

# JOURNAL OF ACCOUNTANCY

TAX PRACTICE CORNER

## When is a casualty "sudden, unexpected, or unusual"?

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MAY 2013



The Second Circuit's recent remand of *Alphonso*, No. 11-2364-ag (2d Cir. 2/6/13), rev'g 136 T.C. 247 (2011) (see "[Tax Matters: Co-op Lessee Has Property Interest in Collapsed Wall](#)," on page 73), allows the Tax Court to consider perhaps the most controversial aspect of casualty loss deductions—the meaning of "sudden, unexpected, or unusual."

Under Sec. 165(c), deductible personal losses (those not incurred in a trade or business or in a transaction entered into for profit) must arise from "fire, storm, shipwreck, or other casualty, or from theft." The IRS and courts have generally restricted such other casualties to those like the named instances—identifiable events of a sudden, unexpected, or unusual nature or due to such causes (see, e.g., *Matheson*, 54 F.2d 537 (2d Cir. 1931)). Generally, therefore, courts have held that where the underlying cause of loss is progressive, such as rust and rot, gradual inundation or erosion, or insect infestation, resulting damage or destruction is not a casualty within the meaning of the statute, even when the damage or destruction becomes suddenly apparent.

Thus, in *Carlson*, T.C. Memo. 1981-702, the Tax Court held that the collapse of a well did not qualify as a casualty loss because its cause was progressive deterioration of the supporting timber sidewalls.

In *Alphonso*, the Tax Court must make a factual determination whether the cause of a retaining wall's collapse was sudden, unexpected, or unusual. Rev. Rul. 72 592 states that to be considered sudden, the event must be swift and precipitous, not gradual or progressive. An unexpected event is one that is ordinarily unanticipated, occurring without the intent of the taxpayer suffering the loss. And an unusual event is one that is extraordinary and nonrecurring, not commonly occurring during the activity in which the taxpayer is engaged or in the ordinary course of day-to-day living of the taxpayer.

The IRS's position in *Alphonso* is that the retaining wall collapsed because of gradual weakening, erosion, or inundation and therefore was not a casualty within the meaning of the statute. This position is consistent with the IRS's view regarding damage to structures that steadily weaken from normal wind and weather conditions.

The IRS also holds that sudden losses arising from defective architectural design, faulty construction, or defective workmanship are not casualties. In *Berry*, T.C. Memo. 1969-162, the IRS successfully argued that damage to the taxpayers' home when a portion of its foundation sank 8.5 inches was attributable to faulty construction over a natural drainage ditch, not a sudden, unexpected, or unusual cause. Likewise, in *Kipp v. Bingler*, No. 63-047 (W.D. Penn. 1964), the IRS successfully contended that the underlying cause of a landslide that damaged the taxpayers' home during construction was the taxpayers' excavation of the site and the foreseeable effects of gravity and a progressive buildup of water.

A different conclusion was reached in *Heyn*, 46 T.C. 302 (1966), acq. 1967-2 C.B. 2, where a taxpayer contracted to have a two-story structure built on a steeply sloped hillside lot. Prior to construction, soil engineers inspected the property and recommended protective measures during excavation to prevent movement of the surface soils. The contractor, however, failed to take adequate measures, and a landslide occurred during excavation. Siding with the taxpayer, the Tax Court determined that the physical characteristics of the landslide were those normally associated with a casualty—a sudden and violent movement of a large mass of earth that was cataclysmic in character and

similar to a fire, storm, or shipwreck. That it might have been foreseen or prevented did not bar the court from classifying it as a casualty.

Given the factual nature of a casualty for tax purposes, many factors need to be considered when determining deductibility. Among these are how much time has elapsed since the damaged property was manufactured or constructed; the materials used in its construction and whether they were the sort likely to deteriorate or decay over time; the architectural and physical soundness of the property's design; the regularity of the property's maintenance; and whether necessary repairs were performed on a timely basis. In addition, the damage must be directly traceable to an identifiable event that could not have been easily anticipated or prevented.

In some cases, the IRS and courts have distinguished between events that are casualties and their causes that are not, such as normal deterioration of equipment and resulting catastrophic damage to surrounding property. Thus, in *Cooper*, T.C. Summ. 2003-168, the taxpayer was allowed a casualty loss deduction for damage to personal belongings from flooding caused by a split in an aging hose connecting a sink to a washing machine. The court distinguished between the gradual deterioration of the hose and the consequential water damage resulting from the hose's failure. In some cases, negligence in attempting to repair non-casualty damage has been held to have caused a casualty. In *Marx*, T.C. Memo. 1991-598, the taxpayers were allowed to deduct some costs and an estimate for repairs when a contractor's attempts to repair a roof leak caused worse leaks and damage.

In at least one instance, the IRS has deviated from the suddenness requirement. Rev. Proc. 2010-36 provides a safe harbor for costs of replacing certain defectively manufactured drywall associated with corrosive damage to residential wiring, plumbing, heating and cooling systems, and household appliances (see "[Tax Relief for Homeowners With Corrosive Drywall](#)," *JofA*, April 2011, page 45).

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