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Abstract

The United States has sustained more than twelve billion dollars in hurricane damage since 1900.1 This country experiences an average of three hurricanes, two of which are major,every two years.

KEYWORDS: taxpayer, hurricane, mandatory

Hurricane Losses: Mandatory Practice and Taxpayer Options

The United States has sustained more than twelve billion dollars in hurricane damage since 1900.[1] This country experiences an average of three hurricanes, two of which are major,[2] every two years. The most vulnerable areas lie along the Gulf Coast—Florida, Alabama, Mississippi, Louisiana, and Texas.[3] In order to mitigate hurricane damage, hurricane losses are accepted by the Internal Revenue Service as a deductible casualty loss under I.R.C. § 165(c).

This article will discuss both the mandatory practice established by federal tax laws, and the options of property owners with respect to establishing the extent of their losses, compensation and gains.

Measuring the Amount of the Loss

As a general rule, the taxpayer may deduct a hurricane loss equal to the lesser of the adjusted basis of the property[4] or the difference between the fair market value of the property immediately before and immediately after the casualty.[5] However, a deductible hurricane loss will only be allowed to the extent that the loss is uncompensated by "insurance or otherwise."[6]

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1. *Hurricane,* 158 NATIONAL GEOGRAPHIC 346 (1980).
2. A hurricane whether it be considered major or minor causes tremendous damage. The taxpayer need not be concerned with the classification of a hurricane but rather with the impact it has on their property. *When Hurricanes Hit, "Complacency" Can Kill You* U.S. NEWS & WORLD REPORT, Aug. 18, 1980, at 56 (Interview with Richard A. Flank, Administrator, National Oceanic and Atmospheric Administration).
3. *Id.*
4. The property's adjusted basis equals its original basis adjusted to the date of damage or destruction. I.R.C. § 1011(a); Treas. Reg. § 1.011, T.D. 6265, 1957-2 C.B. 469.
5. Solomon v. Commissioner, 39 T.C.M. (CCH) 1282 (1980); Treas. Reg. § 165-7(b)(1), T.D. 6445, 1960-1 C.B. 106.
6. Gee v. Commissioner, 41 T.C.M. (CCH) 1366 (1981), I.R.C. § 165(a). *See* section of this note titled compensation for interpretation of phrase "insurance or

If business property or property held for production of profit is completely destroyed, the hurricane loss deduction is equal to the adjusted basis of the property at the time of the occurrence of the casualty.[7] If a taxpayer is a tenant, and is liable to the lessor to return the real property in the same condition as received, the tenant may claim a casualty deduction but only to the extent of his repair obligation.[8]

Basis

The basis of the property depends to a great extent on the manner in which the property was acquired. Usually, a taxpayer acquires property by purchasing it, or, in other words, at cost.[9] However, the property may have been acquired by a different route, as by gift, inheritance, or conversion of property from personal use to business use.[10]

To compute the property's adjusted basis, the taxpayer begins with the cost, or the original basis at the date of acquisition for property acquired by gift, inheritance, or conversion.[11] To that he must add all items chargeable to the capital additions account,[12] and from that subtract items considered to be capital recoveries.[13] The regulations define capital additions or expenditures as expenditures which add to the value or prolong the life of property, or adapt the property to a new or different use.[14] These expenditures include improvements, purchase commissions, legal costs for defending or perfecting title (including title insurance) and recording fees.[15] The capital recoveries which must be subtracted include depreciation, depletion, obsolescence, tax-free dividends, recognized losses on involuntary conversions and deductible cas-

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otherwise."

7. Shroyer v. Commissioner, 42 T.C.M. (CCH) ___, Nos. 1981-327 (June 24, 1981); Treas. Reg. § 1.165-7(b)(1)(ii), T.D. 6445, 1960-1 C.B. 106.

8. INTERNAL REVENUE SERVICE, PUB. NO. 547 TAX INFORMATION ON DISASTERS, CASUALTIES, AND THEFTS (1980) [hereinafter TAX INFORMATION ON DISASTERS].

9. I.R.C. § 1012.

10. Only cost basis will be discussed further. For basis determination on property acquired by gift, inheritance, or conversion *see* I.R.C. § 1.165-9(b)(2).

11. I.R.C. § 1011(a).

12. I.R.C. § 1016(a)(1); Treas. Reg. § 1.1016-2(a) (1957).

13. I.R.C. § 1016(a)(2); Treas. Reg. § 1.1016-3(a)(1)(i) (1957).

14. Treas. Reg. § 1.263(a)-1(b), T.D. 6500, 1960-2 C.B. 107.

15. FEDERAL TAX HANDBOOK 167 (1980).

ualty losses. A depreciation deduction is allowed only for business property or property held for the production of income.[16] The depreciable property's basis must be reduced by the depreciation allowed,[17] which may not be less than the allowable amount.[18] Regardless of the extent of capital recoveries, the adjusted basis may not drop below zero.[19]

Type of Property

The way a taxpayer computes his hurricane loss depends on the type of property damaged or destroyed. The casualty loss deduction allowed property held for personal use is computed according to the general rule stated above except for one limitation: a $100 statutory floor reduces the deductible amount.[20] The $100 deduction limit applies to the entire loss and is subtracted once for each casualty.[21] However, if husband and wife file separate tax returns, the $100 limitation applies separately to each individual's loss.[22]

Personal property includes both real and personal property. The calculation involved for each varies slightly. Real property includes land, plants and trees that grow on land, and buildings thereon. Personal property may be defined as any property that is not real estate.[23] A taxpayer, when determining his hurricane loss deduction for personally used real property, should consider all items together. In other words, the adjusted basis and decrease in fair market value should be calculated for the entire property—land, plants and buildings together.[24] For example, an oceanfront home, which costs $80,000 (including $10,000 for the land) several years ago, was partially destroyed

16. I.R.C. § 167(a); Treas. Reg. § 1.167(a)-1(a), T.D. 6182, 1956-1 C.B. 99.

17. The amount the taxpayer actually deducts is called the allowed depreciation. I.R.C. § 1016(a)(2)(B); Treas. Reg. § 1.1016-3(a)(1)(i) (1957).

18. The allowable depreciation may be defined as the amount the taxpayer should have deducted. Treas. Reg. § 1.1016-3(a)(1)(ii) (1957); I.R.C. § 1016(a)(2); Treas. Reg. § 1.167(a)-10(a) (1956).

19. Federal Tax Handbook 167 (1980).

20. I.R.C. § 165(c)(3).

21. Treas. Reg. § 1.165-7(b)(4)(ii), T.D. 6712, 1964-1 C.B. 103.

22. Treas. Reg. § 1.165-7(b)(2)(iii), T.D. 6712, 1964-1 C.B. 103.

23. Tax Information on Disasters, *supra* note 8.

24. Treas. Reg. § 1.165-7(b)(1), T.D. 6445, 1960-1 C.B. 106, Rev. Rul. 66-9, 1966-1 C.B. 39.

by a hurricane in August. The value of the property immediately before the hurricane was $100,000 ($85,000 for the building and $15,000 for the land), and the value immediately after the hurricane was $50,000. The taxpayer collected $10,000 from his insurance company. His deduction for the hurricane loss is $39,900, computed as follows:[25]

(1) Value of entire property before hurricane	$100,000
(2) Value of entire property after hurricane	50,000
(3) Decrease in fair market value of entire property	50,000
(4) Basis (cost, in this case)	80,000
(5) Amount of loss (lesser of 3 or 4)	50,000
(6) Minus: Insurance	10,000
(7) Loss after reimbursement	40,000
(8) Minus: $100	100
(9) Hurricane loss deduction	39,900

On the other hand, when determining hurricane losses for personal property, each item must be considered independently and then individual losses are grouped for a deductible amount. Each item has its own adjusted basis and decrease in fair market value.[26] For instance: a hurricane hit the taxpayer's home, damaged an upholstered chair and completely destroyed a rug and antique table. There was no insurance. The chair had cost $150; it had a fair market value of $75 before the storm and a value of $10 immediately afterwards. The rug had cost $200 and had a value of $50 just before the hurricane. The taxpayer had purchased the table at an auction for $15 and then discovered it was a valuable antique. It had been appraised at $350 before the hurricane. His loss on each of these items is computed as follows:[27]

25. Reproduced from TAX INFORMATION ON DISASTERS, *supra* note 8, at 234. Numbers have been adjusted for ease of mathematics. Fire has been changed to hurricane for reasons of continuity.

26. *Id.*

27. *Id.* Fire has been changed to hurricane for reasons of continuity.

		Chair	Rug	Table
(1)	Basis (cost)	$150	$200	$ 15
(2)	Value before hurricane	$ 75	$ 50	$350
(3)	Value after hurricane	$ 10	$ 0	$ 0
(4)	Decrease in Value	$ 65	$ 50	$350
(5)	Loss (lessor of 1 or 4)	$ 65	$ 50	$ 15
(6)	Total loss			$130
(7)	Minus $100			$100
(8)	Hurricane loss deduction			$ 30

If the damaged property is business property, the amount of the hurricane loss incurred is computed using the general rule stated above.[28] Property held for the production of income is treated similarly.[29] However the regulations require that the taxpayer figure his loss separately for each item. This rule is termed the single, identifiable property rule. The losses are then combined for one deduction.[30] For example: four years ago the taxpayer bought a house, which he then rented out. He paid $8,000 for the land, $25,000 for the building, and $2,000 for landscaping. During those four years, he was allowed depreciation deductions for the building totalling $5,688. In August 1981, as a result of a hurricane, the house and landscaping were severely damaged.

Competent appraisers determined that the house was worth $33,500 before the hurricane, but only $13,000 afterwards. Trees and shrubs were valued at $2,500 before but only $1,500 after. The trees and shrubs were not covered by insurance, but the house was insured for its fair market value. The insurance company paid $20,500 in full settlement. The taxpayer's gain or loss from the hurricane is computed as follows:[31]

28. Treas. Reg. § 1.165-7(b)(1), T.D. 6445, 1960-1 C.B. 106, Rev. Rul. 66-9, 1966-1 C.B. 39.

29. I.R.C. § 165(c)(1) & (2).

30. Treas. Reg. § 1.165-7(b)(2)(i), T.D. 6445, 1960-1 C.B. 106.

31. Reproduced from TAX INFORMATION ON DISASTERS, *supra* note 8, at 34. The word hurricane has been substituted for the word fire for reasons of continuity.

		Building	Trees and Shrubs
(1)	Value before hurricane	$33,500	$2,500
(2)	Value after hurricane	$13,000	$1,500
(3)	Decrease in value	$20,500	$1,000
(4)	Basis (adjusted for depreciation)	$19,312	$2,000
(5)	Amount of loss (lesser of 3 or 4)	$19,312	$1,000
(6)	Minus: Insurance	$20,500	$ 0
(7)	Loss on trees and shrubs		$1,000
(8)	Gain from insurance received for house	$1,188	

The single, identifiable property rule tends to weaken a business property owner's position. His allowable hurricane loss deduction will generally be smaller than it would have been had the basis of the entire property (land included) been taken into consideration. For example, if land and timber were taken together the property owner would have a larger deduction. The "timber will usually have appreciated in value far in excess of the basis allocable thereto."[32] Although it may be difficult for a property owner to determine the reduction in the fair market value of an area partially destroyed by a casualty, the court in *Westvaco Corp. v. United States*[33] determined the "single, identifiable

32. GEER & GILJUN, LOSSES - CASUALTY, 274-2d TAX MNGM'T (BNA) A-21. The court in Rosenthal v. Commissioner, 48 T.C. 515 (1967) *aff'd* 416 F.2d 491 (2d Cir. 1969) carried this rule one step further by only allowing recovery for that portion of the timber totally destroyed. The *Rosenthal* court concluded that the adjusted basis and fair market value of the destroyed timber should be separated from the rest of the timber.

A casualty loss to timber, usually, is of great significance to the business property owner for timber is often uninsurable. Additionally, "since a tract of timber is a living, growing entity, damage to the tract may cause a greater loss than the basis of the mature trees damaged." 83 HARV. L. REV. 478, 480. For example, a hurricane loss to one hundred trees may decrease the fair market value of the remaining trees in that section. For further analysis *see id.*

33. 639 F.2d 700 (Ct. Cl. 1980).

property damaged by the casualty is the standing timber, merchantable, in an affected area."[34] The *Westvaco Corp.* court does not agree with the decision reached in *Rosenthal v. Commissioner*.[35] *Rosenthal* held that only the destroyed timber's adjusted basis and fair market value may be taken into account when computing casualty deduction for partially destroyed timber. The court in *Westvaco Corp.* considered the fair market value of both destroyed and other standing timber in an affected block.

If both business and personally used property exist on the taxpayer's land, he must figure his deductions as if two separate casualties occurred.[36] For example: taxpayer owns a building that he constructed on leased land. Half of the building is used in his business and he lives in the other half. The original cost of the building was $40,000 and he made no further improvements or additions to it. A hurricane damaged the entire building. The fair market value of the building was $38,000 immediately before the hurricane and $32,000 afterwards. The insurance company reimbursed the taxpayer $4,000 for the hurricane damage. Depreciation deductions on the business part of the building totalled $2,400.

The taxpayer has a deductible business causalty loss of $1,000 and a deductible personal casualty loss of $900, computed as follows:[37]

	Business Loss	Personal Loss
Decrease in value of building: value before hurricane (total $38,000)	$19,000	$19,000
Value after hurricane (total $32,000) ..	$16,000	$16,000
	$ 3,000	$ 3,000
Basis of business-use portion of building before hurricane (cost $20,000 − depreciation $2,400)	$17,600	

34. *Id.* at 717.
35. 48 T.C. 515 (1967) *aff'd* 416 F.2d 491 (2d Cir. 1969).
36. Treas. Reg. § 1.165-7(b)(2)(ii), T.D. 6445, 1960-1 C.B. 106.
37. Reproduced from TAX INFORMATION ON DISASTERS, *supra* note 8, at 235. Flood has been changed to hurricane for reasons of continuity.

Personal-use portion (basis equals cost)		$20,000
Amount of loss (lesser of basis or decrease in fair market value)	$ 3,000	$ 3,000
Minus: Insurance	$ 2,000	$ 2,000
Loss after reimbursement	$ 1,000	$ 1,000
Minus: $100 on property owned for personal-use	none	$ 100
Deductible business loss	$ 1,000	
Deductible personal loss		$ 900

When to Report a Loss

As a general rule the hurricane loss is deducted in the year the casualty occurred.[38] There are exceptions, however. If the taxpayer is a lessee and is subsequently liable to a lessor for casualty damage, he deducts the loss in the year the liability is eliminated.[39] If a taxpayer puts in a claim for reimbursement, and it can be "ascertained with reasonable certainty"[40] that the claim will ultimately be received or honored, then the reimbursement must be subtracted from the casualty loss in the year the loss was sustained.[41] However, if at any future date the taxpayer receives less, he deducts the difference in the year of reimbursement. If on the other hand, he receives more, the additional amount is to be included in income in the year of its receipt.[42]

The taxpayer is given an option to treat the loss as if it occurred in

38. I.R.C. § 165(h) (1974).
39. TAX INFORMATION ON DISASTERS, *supra* note 8.
40. A reasonable prospect of recovery exists when the taxpayer has bona fide claims for recoupment from third parties or otherwise, and when there is a substantial possibility that such claims will be decided in his favor. The standard for making this determination is an objective one, under which [the] Court must determine what was a "reasonable expectation" as of the close of the taxable year for which the deduction is claimed.

Ramsay Scarlett & Co., Inc., v. Commissioner, 61 T.C. 795, 811 (1974) (citations omitted).

41. *Id. See also* Johnson v. Commissioner, 41 T.C.M. (CCH) 849 (1981). Treas. Reg. § 1.165-1(d)(2)(i) & (ii), T.D. 6445, 1960-1 C.B. 96.
42. TAX INFORMATION ON DISASTERS, *supra* note 8.

the preceding year, thereby deducting the amount in that year, if the President of the United States designates the area of hurricane damage as a disaster area.[43] Such an election allows the taxpayer to save taxes immediately, rather than waiting until the end of the year in which the casualty was sustained. However, assuming the tax rates do not drop,[44] if his taxable income is greater in the year the hurricane loss was sustained, he would pay less overall taxes if the deduction were taken in the year of the hurricane.[45]

Alternatively, a hurricane loss may create a net operating loss.[46] The Internal Revenue Service permits the taxpayer to offset losses against previous or subsequent taxable years if in the year of the loss he does not have enough taxable income to use up the deduction.[47] The loss is applied initially to the three preceding years, and if not completely used up, the taxpayer may carry the loss forward up to seven[48] years or until used up, whichever comes first.[49]

However, the taxpayer may elect not to carry back the net operating loss. He may, alternatively, carry forward the loss, if the loss was sustained after 1975.[50] Assuming the tax rates do not drop, if taxable income is greater during post casualty years, he would pay less overall taxes if net operating loss were carried forward.

Burden of Proof

Frequently, the Internal Revenue Service refuses taxpayer hurri-

43. I.R.C. § 165(h) (1974), Treas. Reg. § 1.165-11(a), T.D. 7522 1977-2 C.B. 64.

44. The tax rates are currently scheduled to drop under the Economic Recovery Tax Act of 1981.

45. TAX INFORMATION ON DISASTERS, *supra* note 8.

46. Net operating loss may be defined as the excess of deductions over gross income. I.R.C. § 172(c).

47. I.R.C. § 172(d)(4)(c); Treas. Reg. § 1.172-3(a)(3)(iii), T.D. 6192, 1956-2 C.B. 138.

48. The Economic Recovery Tax Act of 1981 substitutes 15 years in the place of 7 years. The 15 year carry forward applies to taxable years ending after December 31, 1975. Economic Recovery Tax Act of 1981, Pub. L. No. 97-34, §§ 207(a)(1)&(2), 95 Stat. 225.

49. I.R.C. § § 172(b)(1) & (2) (1980).

50. I.R.C. § 172(b)(1)(B).

cane loss deductions, characteristically because taxpayers fail to meet their burden of proof. An income tax deduction is a right granted only to taxpayers who meet this burden.[51] The essential elements which must be met have been outlined by the Internal Revenue Service:

> A deduction is allowed . . . for damages to or losses of property owned by you. You must substantiate the amount of any casualty loss and be prepared to submit evidence showing:
> (1) The nature of the casualty and when it occurred;
> (2) That the loss was the direct result of the casualty;
> (3) That you were the owner of the property or were contractually liable to the owner of the property for damage to property leased by you.[52]
> (4) The cost or other [adjusted] basis of the property, evidenced by purchase contract, [checks, receipts,] etc;
> (5) The depreciation allowed or allowable if any;
> (6) The values before and after the casualty (pictures and appraisals before and after the casualty are pertinent evidence); and
> (7) The amount of insurance or other compensation received or expected to be received, including the value of repairs, restoration, and clean-up provided without cost by disaster relief agencies or others.[53]

Generally, to claim a casualty deduction, the property must have sustained actual, physical damage. But in *Stowers v. United States,*[54] the taxpayer, was allowed a casualty loss deduction even though his property was only indirectly damaged. In *Stowers,* access to and from the taxpayer's home was obstructed as a result of neighboring landslides. The court based its decision on the fact that the property was valueless in the hands of the property owner.

However, a taxpayer will not be permitted to take a casualty deduction when the decline in market value is solely attributable to "ad-

51. Interstate Transit Lines v. Commissioner of Internal Revenue, 319 U.S. 590 (1943), *appeal denied* 320 U.S. 809 (1943).

52. A tenant may claim a casualty deduction for "leasehold improvements" erected by him, if damaged or destroyed. Rev. Rul. 73-41, 1973-1 C.B. 74.

53. INTERNAL REVENUE SERVICE, PUB. NO. 334, TAX GUIDE FOR SMALL BUSINESS 113 (1979).

54. 169 F. Supp. 246 (S.D. Miss. 1958).

verse buyer resistance."[55] For instance, future buyers may shy away from homes which are located in highly vulnerable hurricane areas. If this resistance is the sole reason for decrease in market value no deduction is allowable.

In determining the decrease in fair market value, the property owner has several options. If it is possible, the fair market value of the property before and after the hurricane should 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 within the casualty, in order that any deduction under this section shall be limited to the actual loss resulting from damage to the property."[56] The appraiser should be experienced, reliable and familiar with the taxpayer's property both before and after the hurricane.[57] Appraisals must be substantiated and are subject to reassessment by the court.[58] The taxpayer's own testimony is acceptable evidence, but is also subject to reassessment.[59] The purchase price of property, purchased shortly before a hurricane, can be used to establish its fair market value.[60]

If the taxpayer chooses to repair or restore damaged property, rather than await appraisal, he may not deduct the repair or replacement cost. This cost may, however, be an indication of the fair market value of the property.

> The cost of repairs to the property damaged is acceptable as evidence of the loss of value if the taxpayer shows that (a) the repairs are necessary to restore the 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 damage suffered and (d) the value of the property does not as a result of the repairs exceed the value of the property immediately before the

55. Corby v. Commissioner, 40 T.C.M. (CCH) 21 (1980).
56. Treas. Reg. § 1.165-7(a)(2)(i), T.D. 6445, 1960-1 C.B. 105.
57. TAX INFORMATION ON DISASTERS, *supra* note 8.
58. In Breon v. Commissioner, 41 T.C.M. (CCH) 1621 (1981), the court determined the appraisals performed by local real estate agents (although highly qualified) failed to show support for their appraisal.
59. *Id.;* Guilbeau v. Commissioner, 40 T.C.M. (CCH) 323 (1980); Corby v. Commissioner, 40 T.C.M. (CCH) 21 (1980).
60. Kahl v. Commissioner, 41 T.C.M. (CCH) 1433 (1981).

casualty.[61]

The taxpayer is not permitted to submit estimates for repairs but rather is required to submit evidence of repairs actually made. In *Bidelspacher v. Commissioner,*[62] the tax court construed § 1.165-7 as requiring evidence of repairs actually made. The court rejected the use of estimates in an effort to "guar[d] against possible abuse that would result from the use of flexible or inflated estimates of repairs, particularly in situations where the repairs are never made."[63]

In addition, taxpayers do not have the option of deducting the amount spent on preventive measures to mitigate hurricane damage. In *Austin v. Commissioner,* the court determined that chopping down trees as a preventive measure cannot be used as a casualty deduction. Similarly, the purchase and installation of hurricane shutters is also not deductible.[64]

It is important to stress that, despite occasional broad interpretation as in *Stowers v. United States,*[65] the Internal Revenue Service tends to limit taxpayer options in the area of hurricane losses.

Compensation

When a taxpayer figures his deduction, reimbursements received, whether "insurance or otherwise," must be subtracted from the casualty loss amount.[66] Recently, the tax court, has determined the meaning of the phrase "insurance or otherwise" within I.R.C. § 165(a). In *Estate of Bryan v. Commissioner,*[67] the court held the phrase indicated a form of compensation received by the taxpayer which is structured to replace what was lost.[68] The burden of proof was placed on the taxpayer to establish his right to a deduction. Furthermore, the absence of

61. Treas. Reg. § 1.165-7(a)(ii), T.D., 6445, 1960-1 C.B. 105, Gee v. Commissioner, 41 T.C.M. (CCH) 1366, (1981); Shroyer v. Commissioner, 42 T.C.M. (CCH) ___, Nos. 1981-327 (June 24, 1981).
62. 41 T.C.M. (CCH) 477 (1980).
63. *Id.*, at 483; Gee v. Commissioner, 41 T.C.M. (CCH) 1366 (1981).
64. 74 T.C. 1334, No. 98 (1980).
65. 169 F. Supp. 246 (S.D. Miss. 1958).
66. I.R.C. § 165(a).
67. 74 T.C. 725 (1980).
68. *Id.* at 727.

any "legal or moral obligation" resting with the agency making payment does not prevent the payment from being characterized as insurance.[69] Thus, it appears that a payment by an agency, in an attempt to compensate a taxpayer for hurricane destroyed property, will clearly constitute compensation under the "insurance or otherwise" language.[70]

Another issue, recently litigated, concerned the taxpayer's election to deduct a casualty loss rather than file a claim with his insurance company for reimbursement. The Internal Revenue Service takes this position:

> If you have insurance that would cover all or part of a casualty . . . but you do not put in a claim for reimbursement, your deduction must be reduced by any amount that you could have received from the insurance company if you had put in a claim. Your failure to put in a claim is the cause of that part of your loss, not the casualty . . . .[71]

The courts, however, apply this policy inconsistently. In *Miller v. Commissioner,*[72] the court adhered to the Internal Revenue Service position. However, in *Hills v. Commissioner,*[73] the court held if "a taxpayer fails to pursue a right of insurance recovery, his economic loss is nonetheless sustained and a deduction should be allowed."[74]

As mentioned above, insurance is not the only form of reimbursement. For example, if a taxpayer falls under the Disaster Relief Act[75] the amount of the loan that is forgiven is considered reimbursement.[76] Similarly, the amount of a Small Business Association loan forgiven is considered reimbursement.[77] Repairs, restoration, and clean-up services

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69. *Id.*

70. Smith v. Commissioner, 76 T.C. __, No. 39 (1981); Spak v. Commissioner, 76 T.C. __, No. 40 (1981).

71. TAX INFORMATION ON DISASTERS, *supra* note 8, at 233.

72. 41 T.C.M. (CCH) 528 (1980). *See also* Bartlett v. United States, 397 F. Supp. 216 (D. Md. 1975).

73. 76 T.C. __, No. 42 (1981).

74. *Id.*

75. Pub. L. No. 91-606, 84 Stat. 1744 Rev. Rul. 71-160, 1971-1 C.B. 75.

76. TAX INFORMATION ON DISASTERS, *supra* note 8.

77. Gee v. Commissioner, 41 T.C.M. (CCH) 1366 (1981).

provided by relief agencies are considered reimbursement.[78] Relocation payments can, when warranted, be considered compensation.[79]

Aside from the types of reimbursement mentioned above, grants, gifts and other payments received after a casualty, for the purpose of getting the taxpayer back on his feet, are only considered compensation if "specifically earmarked to repair or replace property."[80] Even where the property owner applies payments received to replace property, payments will not be considered compensation absent appropriate conditions on their use.[81]

Gain

If a property owner receives compensation and it is more than his basis in the destroyed or damaged property, there is a gain from the casualty. This gain can be reported in the year the reimbursement was received, or reporting may be postponed.[82]

If the taxpayer receives a reimbursement in the form of property which is similar or related in service to his damaged property, postponement of gain recognition is mandatory.[83] The meaning of the phrase "similar or related in service" depends on whether the taxpayer is an owner-user or an owner-investor. If the taxpayer is an owner-user, the "replacement property must function the same as the property it replaces."[84] On the other hand, if the taxpayer is an owner-investor, "any replacement property must have the same relationship of services or uses to [the taxpayer] as the property it replaced."[85] This may be

78. TAX INFORMATION ON DISASTERS, *supra* note 8.

79. Relocation payments if made for the purpose of reimbursing the taxpayer for casualty losses must be considered compensation, however, if there is not a direct relationship between relocation payment and casualty loss the taxpayer will not have to subtract payment from loss. Spak v. Commissioner, 76 T.C. ___, No. 40 (Mar. 26, 1981).

80. TAX INFORMATION ON DISASTERS, *supra* note 8, at 233.

81. *Id.*

82. *Id.*

83. I.R.C. § § 1033(a)(1)&(b) (1978); Treas. Reg. § 1.1033(a)-2(b), T.D. 6222 1957-1 C.B. 249.

84. I.R.C. § 1033(a) (1978); Treas. Reg. § 1.1033(a)-1, T.D. 6222 1957-1 C.B., 249.

85. INTERNAL REVENUE SERVICE, PUB. NO. 334, TAX GUIDE FOR SMALL BUSI-

done by determining; (1) whether the properties are of similar service, (2) the nature of the business risks connected with the properties, and (3) what the properties demand of the taxpayer in the way of management, service, and relations to tenants.[86]

The taxpayer may also postpone the gain if he purchases replacement property[87] which is similar or related in use to property damaged by the hurricane.[88] The taxpayer can postpone all of the gain if the replacement property's cost is equal to or greater than the net proceeds.[89] Otherwise the property owner must recognize some or all of the gain immediately.

The property owner faces a time limitation if he desires to purchase replacement property with net proceeds. The replacement period begins on the date the hurricane damaged or destroyed the property. The taxpayer has until two years after the close of the taxable year in which any gain is realized from the involuntary conversion to replace the property.[90]

Conclusion

The preceding sections are all interrelated and therefore must all be dealt with. In closing, the purpose of this paper is two-fold—to make the taxpayer aware both of his responsibilities as claimant, as well as the responsibility of the federal government as stated in the Internal Revenue Code, Treasury Regulations and case law. The most recent cases reveal both the basic stance of the Internal Revenue Service and the occasional, subtle shifting of their perspective. Although property losses due to hurricanes can be severe, there are ways to miti-

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NESS 116 (1979).

86. Rev. Rul. 64-237, 1964-2 C.B. 319.

87. TAX INFORMATION ON DISASTERS, *supra* note 8. Property acquired by gift or inheritance does not qualify as replacement property.

88. I.R.C. § 1033(a) (1978); Treas. Reg. § 1.1033(a)-1, T.D. 6222, 1957-1 C.B. 249.

89. Net proceeds equal the money plus the fair market value of unlike property you receive in exchange for the damaged property less expenses incurred in obtaining them. I.R.C. § 1033(a)(2)(A); Treas. Reg. § 1.1033(a)-2(c)(1), T.D. 6222, 1957-1 C.B. 249.

90. I.R.C. § 1033(a)(2)(B); Treas. Reg. § 1.1033(a)-2(c)(3), T.D. 7075, 1970-2 C.B. 160.

gate some of the losses. Corrupting an old adage, "Let the Taxpayer Beware." The burden of proof is on the taxpayer: he should follow the guidelines, know his options and be prepared.

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