

**JOHNSTON v. COMMISSIONER**  
**41 T.C.M. (CCH) 258 (1980)**  
**1980 P-H T.C. Memo ¶ 80, 477**  
(Timber issue only)

*Editor's Summary*

*Key Topics*

**CASUALTY LOSSES**

· Logging roads

*Facts*

A 200 foot portion of taxpayer's logging road was washed out by a flooded river in 1974. The road cost approximately \$23 per foot to build. The taxpayer sought a casualty loss deduction of \$25,000, the estimated cost of driving piles for a retaining wall needed to hold the road fill adjacent to the river. There was no retaining wall in place at the time of the flood. The Commissioner of Internal Revenue allowed a casualty loss of \$3,400.

*Tax Court*

HELD: For the Government. The amount allowable as a Casualty loss is limited to the lesser of (1) the adjusted basis or (2) fair market value of the property immediately before the casualty reduced by the fair market value of the property immediately after the casualty. Repair costs serve only as a measure of the loss of fair market value. To use repair costs as such a measure, the taxpayer must show that the repairs are necessary, reasonable in amount, only restore rather than enhance the property, and do not increase the value of the property beyond its pre-casualty level. Since the taxpayer submitted neither evidence that the road could not be restored without the retaining wall, nor evidence regarding the fair market value of the road before and after the flood, the Government's determination was sustained.

*Case Text*

FAY, Judge: Respondent's determined deficiencies in petitioners' Federal income taxes as follows:

<i>Year</i> .....	<i>Deficiency</i>
1971 .....	\$607.42
1972 .....	335.92
1973 .....	257.60
1974 .....	625.00
1975 .....	533.91

The issues for decision are whether petitioners are entitled to a greater casualty loss in 1974 and larger deductions for travel and transportation expenses in 1974 and 1975 than those allowed by

respondent. Resolution of the 1974 casualty loss issue will determine whether petitioners are entitled to net operating loss carrybacks to 1971, 1972, and 1973 and a net operating loss carryover-to 1975.

### *Findings of Fact*

Some of the facts have been stipulated and are so found.

Petitioners, Art and Veda Johnston, were residents of Portland, Oreg., when they filed their petition herein.

Petitioner Art Johnston (hereinafter petitioner) has been a logger for many years. Before 1954, he entered into an agreement to purchase some Oregon timberland which he bought around 1960. In 1954, he began construction of a road to reach the timberland which he later completed and maintained until 1974. The road was gravel over natural cover and required periodic regrading. Petitioner estimated that the road, which was one-half mile long, cost him approximately \$60,000 including about \$19,000 paid to outside construction firms, use of his own tractor at \$30 per hour, cost of materials such as gravel, and maintenance expenses.

In January 1974, the Nehalem River flooded and completely washed out 200 feet of petitioner's road. The river's flooding was a recurring nuisance to petitioner as evidenced by casualty losses of \$4,000 in 1972 when another section of the road was damaged and \$6,000 in 1973 when some logs were lost. Although Piling was not used before the 1974 flood, petitioner sought estimates of the cost of rebuilding the road by driving steel sheet piling along the roadway for 150 feet to establish a retaining wall which would hold fill. The lowest estimate was \$25,000 from Western Construction Piledriving Company. That estimate only covers the cost of driving piling and does not include any amount for fill or gravel. The road has yet to be repaired because petitioner has not obtained requisite permissions from the United States Army Corps of Engineers and the State of Oregon.

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In his statutory notice of deficiency respondent allowed a casualty loss of \$3,440 in 1974; disallowed net operating loss carrybacks to 1971, 1972, and 1973 and a net operating loss carryforward to 1975.

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### **Opinion**

#### *1. The Casualty Loss*

In January 1974, the Nehalem River flooded washing out 200 feet of petitioner's one-half mile logging road. That petitioner incurred a casualty loss deductible under section 165<sup>3</sup> is not disputed. The parties disagree over the amount of the loss. Petitioner contends that the proper

amount should be the \$25,000 estimate he received for repairing the road with steel sheet piling. Respondent contends that driving piling to shore up the road would improve rather than just repair the road; that repair costs are irrelevant when repairs are not actually made; and that the proper measure of the loss is the value before the casualty minus the value after the casualty, limited by petitioner's basis in the road. We agree with respondent for the reasons below.

Section 165(a) allows a deduction for any loss sustained which is not compensated by insurance or otherwise.<sup>4</sup> The amount of the loss is the lesser of the adjusted basis or the fair market value of the property immediately before the casualty reduced by the fair market value of the property immediately after the casualty. Sec. 1.165-7(b)(1), Income Tax Regs. The fair market value before and after must generally be ascertained by competent appraisal, sec. 1.165-7(a)(2)(i), Income Tax Regs., and petitioner offered no appraisal. However, petitioner contends that the \$25,000 estimate for repairing the road is sufficient to demonstrate the amount of his loss. Section 1.165-7(a)(2)(ii), Income Tax Regs., provides:

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 after the repairs does not as a result of the repairs exceed the value of the property immediately before the casualty.

Thus, before repair costs can serve as a measure of loss of value, the taxpayer must show the repairs are necessary, reasonable in amount, only restore rather than enhance the property, and do not increase the value of the property beyond its pre-casualty level.

Respondent contends that, since the road was only gravel over natural cover before the flood, adding steel sheet piling to serve as a retaining wall would "care for more than the damage suffered" and increase the value of the property above its value before the flood. Petitioner contends that a retaining wall is necessary to hold a fill before the original condition of the road can be restored. Credence is added to his position by photographs introduced at trial showing the complete destruction of the road section involved here and by past losses incurred due to the flooding river. Nevertheless, petitioner has not shown that the road could not be restored without the retaining wall or that the retaining wall is not a measure of protection against future floods rather than a prerequisite to any repair. See *Austin v. Commissioner* [Dec, 37,258], 74 T. C.-- (Sept. 18, 1980). Furthermore, petitioner has not shown that the value of the repaired road with a retaining wall would not exceed the value of the road before the 1974 flood.

Petitioner estimated that his adjusted basis in the road was \$60,000--a figure which' respondent challenges as being unsupported by proof. Even if we were to accept petitioner's estimate as his correct basis in the road, it could not determine the amount of his loss. Adjusted basis serves only as a lower limit on the amount of a casualty loss. The loss amount is the *lesser* of the adjusted basis or the decline in value. Since petitioner has not shown the amount of his loss by the decline in the road's value, we cannot surmise whether his basis attributable to the damaged section of the road is lesser or greater than that decline in value amount<sup>5</sup>

Petitioner bears the burden of proof. *Welch v. Helvering* [3 usc ¶ ! 164], 290 U.S. 111 (1933); Rule 142(a), Tax Court Rules of Practice and Procedure, and that burden has not been met. Petitioner offered no proof of the road's fair market value before or after the flood, Nor did he offer proof or any estimate concerning the cost of repairing the road without using piling which might have been indicative of the decline in value <sup>6</sup> It is evident that petitioner suffered a significant loss; but we have absolutely no basis for calculating a loss greater in :amount than that allowed by respondent. Therefore, we sustain respondent's: determination with regard to petitioner's casualty loss.

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3. All section references are to the Internal Revenue Code of 1954, as amended and in effect during the years in issue, unless otherwise indicated.

4. In the case of an individual, such as petitioner, deductible losses are limited by sec. 165(c) to those incurred in a trade or business, those incurred in connection with a profit motivated transaction, or casualty and theft losses. Petitioner's was incurred in his trade or business as a logger and was a casualty loss. See Sec. 1.165-7(a)(1), Income Tax Regs.

5. We do not mean: to imply that, if petitioner had proved the decline in the road's value, his loss would be limited to the portion of his adjusted basis in the entire road mathematically attributable to the 200 feet segment damaged. While the record is unclear on this point, if the damaged road section actually crossed the river, it would certainly have been more costly to construct than a section which only ran along the river. Likewise, we recognize that when a portion of a road is destroyed more than the destroyed portion is affected--the entire road may decline in value. We simply do not have before us the type of proof necessary to apply these principles,

6. We need not address respondent's contention that evidence of repair costs is not competent when no repairs have been made. See generally *Lamphere v. Commissioner* [Dec. 35,183], 70 T. C. 391 (1978).