

**BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO**

In the Matter of the Protest of	)	
	)	DOCKET NO. 0-721-454-080
	)	
	)	
Petitioners.	)	DECISION
	)	

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The Income Tax Audit Bureau (Bureau) at the Idaho State Tax Commission (Tax Commission) issued a Notice of Deficiency Determination (Notice) to (Petitioners) covering tax years 2014 through 2020. The Bureau denied refund claims of (\$7,794) and asserted an income tax deficiency of \$4,720. Petitioners filed a timely appeal and petition for redetermination of the Notice.

The primary issue for decision is whether the loss of Petitioners’ home and possessions due to contamination by toxic mold was an event of a “sudden, unexpected, or unusual nature” and, if so, whether Petitioners may deduct a casualty loss of \$308,568. The Tax Commission has reviewed the file and hereby issues its decision.

**BACKGROUND**

Petitioners claimed a \$308,568 casualty loss deduction for loss of their home, household furnishings and personal property to toxic mold for tax year 2016. The casualty loss deduction exceeded taxable income, creating a net operating loss. Petitioners used the net operating loss to offset taxable income in tax years 2014, 2015, 2017, 2018, 2019 and 2020.

The Bureau determined Petitioners’ loss did not meet the requirements for a casualty loss deduction. Accordingly, Petitioners did not have a net operating loss. Petitioners appealed. The Tax Commission need not recite all the facts of this case since they are set forth in detail in the

Bureau's Notice, Petitioners' correspondence, and petition for redetermination. The Tax Commission assumes familiarity with these facts.

## LAW AND ANALYSIS

### Casualty Loss

Internal Revenue Code (IRC) section 165(a) and (c)(3) allows an individual a deduction for loss of property not connected with a trade or business or a transaction entered into for profit if the loss arises from fire, storm, shipwreck, or other casualty and was not compensated for by insurance or otherwise. "Other casualty" is defined as a loss proximately caused by a sudden, unexpected, or unusual event, excluding the progressive deterioration of property through a steadily operating cause or by normal depreciation. *Maher v. Commissioner*, 680 F.2d 91, 92 [50 AFTR 2d 82-5290] (11th Cir. 1982), affg. 76 T.C. 593 (1981); *Coleman v. Commissioner*, 76 T.C. 580, 589 (1981). There must be a causal connection between the alleged casualty and the loss claimed by the taxpayer. *Kemper v. Commissioner*, 30 T.C. 546, 549-550 (1958), affd. 269 F.2d 184 [4 AFTR 2d 5119] (8th Cir. 1959).

Whether damage qualifies as a casualty typically turns on whether the damage satisfies the suddenness requirement, which denotes an accident, a mishap, some sudden invasion by hostile agency rather than progressive deterioration of property through steadily operating cause. *Fay v. Helvering*, 120 F.2d 253 [27 AFTR 432] (2d Cir. 1941), affg. 42 B.T.A. 206 (1940). In considering whether termite damage qualified as a casualty, the Tax Courts have held that the "suddenness" of the loss itself (the lapse of time between the precipitating event and the loss proximately caused by that event) is a determining factor. *Maher v. Commissioner*, 76 T.C. 593, 599-600 (1981), affd. 680 F.2d 91 [50 AFTR 2d 82-5290] (11th Cir. 1982); *Pryor v. Commissioner*, T.C. Memo. 1987-80 [¶87,080 PH Memo TC].

Progressive deterioration from a steadily operating cause isn't a casualty. However, although damage to equipment may be gradual, resulting from progressive deterioration, the consequential damages from the failure of the equipment may qualify as deductible casualty losses because they result from an identifiable event that's sudden in nature. For example, a casualty loss deduction was allowed for damage to taxpayer's personal belongings from the flooding of her home caused by the failure of a washing machine hose, even though the damage to the hose itself was due to progressive deterioration and so wasn't a deductible loss from a casualty. *Cooper, Pamela S.*, (2003) TC Summary Opinion 2003-168.

Whether a taxpayer can claim a casualty loss for mold damage to personal-use property depends on the facts and circumstances. A key factor is whether the mold damage occurred as a direct result of a disaster or from an intervening cause. For example, mold damage that occurred as a result of insufficient repairs after a storm isn't deductible. The casualty loss deduction would be limited to the property damage caused by the storm. Also, a large amount of time lapsing between the date of the storm and the formation of the mold raises the question of whether the mold damage was caused by the storm or by some other factor. See Miscellaneous IRS Documents FAQs for Disaster Victims (Valuations and Sections 165(i)), Q&A 8 (8/24/2021).

The formation of mold may qualify as a separate casualty if, under a particular set of facts, it is an identifiable event that is sudden, unexpected, and unusual. An event is sudden if it is swift, precipitous, not gradual, or due to progressive deterioration of property through a steadily operating cause. An event is unexpected if it is unanticipated, and it occurs without the intent of the one who suffers the loss. An event is unusual if it is an extraordinary, nonrecurring one that does not commonly occur during the activity in which the taxpayer was engaged when the destruction or damage occurred and does not commonly occur in the ordinary course of the

taxpayer's day-to-day living. Miscellaneous IRS Documents FAQs for Disaster Victims (Valuations and Sections 165(i)), Q&A 8 (8/24/2021).

The Bureau determined Petitioners' loss was due to progressive deterioration. Petitioners argue the loss was due to an identifiable event of a sudden, unexpected or unusual nature. Deductions are a matter of legislative grace, and generally the taxpayer bears the burden of proving entitlement to any deduction claimed. *INDOPCO, Inc. v. Commissioner*, 503 U.S. 79, 84 [69 AFTR 2d 92-694] (1992).

Petitioners have testified the loss was sudden, unexpected, or unusual. However, they have not provided any documentary evidence to support their claim, only self-serving testimony. Currently the only thing known for certain is Petitioners' home tested positive for mold and the mortgage lender sold the house in a short sale.

The Tax Commission requires Petitioners provide photocopies of the required documentation listed to support the items in dispute.

- The name, contact information, and work orders for the contractor hired to conduct the remodel. Additionally, a signed statement from the contractor certifying the mold was contained before the remodel was started.
- The name, contact information, and work orders for the contractors hired to dispose of the household contents.
- A signed statement from the mold investigator that he advised Petitioners that all their personal items were unsalvageable and to move immediately. The Tax Commission notes the mold report does not support these claims and most mold remediation guidelines state nonabsorbent items (items made of plastic, metal, ceramic, or glass) can be salvaged.
- Photographs showing extent of the loss.
- Verification of cost or other basis of property and date acquired.

- Communications between Petitioners, contractors, mortgage lenders, and insurance agencies establishing the timeline of events and Petitioners' claims.

Petitioners have not provided the requested information. Therefore, the Tax Commission will affirm the Bureau's determination on this matter.

### **Amount of Casualty Loss**

A casualty loss not connected with a trade or business, or a transaction entered into for profit is deductible under IRC section 165(h) only to the extent (1) the loss exceeds \$100, and (2) the net casualty loss exceeds 10 percent of the adjusted gross income of the taxpayer. The amount of the casualty loss from a partial destruction of property is the lesser of the taxpayer's adjusted basis of the property or the difference in the property's fair market value immediately before and after the casualty. IRC section 1.165-7(b)(1), Income Tax Regs. The amount of the loss is reduced by any insurance recovery and salvage value. IRC section 165(a); Income Tax Regs. 1.165-1(c)(4). To establish the amount of the loss, the relevant fair market values of the property "shall generally be ascertained by competent appraisal" conducted in a manner to ensure that any casualty loss deduction "be limited to the actual loss resulting from damage to the property." Income Tax Regs. 1.165-7(a)(2)(i), As an alternative, the taxpayer may use the cost of repairs to prove the casualty loss (the cost of repairs method). Income Tax Regs. 1.165-7(a)(2)(ii).

As a secondary position, the Bureau determined Petitioners overstated their losses. The Bureau found Petitioners' vague and incomplete testimony was not sufficient to substantiate the amount of the casualty loss deduction. The Bureau found the mortgage lender sold the homestead for \$133,000 canceled \$33,145 of Petitioners' debt, and Petitioners did not include the FMV and cancelation of debt in their loss calculations. Additionally, the Bureau found Petitioners used replacement costs versus FMV in calculating the casualty loss.

The Tax Commission has reviewed all the available facts and circumstances and to the extent not discussed above finds Petitioners incorrectly calculated and overstated their loss, and the Bureau's calculations are a more reasonable estimate. Therefore, the Tax Commission will affirm the Bureau's secondary position. However, this only applies if Petitioners show their loss qualifies as a deductible casualty loss.

### **Negligence Penalty**

Idaho Code section 63-3046(a) provides a 5% negligence penalty shall be imposed if the deficiency results from either negligence by the taxpayer or from disregard by the taxpayer or his agent of state or federal tax laws, rules of the Tax Commission, or Treasury Regulations. Administration and Enforcement Rule 410 provides examples of situations that justify the negligence penalty.

Idaho Code section 63-3044 defines deficiency as the amount by which the tax imposed by this act exceeds the amount shown as the tax by the taxpayer upon his return; but the amount so shown on the return shall first be increased by the amounts previously assessed (or collected without assessment) as a deficiency, and decreased by the amounts previously abated, credited, refunded, or otherwise repaid in respect of such tax.

The Bureau added the negligence penalty to the income tax deficiency. The Tax Commission finds the addition appropriate. However, during the appeals process, the Tax Appeals Unit found, and the Bureau agreed, the Bureau overstated the proper amount of negligence penalty. Therefore, the Tax Commission will reduce the negligence penalty.

### **CONCLUSION**

The Tax Commission's determination of a deficiency is presumed correct, and the taxpayer bears the burden of proving it incorrect. *Albertson's Inc. v. State Dep't of Revenue*, 106 Idaho 810,

814, 683 P.2d 846, 850 (1984). Additionally, deductions are a matter of legislative grace, and the taxpayer must establish his right to take them. *New Colonial Ice Co Inc v. Guy T. Helvering*, (1934, S Ct) 13 AFTR 1180, 292 US 435, 78 L Ed 1348, 4 USTC ¶1292. The Tax Commission requires Petitioners to provide adequate evidence to establish the amount asserted in the Notice is incorrect. Petitioners did not provide adequate evidence. As a result, the Tax Commission will uphold the Notice.

The Bureau added interest. The Tax Commission has reviewed the addition, finds it to be appropriate per Idaho Code section 63-3045, and has updated interest accordingly. Interest is calculated through December 22, 2022 and will continue to accrue at the rate set forth in Idaho Code section 63-3045(6) until paid.

THEREFORE, the Modified Notice of Deficiency Determination dated June 1, 2022, is hereby APPROVED, in accordance with the provisions of this decision, and is AFFIRMED and MADE FINAL.

IT IS ORDERED that Petitioner pay the following tax, penalty, and interest.

<u>YEAR</u>	<u>REFUND CLAIMED</u>	<u>REFUND ALLOWED</u>	<u>TAX</u>	<u>PENALTY</u>	<u>INTEREST</u>	<u>TOTAL</u>
2014	(\$988)	\$0	0	\$0	\$0	\$0
2015	(60)	0	0	0	0	0
2016	0	0	779	39	127	945
2017	(724)	0	0	0	0	0
2018	(2,652)	0	12	10	1	0
2019	0	0	3,225	161	112	3,498
2020	(3,370)	(126)	0	0	(5)	(131)
						\$4,312

DEMAND for immediate payment of the foregoing amount is hereby made and given.

An explanation of Petitioners' right to appeal this decision is enclosed.

DATED this \_\_\_\_\_ day of \_\_\_\_\_ 2022.

IDAHO STATE TAX COMMISSION

**CERTIFICATE OF SERVICE**

I hereby certify that on this \_\_\_\_\_ day of \_\_\_\_\_ 2022,  
a copy of the within and foregoing DECISION was served by sending the same by United States  
mail, postage prepaid, in an envelope addressed to:

Receipt No.

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