taxpayers are
3 instructed in IRS Publication 547 that a casualty loss is only for actual casualty damage to a property
4 and instructs taxpayers that progressive deterioration is not deductible as a casualty loss. (Resp. Op. Br.,
5 p. 6; Ex. L, p. 2.)

6 Respondent contends that there is no undesigned, sudden, and unexpected event giving
7 rise to a casualty loss. Respondent asserts that appellants do not claim a casualty based on a fire, storm,
8 or shipwreck, and that their claim is that there was an “other casualty” pursuant to IRC section
9 165(c)(3). Respondent asserts that tax courts have ruled that “other casualty” requires an undesigned,
10 sudden, and unexpected event, or a sudden, cataclysmic, and devastating loss, citing *Torre v.*
11 *Commissioner* (2001) T.C. Memo 2001-218. Respondent contends that there is no evidence of an
12 undesigned, sudden, and unexpected event in 2009 required for a casualty loss deduction. (Resp. Op.
13 Br., p. 7.)

14 Respondent asserts that appellants claim that slippage occurred on March 23 and 24,
15 2009, but there is no evidence in the documentation provided that there was an undesigned, sudden, and
16 unexpected event, or a sudden, cataclysmic, and devastating loss on March 23 and 24, 2009, or any
17 other date in 2009. Rather, respondent asserts that there is a well-documented history of the slippage
18 dating back at least 30 years. Respondent notes that appellants purchased their house in 1988, over
19 25 years ago, and the hillside slippage is not sudden to the property. Respondent asserts that the
20 engineering report dated January 2013 reported on geologic examinations and analysis of the hillside
21 behind appellants’ property, but did not report any specific event on March 23 or 24, 2009. Respondent
22 asserts, however, that the engineering report does note that a major landslide occurred sometime
23 between 1983 and 1992. Respondent also asserts that the engineering report also states that there was a
24 repair of the failed slope in 2000 and that the repaired slope failed again in 2005, but that no further
25 incidents are indicated in the engineering report. (Resp. Op. Br., p. 7; Ex. K, pp. 5-6.)

26 Respondent contends that appellants appear to acknowledge that slippage is a constant
27 natural phenomenon endemic to hillsides by claiming casualty losses in 2008, 2009, and 2010, but do
28 not point to or document any specific events in any of those years, but seem to claim, in effect, that the

1 steady slippage of the hillside behind their property is grounds for a casualty loss deduction.
2 Respondent states that, in 2008, appellants claimed that their property value decreased from \$1.9
3 million to \$1.7 million, a \$200,000 decrease; in 2009, the taxable year at issue, appellants claim that
4 their property value decreased from \$1.7 million to \$1.6 million, a \$100,000 decrease; and in 2010,
5 appellants claim that their property value decreased from \$1.6 million to \$1.5 million, a \$100,000
6 decrease. (Resp. Op. Br., p. 7.)

7 Respondent contends that this pattern indicates that appellants acknowledge that the
8 slope behind their property is continuously slipping, and there has not been a sudden or unexpected
9 event causing damage to their property. Respondent contends that the slippage behind appellants
10 property may diminish its FMV over time, but the slippage behind their property is not a deductible
11 casualty loss. Respondent asserts that a loss is not a recognized tax event until the sale or disposal of
12 the property. (Resp. Op. Br., p. 7.)

13 Respondent asserts that appellants also claim that the FTB is requiring, after that fact,
14 that they provide an additional engineering analysis of their property. Respondent asserts that the FTB
15 is requiring no such thing and that the FTB has examined the professional appraisal and engineering
16 report that appellants provided at protest, and the FTB simply notes that, when the facts of their
17 situation are applied to the law, the facts do not fit within the terms of the legal authorities and
18 requirements for claiming a casualty loss deduction for income tax purposes, citing the *Appeal of*
19 *Robert R. Telles*, 86-SBE-061, decided by the Board on March 4, 1986. Respondent contends that a
20 new appraisal of the property's value in 2009 will not change the fact that appellants' property did not
21 sustain any physical damage in 2009. (Resp. Op. Br., pp. 7-8.)

22 Respondent asserts that appellants claimed at protest that the IRS allowed their casualty
23 loss claim for 2010, and that appellants contended that the FTB should consider the IRS's allowance as
24 a "compelling precedent." Respondent contends that the IRS determination of 2010 has no bearing on
25 the FTB's determination of 2009. Respondent argues that the Board has stated on numerous occasions
26 that respondent is not bound to follow a federal action and may independently examine a taxpayer's
27 return and make a determination independent of the IRS, citing the *Appeal of Der Weinerschnitzel*
28 *International, Inc.*, 79-SBE-063, decided by the Board on April 10, 1979. Therefore, respondent

1 contends that the IRS's allowance of appellants' casualty loss claim on their federal return in 2010 has
2 no bearing on the FTB's determination of their casualty loss claim on their California return in 2009.
3 (Resp. Op. Br., p. 8; Ex. M.)

4 Furthermore, respondent asserts that this appeal is for 2009, and the FTB did not
5 examine appellants' 2010 California return and made no determination for that year. Respondent
6 argues that this does not imply that the FTB would have allowed the casualty loss in 2010 had it
7 examined that year's return. Respondent asserts that *res judicata* is applicable only if the liability
8 involved is for the same year as was involved in another case previously determined, citing R&TC
9 section 19802. Respondent contends that the Board decides cases wholly on their own merits, without
10 regard to any express or implied determination by the FTB with respect to other years, citing the
11 *Appeal of Duane H. Laude*, 76-SBE-096, decided by the Board on October 6, 1976. (Resp. Op. Br., p.
12 8.)

13 Additional Briefing

14 The Appeals Division determined that additional briefing was necessary pursuant to
15 California Code of Regulations, title 18, (Regulation) section 5435, subdivision (a). Appellants were
16 requested to address the following issues:

- 17 (1) whether they could provide an explanation and evidence of the "slippage" that occurred on
18 or about March 23-24, 2009;
- 19 (2) whether the alleged slippage on March 23-24, 2009, was a sudden, unexpected, or unusual
20 incident (e.g., landslide) or part of an ongoing, day-to-day condition (e.g., erosion);
- 21 (3) whether they could provide any evidence in support of actual physical damage to their
22 property resulting from the alleged slippage;
- 23 (4) whether they could provide further evidence to show a diminution in value due to the
24 slippage, and address the following: (a) whether the dates used for the comparable sales in the
25 appraisal were arbitrary; (b) whether any drop in the value of the houses included in the
26 appraisal was arbitrary and unrelated to any alleged slippage and instead related to "general
27 market decline;" and (c) whether the appraisal provided a fair market value of the subject
28 property before and after the alleged casualty;
- (5) whether the case law indicates that a casualty loss cannot be taken when a loss is due to
buyers' future fears of landslides; and

1 (6) whether they could provide any argument or evidence to show the permanent buyer
2 resistance resulting from the alleged slippage on or about March 23-24, 2009.

3 Appellants did not file a response to the additional briefing letter.

4 Applicable Law

5 Burden of Proof

6 The FTB's determination is presumed correct and a taxpayer has the burden of proving
7 it to be wrong. (*Todd v. McColgan* (1949) 89 Cal.App.2d 509; *Appeal of Michael E. Myers*,
8 2001-SBE-001, May 31, 2001.) Unsupported assertions are not sufficient to satisfy a taxpayer's burden
9 of proof. (*Appeal of Aaron and Eloise Magidow*, 82-SBE-274, Nov. 17, 1982.) In the absence of
10 uncontradicted, credible, competent, and relevant evidence showing error in respondent's
11 determinations, such proposed assessments must be upheld. (*Appeal of Oscar D. and*
12 *Agatha E. Seltzer*, 80-SBE-154, Nov. 18, 1980.)

13 Tax deductions are a matter of legislative grace, meaning that a taxpayer must show that
14 he or she clearly meets all of the statutory requirements for a deduction. (See *Appeal of James C. and*
15 *Monablanch A. Walshe*, 75-SBE-073, Oct. 20, 1975; *New Colonial Ice Co. v. Helvering* (1934) 292
16 U.S. 435.) It is well-established that a taxpayer who claims a deduction must keep sufficient records to
17 substantiate the claimed deduction. (*Sparkman v. Commissioner* (9th Cir. 2007) 509 F.3d 1149, 1159.)

18 Casualty Loss Deduction

19 R&TC section 17201, subdivision (a), incorporates by reference IRC section 165, except
20 as otherwise provided. IRC section 165(a) provides generally that there shall be allowed as a deduction
21 any loss sustained during the taxable year and not compensated for by insurance or otherwise. IRC
22 section 165(c)(3) provides that, in the case of an individual, the deduction under IRC section 165(a)
23 shall be limited, except as provided under IRC section 165(h), to losses of property not connected with a
24 trade or business or a transaction entered into for profit, if such losses arise from fire, storm, shipwreck,
25 or other casualty, or from theft.

26 Treasury Regulation section 1.165-1(b) provides, in part, that, to be allowable as a
27 deduction under IRC section 165(a), a loss must be evidenced by closed and completed transactions,
28 fixed by identifiable events, and, except for certain stated exceptions, actually sustained during the

1 taxable year. A casualty loss is deducted only for the tax year in which the loss is sustained. (Int.Rev.
2 Code, § 165(a); Treas. Regs. § 1.165-1(d)(1) & 1.165-7(a)(1); *Lewis v. Commissioner*, T.C. Memo.
3 2000-249.) IRC section 165 is not intended to cover “a newfound awareness of an old risk attached to
4 the property.” (*Leonard v. United States*, 1995 U.S. Dist. LEXIS 10378.)

5 The Tax Court requires that the events giving rise to the loss through damage to the
6 taxpayer’s property be sudden, unexpected, or unusual in nature. The scope of “other casualty” has
7 been determined by looking to the shared characteristics of the enumerated casualties of fire, storm,
8 shipwreck, and theft. (See *White v. Commissioner*, 48 T.C. 430, 433 (1967); *Heyn v. Commissioner*
9 (1966) 46 T.C. 302.) “Where the taxpayer’s loss was due to progressive deterioration rather than some
10 sudden, unexpected, or unusual cause, such loss is not a deductible casualty loss.” (Rev. Rul. 76-134.)

11 Temporary buyer resistance that results from fears of future casualty does not qualify as a
12 casualty loss. (See *Thornton v. Commissioner, supra*; *Kamanski, supra*; *Finkbohner v. U.S.* (11th Cir.
13 1986) 788 F.2d 723.) A loss that is attributed to adverse buyer resistance is inadequate where it
14 represents a hypothetically calculated loss or a mere fluctuation in value due to fears of a future natural
15 casualty, such as a flood. (Rev. Rul. 66-242.)

16 *Pulvers* involved a Ninth Circuit decision involving a claimed casualty loss due to a
17 nearby landslide that ruined three nearby homes but did no physical damage to the taxpayers’ property.
18 The court agreed that there was a decline in value of the property but determined that the taxpayers
19 incurred no actual loss and instead, suffered only a hypothetical loss or mere fluctuation in value. The
20 court stated that Congress did not intend that such fluctuations in value be deductible, or else there
21 would be numerous instances with declines in value without physical damage. (See also *Kamanski,*
22 *supra* [the court denied a casualty loss deduction based on the loss of market value due to predictions of
23 future earthslides].)

24 A casualty loss deduction is limited to the actual loss resulting from damage to the
25 property. (Treas. Reg. § 1.165-7(a)(2)(i).) Physical damage to the property is required for the taxpayer
26 to be entitled to a casualty loss deduction, as held by the Ninth Circuit and federal courts. (See
27 *Chamales v. Commissioner*, T.C. Memo 2000-33 [the Tax Court, in rejecting *Finkbohner*, held that an
28 attempt to base a deduction on market devaluation was not permissible and contrary to existing law,

1 and that the Ninth Circuit requires physical damage]; *Caan v. United States*, 1999 U.S. Dist. LEXIS
2 6886 [“the Ninth Circuit limits casualty losses to damage directly caused by the casualty and does not
3 recognize losses based merely on ‘buyer resistance.’”]; IRS Action on Decision CC-1987-008
4 [rejecting *Finkbohner* and stating that actual physical losses are required and buyer resistance is not to
5 be taken into account].) Only the amount of the loss resulting from the physical damage to property is
6 deductible under IRC section 165. (*Squirt Company v. Commissioner* (1969) 51 T.C. 543.) The
7 physical damage or destruction of property is an inherent prerequisite in showing a casualty loss.
8 (*Kamanski v. Commissioner, supra.*)

9 The Eleventh Circuit has once found that permanent buyer resistance could form the
10 basis for a casualty loss deduction if the permanent impairment of value is based on factors that have
11 forever changed and markedly diminished the amenities and attractiveness of the home. The court in
12 *Finkbohner* did not grant the casualty loss based on fear of a future casualty, in that case a flood, but on
13 the destruction of neighboring homes which led to the neighborhood’s isolation, increased crime, and
14 diminished privacy. In addition, there was physical damage to the taxpayer’s property in *Finkbohner*
15 due to the flood. Furthermore, such a loss must be attributable to permanent changes in the
16 neighborhood arising from more than just the reluctance of buyers to invest in property in an area
17 perceived to be so highly prone to damage due a natural casualty, such as an earthquake, landslide, or
18 avalanche. (*Finkbohner v. U.S., supra, Leonard v. United States, supra; Lund v. United States*, 2000
19 U.S. Dist. LEXIS 2099.)

20 *Competent Appraisal*

21 In determining the amount of a casualty loss, the FMV of the property immediately
22 before the casualty and immediately after the casualty shall generally be ascertained by competent
23 appraisal. (Treas. Reg. § 1.165-7(a)(2)(i).) Furthermore, the regulation states that this appraisal must
24 recognize the effects of any general market decline affecting undamaged as well as damaged property
25 that may occur simultaneously with the casualty, in order that any deduction under IRC section 165(a)
26 shall be limited to the actual loss resulting from damage to the property. (*Id.*)

27 The IRS states that, in determining a decrease in FMV (IRS Publication 17), the factors
28 important in evaluating the accuracy of an appraisal include: (1) the appraiser’s familiarity with the

1 property before and after the casualty; (2) the appraiser’s knowledge of sales of comparable property in
2 the area; (3) the appraiser’s knowledge of conditions in the area of the casualty; and (4) the appraiser’s
3 method of appraisal.

4 The appraisal must be competent to show the decline, if any, in the FMV of the property
5 attributable to the loss. (See *Baker v. Commissioner*, T.C. Memo 1990-553; *Taylor v. Commissioner*,
6 T.C. Memo. 1979-261; *Krahn v. Commissioner*, T.C. Memo 1980-42.) The appraisal cannot include
7 unexplained methodology, speculative factors, or arbitrary calculations. (*Goodfriend v. Commissioner*,
8 T.C. Memo 1986-519; *Brandom v. United States*, 78-2 U.S. Tax Cas. (CCH) P9687; *Thornton, supra.*)

9 The appraisal must use comparable values of similar houses as a result of similar damage.
10 (*Godwin v. Commissioner*, T.C. Memo 2003-289.) The appraisal must offer examples or statistics
11 regarding the effect of a similar casualty on the values of neighboring properties. (*Chamales, supra*;
12 *Beyer v. commissioner*, TC Memo 1993-313.)

13 STAFF COMMENTS

14 Appellants do not appear to qualify for the claimed casualty loss deduction for three
15 major reasons: First and most importantly, appellants have not provided any evidence of a casualty or
16 slippage in 2009, the year at issue. It is well-settled that a casualty loss requires a sudden, unexpected,
17 or unusual incident, such as a landslide. The appraisal and the engineering report submitted by
18 appellants do not state or even mention that any casualty or slippage occurred in 2009.

19 Appellants contend that “slippage” occurred on or about March 23-24, 2009, on property
20 contiguous to and below their property. However, appellants have not provided any evidence of
21 slippage at that time. The appraisal states that “[t]here is a noticeable difference in the hillside directly
22 behind the subject property in 07/2008 (9 months prior to valuation)” and the appraisal and the
23 engineering report state that the slope failure occurred sometime between 1983 and June 1992. (The
24 subject property was purchased in 1988). These dates do not coincide with 2009 and, therefore, no
25 evidence has been provided of any casualty in 2009.

26 Furthermore, there was no actual or physical damage to appellants’ property and
27 appellants do not allege any physical damage to their property. Appellants only contend that there was
28 damage to adjacent property. However, physical damage to a taxpayer’s property is a prerequisite for a

1 casualty loss. (Treas. Reg. § 1.165-7(a)(2)(i).) As there is no evidence to show that there was any
2 actual or physical damage to appellants' property, appellants do not satisfy the physical damage
3 prerequisite for a casualty loss.

4 In addition, as noted above, appellants claimed a casualty loss in 2008, 2009, and 2010,³
5 and appear to believe that an alleged ongoing, day-to-day condition (e.g., erosion) of their property
6 grants them the ability to claim a casualty loss deduction. However, where a taxpayer's loss is due to
7 progressive deterioration rather than some sudden, unexpected, or unusual cause (e.g., landslide), such
8 loss is not a deductible casualty loss. (Rev. Rul. 76-134.) Furthermore, the claimed casualty is not a
9 closed and completed transaction as required by Treasury Regulation section 1.165-1(b), as appellants
10 have not tied their claim to a single event but rather slippage that started years before. Therefore,
11 appellants are not entitled to a casualty loss deduction for the alleged ongoing condition of their
12 property.

13 Appellants were requested by the FTB and the Appeals Division to provide evidence or
14 information regarding a slippage in 2009 and appellants have failed to do so. If appellants do not
15 provide any evidence of such an incident, then appellants do not qualify for a casualty loss deduction
16 based on that factor alone.

17 The second reason why appellants do not qualify for the casualty loss deduction is
18 because the appraisal specifically attributes the loss in value to buyers' perceptions of future landslides.
19 However, a casualty loss cannot be taken when the loss is due to buyers' future fears of landslides.
20 (*Pulvers, supra.*) The appraisal states that, because of "adjacent landslide activity, the subject suffers –
21 and will continue to suffer – from buyer's perceptions of the dangers of landslides near homes." Thus,
22 the appraisal attributes the loss to "buyers' perceptions" of future landslides, which specifically
23 prohibits the loss from qualifying as a casualty loss deduction. Significantly, since appellants have not
24 shown that any casualty or landslide occurred in 2009, appellants have no basis to claim any change in
25 buyer's perceptions in 2009 because they have not provided evidence that a casualty occurred in the
26

27
28 ³ We note that the casualty loss which appellants claimed for 2009 (of \$100,000), along with their claimed casualty losses for
2008 and 2010, totals a combined loss in the value of their property of \$400,000 (i.e., \$200,000 (2008) + \$100,000 (2009) +
\$100,000 (2010)).

1 first place.

2 The third major reason why appellants do not qualify for the casualty loss deduction is
3 because the appraisal provided by appellants is not competent, as required by statute. As stated above,
4 the appraisal does not state that any casualty occurred in 2009. Yet the appraisal arbitrarily calculates
5 the difference in value of houses between January-March and April-June because, as the appraisal
6 states, “the ‘before and after-exact date’ of the landslide is difficult to ascertain”. Such a calculation is
7 irrelevant because the appraisal and engineering report do not indicate, and the evidence does not show,
8 that any casualty occurred between January-March and April-June, let alone 2009. Therefore, the
9 calculation is baseless. Moreover, the use of comparable sales in this case would only be valid if the
10 comparable sales were of houses with similar slippage issues. Otherwise, any changes in value are
11 unrelated to slippage and do not reflect a loss of value due to slippage. Appellants were asked to
12 address these material flaws during additional briefing and failed to respond.

13 Pursuant to Rules for Tax Appeals Regulation 5523.6, appellants should provide any
14 additional evidence in support of their position to the Board Proceedings Division at least 14 days prior
15 to the oral hearing.⁴

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⁴ Evidence exhibits should be sent to: Khaaliq Abd’Allah, Appeals Analyst, Board Proceedings Division, State Board of Equalization, P.O. Box 942879 MIC:80, Sacramento, California, 94279-0080.