



87-SBE-030

BEFORE THE STATE BOARD OF EQUALIZATION  
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of )  
ESTATE OF C. 8. FRITRSCHEN ) No. 84R-355-MA

For Appellant: William C. Spalding  
Certified Public Accountant

For Respondent: Elleene K. Tessier  
Counsel

O P I N I O N

This appeal is made pursuant to section 19057, subdivision (a),<sup>1/</sup> of the Revenue and Taxation Code from the action of the Franchise Tax Board in denying the claim of the Estate of C. E. Pritrschen for refund of personal income tax in the amount of \$10,659.31 for the year ended August 31, 1978.

1/ Unless otherwise specified, all section references are to sections of the Revenue and Taxation Code as in effect for the year in issue.

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The issue for consideration in this appeal is whether respondent properly denied appellant's claimed business casualty loss.

Mr. C. H. Fritrschea died testate on August 27, 1974. The assets in his estate included certain income producing property located at 460 Ellis Street, San Francisco. The first-year fiduciary return filed by the Estate of C. H. Fritrschen (Estate) reported that the basis of the subject property on the date of death was 5263,000. Of that amount \$85,360 was allocated to the land, \$174,640 was allocated to the building and \$3,200 was allocated to the equipment.<sup>2/</sup> For the fiscal year ended August 31, 1978, the Estate claimed a business expense of \$113,005 for fire damage sustained because of a fire at the Ellis Street property. The amount of the claimed expense was based upon the cost of repairs (\$305,701), less insurance reimbursement (\$192,696).

After an audit of the fiduciary return, respondent disallowed the claimed business expense on the grounds section 17206 Limits the deduction for casualty losses relating to property used in a trade or business to the lesser of (1) the difference between the fair market value of the property immediately before and after the event resulting in the loss, or (2) the amount of the adjusted basis of the property. In determining the allowable loss, the lesser of these two amounts must further be reduced in order to reflect the receipt of any insurance reimbursement or other compensation. Because the amount of the insurance proceeds recovered by appellant (\$192,696) exceeded the building's adjusted basis (\$148,444),<sup>3/</sup> respondent concluded that appellant sustained no deductible loss as a result of the fire damage. As such, respondent treated the difference between the cost of repairs and the insurance proceeds as a capital improvement which was capitalized by adding the cost of the improvement to the post-fire adjusted basis of the building.

<sup>2/</sup> These amounts actually total \$263,200 rather than \$263,000. However, the actual amount does not affect the outcome of our decision.

<sup>3/</sup> The adjusted basis of the building was determined by subtracting the depreciation allowed prior to the fire damage (\$26,196) from the basis of the building on the date of the estate's acquisition (5174,640).

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Appellant paid the amount of the proposed assessment and thereafter filed a claim for refund of the taxes paid. Respondent denied appellant's claim for refund and this timely appeal followed.

Appellant argues that the cost of repairs of a damaged building is evidence of loss of value and therefore the deduction taken was proper. It also argues that the amount claimed was an ordinary business expense for the repair of damaged property.

Respondent argues that no deductible loss is sustained when the insurance proceeds recovered with respect to a claimed loss exceed the adjusted basis of the damaged property. Section 17206 and Internal Revenue Code section 165 provide for the deduction of losses **uncompensated** for by insurance which were incurred in a trade or business or in any transaction entered into for a profit.

We find this **appeal to** be directly on point with a federal appellate decision, United States v. Koshland, 208 **F.2d** 636 (9th Cir. 1954), in which the United States Court of Appeals concluded that in such a situation a taxpayer sustains no deductible loss. In Koshland, the taxpayer claimed a fire loss of **\$43,166.42** (**the difference** between the adjusted basis of the land and hotel building at the time of the fire [**\$138,166.42**], and the sum of the market value of the property thereafter [**\$50,000**] and the proceeds of the fire insurance policies [**\$45,000**]). In ruling on the claimed fire loss, the court **held** that:

A casualty loss of business property is measured for tax purposes by the adjusted basis of the property destroyed. [Citations .] **Here**, the property destroyed was the hotel building. At the time of the fire the building had an adjusted basis of **\$1,408.00** [this figure is the building's **cost--\$53,000**, plus improvements of **\$2,092.16**, less allowed depreciation of **\$53,604.16**]. That was the extent of the decedent's loss for tax purposes. The insurance proceeds she received (\$45,000) more than compensated her for the loss. She therefore sustained no deductible loss .... (Emphasis added.)

(United States v. Koshland, *supra*, 206 F 2d at 639.)

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The court also noted that not only did the taxpayer not sustain a loss from the **fire**; she realized a gain to the extent that the insurance proceeds received by her **exceeded the** adjusted basis of the building.

In the instant case, we agree with respondent's conclusion that appellant has sustained *no* deductible fire loss. The insurance proceeds recovered by appellant exceeded its adjusted basis in the damaged property. Appellant contests respondent's conclusions in this regard on the ground that the applicable **regulations** provide that the *cost* of repairs is evidence of the loss of value if the taxpayer shows that **(a)** the repairs are necessary to restore property to its condition immediately *before* the casualty; **(b)** the amount spent for such repairs is not excessive; **(c)** the repairs do not care for more than the damages suffered; and **(d)** the value of the property **after repairs** does not, as a result of the repairs, exceed the value of the property immediately before the casualty. (*Treas. Reg. §1.165-7(a)(2)(ii)* (1977).)

While appellant is correct that the cost of repairs may be acceptable evidence **as to a** loss of value, **we** do not **agree** that the cost of repairs determines the allowable deduction. The amount of the deduction is limited by express statutory provision to the lesser of the decline in fair market value **or** the adjusted basis. As such, the casualty loss provisions are not intended to allow a taxpayer a full deduction for every loss in market value sustained by reason of a casualty. The permissible deduction is limited to the taxpayer's basis, or cost, in the property damaged. (*Rosenthal v. Commissioner*, 416 **F.2d** 491, 497 (2d Cir. 1969).)

**Accordingly, we** conclude that appellant's argument that respondent erroneously denied the claimed deduction is without merit and that appellant has failed to demonstrate its entitlement to the claimed casualty loss because the insurance proceeds it recovered exceeded its adjusted basis in the damaged property. Appellant's alternate contention that the claimed loss should be allowed as a deductible business expense is equally without merit because it has provided no substantiation as to the expenses incurred after the fire or the extent of the damage. Therefore, respondent's disallowance of the claimed fire loss must be sustained.

