

ROSENTHAL v. COMMISSIONER
48 T.C. ___ No. 50 (1967).

Editor's Summary

Key Topics

CASUALTY LOSS

- Timber partially destroyed by ice storm
- Deduction limited to basis in trees destroyed
- No deduction for losses to pulpwood and young growth--failure of proof

Facts

The taxpayers were members of a joint venture which owned a timber tract consisting of 24,600 acres. As of January 1, 1960, the timber on the tract had a basis of \$212,-000, and the land had a basis of \$113,000. On March 2, 1960, an ice storm struck the property, partially destroying saw timber, pulpwood and young growth, and thereby reducing the value of the entire tract of timber by \$130,000. The joint venture deducted \$130,000 as a casualty loss, but the Commissioner reduced the allowable deduction to \$17,-315.48. The Commissioner computed the deduction by dividing the total estimated board feet of saw timber on the tract before the storm (58,445,000) into the total basis of the timber (\$212,000) and multiplied that result by the number of board feet of saw timber actually destroyed by the storm (4,757,100). He disallowed any deduction with respect to the pulpwood and young growth on the theory that neither of those two categories of timber had a basis. The taxpayers contended that the entire reduction in the timber's market value (\$130,000) was deductible since the reduction in market value did not exceed the total basis in the timber (\$212,000).

Tax Court

Held: For the Commissioner. Under the Treasury Regulations (§1.165-7(b)(2)) deductions for losses incurred in a trade or business or in any transaction entered into for profit are determined by reference to the single, identifiable property damaged or destroyed. The question here is whether the single, identifiable property damaged or destroyed is the entire quantity of timber on the tract, as contended by the taxpayer, or whether it is only those trees which are actually damaged or destroyed, as contended by the Commissioner? The Court argues with the Commissioner. For purposes of determining the depletion allowance for timber under sections 611 and 612 of the Internal Revenue Code and for determining gain or loss under section 631, each tree is assigned its own basis. Where property is such that it is normally allocated a specific basis upon its disposition, as in the case of timber, a casualty loss of such property should likewise be limited to the basis of the specific property lost in the casualty. Furthermore, since young growth has no basis, and since the taxpayer failed to show what amount of the timber's total basis should be allocated to pulpwood, the Commissioner was correct in limiting the deduction to the

basis in the 4,757,100 board feet of saw timber destroyed.

Case Text
[Timber Issues Only]

Scott, Judge: Respondent determined deficiencies in the income tax of Fred and Irene Rosenthal, Fenya Ginzberg, Joachim Ginzberg, Leo and Zara Eliash, and Estate of Fallny Golodetz, Deceased, Efim Golodetz, Administrator, and Efim Golodetz for the calendar year 1960 in the amounts of \$2,461.15, \$757.21, \$31,681.07, \$9,223.28, and \$7,947.15, respectively.

The issues for decision are:

(1) Whether the casualty loss in 1960 with respect to timber held by-a joint venture in which petitioners held varying percentage interests should be limited to the basis of the specific timber which was damaged or limited only by the basis of the timber in the tract with respect to which damage was suffered.

FINDINGS OF FACT

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

Fred and Irene Rosenthal, who resided at the time of the filing of the petition in this case in Leonia, New Jersey, filed their joint Federal income tax return for the calendar year 1960 with the district director of internal revenue, San Francisco, California.

Fenya Ginzberg, who resided at the time of the filing of her petition in this case in New York, New York, filed an individual income tax return for the calendar year 1960 with the district director of internal revenue, Manhattan, New York.

Joachim Ginzberg filed his individual Federal income tax return for the calendar year 1960 with the district director of internal revenue, Manhattan, New York.

Leo and Zara Eliash filed their joint Federal income tax return for the calendar year 1960 with the district director of internal revenue, Manhattan, New York.

Fanny Golodetz, who is now deceased, and Efim Golodetz, filed a joint Federal income tax return for the calendar year 1960 with the district director of internal revenue, Manhattan, New York.

Casualty Loss Issue

Irene Rosenthal and Fenya Ginzberg owned a $6 \frac{2}{3}$ percent interest and a $3 \frac{1}{3}$ percent interest, respectively, in a joint venture organized under the laws of the State of New York and known as Namarib Company-Timber Venture.

Namarib Company is a partnership organized under the laws of the State of New York, and this partnership during the calendar year 1960 owned a $67 \frac{1}{2}$ percent interest in the Namarib

Company-Timber Venture (hereinafter referred to as the joint venture).

During the calendar year 1960 Joachim Ginzberg owned a 60 percent interest and Efim Golodetz and Leo Eliash each owned a 20 percent interest in the Namarib Company partnership.

On January 1, 1960, the joint venture owned a timber tract in the State of Tennessee, consisting of 24,605.6 acres of which 19,734.7 acres had been acquired on August 7, 1951 for \$300,000 and the remaining 4,870.9 had been acquired on March 20, 1956 for \$60,000. The joint venture set up this tract on its books by allocating \$93,-825 of the purchase price of \$300,000 (to which were added certain capitalized expenditures) to the land and \$217,875 to the timber, and allocating the purchase price of \$60,000 (to which were added certain capitalized expenditures) between land and timber on the basis of \$19,225.93 to the land and \$44,800 to the timber.

The adjusted basis of the land on January 1, 1960, was \$113,080.93, and the cost basis of the timber to the joint venture as of January 1, 1960, was \$212,476.30. The depletion deducted on the joint venture's United States partnership return of income for the calendar year 1960 was \$2,633.90. The estimated board feet of saw timber in the tract as of January 1, 1960, used in arriving at the depletion deduction taken on the return of the joint venture was 58,445,000.

On March 2, 1960, an ice storm struck the southern central section of the Tennessee River Basin and adjacent areas outside of the Basin. The joint venture's timber tract was located within the area of the Tennessee River Basin where the storm occurred and the timber on this tract suffered damage as a result of the ice storm. There was also damage caused by the ice storm to plantations on the timber tract, and respondent allowed the full amount of deduction claimed by the joint venture for the damage to these farms.

After taking into account salvage, the loss of the joint venture was 4,757,100 board feet of saw timber and 5,-058.3 cords of pulpwood. The 4,757,100 board feet of saw timber was composed of 3,663,500 board feet of Virginia and short leaf pine which had a fair market value as of March 2, 1960, of \$24.20 per 1,000 board feet, 211,-250 board feet of hemlock which on March 2, 1960, had a fair market value of \$18 per thousand board feet, 145,-650 board feet of pine which had a fair market value as of March 2, 1960, of \$15.60 per thousand board feet, and 736,700 board feet of hardwoods which had a fair market value as of March 2, 1960, of \$13.65 per thousand board feet.

Pulpwood is the wood from trees which are at least 4 inches in diameter at breast height but are below 8 inches in diameter at breast height. Trees 8 inches or more in diameter at breast height are saw timber Size. The fair market value at March 2, 1960, of the 5,058.3 cords of pulpwood which the joint venture lost as a result of the ice storm was \$2.30 per cord.

In addition to the loss of the saw timber and pulpwood which the joint venture sustained as a result of the ice storm, there was also a loss of young growth of trees which measured less than 4 inches at breast height. These young trees were a result of natural growth from seed on the joint venture's land and were not trees which had been planted by the joint venture. The fair market value as of March 2, 1960, of the naturally produced young growth lost as a result of the ice

storm was \$12,173.

The fair market value of the entire timber tract of 24,605 acres immediately preceding the ice storm of March 2, 1960, exceeded the fair market value of this entire tract after the storm by at least \$130,000.

The following schedule shows the sales of timber in thousands of board feet and in dollars made by the joint venture and the expenses (other than depreciation and depletion) incurred by the joint venture in connection with the tract for the calendar years 1951 through 1965:

Sales			
Year	In Thousands of Board Feet	Dollar value	Expenses Excluding Depreciation and Depletion
1951	-----	-----	\$ 4,683.82
1952	324	\$ 6,537.08	36,402.77
1953	2,716.171	66,365.12	53,923.84
1954	2,534.830	66,933.24	63,620.57
1955	3,099.208	97,731.15	81,147.26
1956	2,050.443	51,456.58	47,597.61
1957	900	25,912.49	33,846.36
1958	2,000	31,864.81	28,278.99
1959	1,766	33,303.63	34,962.38
1960	1,725	28,740.14	44,964.90
1961	996	17,909.51	55,604.70
1962	1,408	24,456.31	52,915.30
1963	1,418	21,618.24	58,527.51
1964	936	11,490.12	55,244.04
1965	1,258	8,513.73	50,731.67
Totals	23,131.652	\$492,832.15	\$702,451.72

From 1953 until the time of the trial of this case the joint venture's timber tract had been managed by Charles R. Page, Jr., a consulting forester. Page at all times managed the tract with an effort toward promoting the best forest management practices. This management entailed timber stand improvement by hardwood control which consisted of planting of trees, both hardwood and pine, to improve and reinforce areas that did not have sufficient number of trees or trees of the right quality and kinds, as well as taking measures to protect the area from fire, insects, and disease. In his timber management of the joint venture's tract, Page also made sales for the joint venture of the timber which should be sold to carry out best forestry practices. Originally sales were of the low quality hardwood entirely, in order to have it removed from the area and promote the development and growth of pine.

In 1956 there had been some salvaging of timber as a result of a windstorm and in 1960 there was salvaging as a result of the ice storm. After the 1960 storm some areas were "clear cut" which means that all trees on the property were cut in order that the area might be planted with pine.

The timber which was cut in each year would amount to approximately one-half of the growth of timber in that year. In some timber tracts, depending on the condition of the forest when the management of the tract started, the timber cut will be more, and in some less, than 50 percent of the timber growth in the tract. Generally, in a forest management program, the manager attempts to avoid cutting in any one year in excess of 75 percent of the growth in that year until the timber stand is built up to a reasonable intensity. Most of the stands in the area in which Page acted as a manager were understocked, but the tract of the joint venture was somewhat above average for the area.

The joint venture on its partnership return of income for the calendar year 1960 reported the amount of \$24,237.52, which it made from the sale of timber as capital gain. This amount was computed by subtracting from a gross sales price of \$27,999.85, depletion of \$2,633.90 and expenses of \$1,128.43. The sales made by the joint venture in 1960, as they had been for prior years, were of "stumpage" which means that the joint venture sold standing timber and the purchasers cut it. The timber to be cut would be marked by an employee of the joint venture. The joint venture on its partnership return of income for the calendar year 1960 claimed a casualty loss from the storm of \$130,500.38 which it computed by adding to the \$104,787.29 which it determined to be the fair market value of the 4,757,100 board feet of saw timber lost as a result of the storm, the fair market value of \$11,634.09 of pulpwood lost as a result of the storm and \$12,173 as fair market value of the young growth destroyed by the storm, plus \$1,906 damage to plantations on the timber tract.

Respondent in his notice of deficiency to each of petitioners disallowed a portion of the casualty-loss claimed by the joint venture from the loss of timber. His determination was that the allowable amount of the casualty loss was \$17,315.48, which he computed by use of 4,757,100 board feet of saw timber being lost as a result of the ice storm with a cost basis to the joint venture of \$3.64 per thousand board feet. Respondent arrived at the amount of \$3.64 per thousand board feet of saw timber to be multiplied by the board feet of saw timber lost in the storm to obtain the total deductible casualty loss by dividing the total estimated board feet of saw timber in the tract owned by the joint venture as of January 1, 1960 of 58,445,000 into the total basis of the timber on the tract of \$212,476.30.

* * *

OPINION
Timber Loss Issue

The parties do not disagree as to the basic facts with respect to the issue concerning the claimed casualty loss by the joint venture.

The facts show that from the standpoint of either the fair market value of the timber destroyed by the ice storm or the difference in the value of the joint venture's entire tract of timber before and after the storm, the joint venture sustained a loss of approximately \$130,000. The parties have stipulated that respondent accepted a cost basis to the joint venture of the timber in the amount of \$212,476.30 as of January 1, 1960.

Petitioners take the position that since the \$130,000 loss computed on the basis of the fair market value of the timber lost or on the basis of the fair market value of all timber in the tract before and after the casualty is less than the cost basis of the timber in the tract of \$212,476.30, the joint venture is entitled to deduct the entire \$130,000 loss. Although petitioners argue that the joint venture was holding the timber primarily as an investment even though there had been cutting of some timber from the time the tract was acquired, they do not contest respondent's position that the timber on the timber tract is property used in a trade or business or held for the production of income. Neither do they attack respondent's regulations which provide that in the case of any casualty loss incurred in a trade or business or in a transaction entered into for profit, the amount of the loss shall be determined "by reference to the single identifiable property damaged or destroyed."¹ Petitioners' position is that all the timber on the tract should be considered as the "single identifiable property damaged or destroyed."

Respondent takes the position that the particular timber lost in the ice storm is the "single identifiable property." It is respondent's position that only the 4,757,100 board feet of saw timber lost in the storm has a basis to the joint venture and that since there is no basis to the joint venture in the pulpwood and natural regeneration, no amount of casualty loss is deductible by the joint venture with respect to those items.

Both parties cite and rely on *Carloate Industries, Inc. v. United States*, 354: F. 2d 814 (C. A. 5, 1966), which specifically approved respondent's regulation providing that a casualty loss incurred with respect to property used in a trade or business or in a transaction entered into for profit shall be determined by reference to the single identifiable property damaged or destroyed. In that case the Court stated, at page 817, as follows:

Carloate separated the land and the trees when it purchased its groves to establish a basis for depreciation of the trees; it has since taken a deduction for depreciation of the trees. Thus Carloate has already recovered a portion of the cost of its trees through annual depreciation deductions. Under the approach urged by Carloate it would be allowed a casualty loss deduction against the bases of both the land and the trees based on a casualty loss to the trees alone and without a showing of any casualty loss to the land. To permit Carloate a casualty loss deduction in excess of the adjusted basis of its trees without a showing of loss to the land would in effect enable Carloate to recover, as a result of the destruction only of the trees, *more* than its investment in the trees and to offset this recovery against the basis of the land.

It is petitioners' position that the Court, in *Carloate Industries, Inc. v. United States*, *supra*, held that the grove of citrus trees was a "single identifiable property" separate from the land. Petitioners rely for this interpretation of *Carloate Industries, Inc. v. United States*, *supra*, on *Alcoma Association v. United States*, 239 F. 2d 365 (C. A. 5, 1956), which was distinguished by the Court in *Carloate Industries, Inc. v. United States*, *supra*.

Respondent argues that since *Carloate Industries, Inc. v. United States*, *supra*, involved a situation where all the trees on the taxpayer's property were destroyed, only a separation of the land and the trees was involved and that the Court's reliance on *Bessie Knapp*, 23 T. C. 716

(1955), as well as *United States v. Koshland*, 208 F. 2d 636 (C. A. 9, 1953), in support of its holding and particularly its reference to the *Bessie Knapp* case being directly in point, supports the conclusion that the Court was not treating all the trees in the grove as a "single identifiable property" other than for the reason that in the particular case all such trees had been destroyed. Respondent argues that *Alcoma Association v. United States*, *supra*, does not support petitioners' contention that only the timber and land should be separated in the case of the joint venture, calling attention to the fact that in that case the Court merely disapproved a formula, the use of which the Commissioner was contending was appropriate in computing a partial casualty loss to business property. In the case of *Alcoma Association v. United States*, *supra*, which involved the partial destruction of a citrus grove, the Court stated that the Commissioner was not attempting to distinguish the case of *Helvering v. Owens*, 305 U.S. 468 (1939), on the ground that it involved partial destruction of an automobile which was property of a type that could not be destroyed piece by piece without affecting the utility of the whole, and therefore clearly had an indivisible basis, whereas the case there under consideration involved trees growing on land which might be considered separately. As to the divisibility of basis of property partially destroyed the Court stated:

The same is not necessarily true of a citrus grove, where the destruction of some of the trees throughout the grove, or perhaps of all the trees in a portion of the grove, leaving the rest of the trees productive, might allow for the matching of the destroyed property with particular portions of the "basis"; clearly for some kinds of property physical separability means that each portion has its own "basis."

Respondent in the instant case argues that each physically separate tree which is a portion of the timber on the joint venture's tract does have its own basis and that this is recognized in the revenue laws which provide for allowance of a deduction for depletion of timber on the basis of the units of timber cut. Respondent refers to sections 611, 612, and 631 of the I. R. C. of 1954 and his regulations issued pursuant thereto dealing specifically with timber. Respondent calls attention to state-merits in section 1.611-3 and section 1.612-1, Income Tax Regulations, which refer to the computation of the deduction for cost depletion in respect of timber to be made by reference to its adjusted basis provided in sections 1011, 1012, and 1016 relating to basis for the purpose of determining gain upon the sale or other disposition of such property.

Petitioners recognize that for depletion purposes specific timber cut has a specific basis and also that under section 631, the gain or loss on timber disposed of in any taxable year is the difference between the amount realized from, or fair market value of, the timber disposed of and the adjusted basis thereof for depletion purposes. Petitioners contend that basis for depletion purposes determined from the estimated timber on a tract and the estimated growth during the year is not the basis to be used for any purposes other than those specified by statute. Petitioners state that timber which is not voluntarily disposed of by the joint venture, but is involuntarily lost in a casualty should not be considered to have the same basis which it would have if disposed of under a cutting contract which would require that its basis be computed in accordance with section 631. Petitioners attempt to distinguish the circumstances in the present case from those in *Bessie Knapp*, *supra*, on the ground that the timber here differs from the citrus trees involved in that case and that none of the trees damaged by the casualty in the instant case were trees planted by the

joint venture, the cost of planting of which had been deducted in computing taxable income. *Bessie Knapp, supra*, involved a citrus grove used in the taxpayer's trade or business of growing oranges. The instant case involves timber which is held for sale by the joint venture either in its trade or business or in a transaction entered into for profit. Even though this constitutes a distinction in the cases, if petitioners' timber were considered to be in the nature of inventory or of crops grown by a farmer, this distinction would not necessarily require a result as to the limitation of the deductible amount of the casualty loss to be determined in a manner different from that used in *Bessie Khan, supra*. Respondent's regulations specifically provide that no casualty loss deduction is allowable for items in inventory and that no casualty loss deduction is allowable with respect to growing crops since the cost of producing the crops has been expensed. The regulations do allow deduction for a casualty loss to capitalized items used by a farmer in his trade or business to the extent of his basis therein. See section 1.165-7(a)(1) and (4) and section 1.165-6(c) and (d), Income Tax Regs.

The underlying theory of the limitation on the amount of a casualty loss which is deductible when the fair market value of the property lost is not the limiting factor is that the loss is limited by an amount which would otherwise at some other time be deductible for income tax purposes. If the deduction has already been taken in some other manner, it is not again allowable as a casualty loss. In *United States v. Koshland, supra*, the Court stated that "a casualty loss of business property is measured for tax purposes by the adjusted basis of the property destroyed," citing respondent's regulations then in effect. In support of this conclusion the Court pointed out that all the taxpayer in that case had lost was its hotel building, the cost of which it had substantially recovered through the years by depreciation deductions, and that to allow a deduction where the building only was lost to the extent of the basis of the land and building would be in effect to allow a loss for the land which was not injured by the fire. In effect in the instant case, to allow a deduction for more of the basis of the timber of the joint venture than that applicable to the trees damaged would be to allow a deduction for a loss to trees that were not damaged. In *Bessie Knapp, supra*, we not only considered the trees as a separate property from the land, but also separated the trees purchased by the taxpayer from trees which had been killed in the freeze which had no basis to the taxpayer because the cost of the planting and growing of the trees had been expensed. We allowed no casualty loss with respect to those trees in which the taxpayer had no basis. In determining the loss on the trees which had been on the land when it was purchased by the taxpayer in *Bessie Knapp, supra*, we did not allow the loss to the extent of the entire basis of all the trees on the land when purchased but only allowed a deduction of that percentage of the basis which we determined to be applicable to the trees lost in the freeze. Under the theory of *Bessie Knapp, supra*, as well as the underlying theory of the deductible amount of casualty losses to property connected with a trade or business or transaction entered into for profit, we conclude that where property is such that it is normally allocated a specific basis upon its disposition, as in the case of timber, a casualty loss of such property should likewise be limited to the basis of the specific property lost in the casualty. This, in effect, is the holding of *Bessie Knapp, supra*. This holding is not contrary to the holding of *Alcoma Association v. United States, supra*, because of the limited basis of the decision in that case and the statements made in that case by the Court as to the limited scope of the holding. We conclude that the naturally regenerated young growth lost by the joint venture in the freeze had no basis to the joint venture and therefore the joint venture is entitled to no casualty loss deduction for the loss of the young growth.

Although the pulpwood in actual fact probably had some basis to the joint venture in that it was very likely on the land as young growth at the time the joint venture acquired the land, if a portion of the basis were allocated to the pulpwood, the amount so allocated would have to be used to reduce the basis allocable to the saw timber thereby reducing the basis per thousand board feet of saw timber which respondent used to compute the basis of the saw timber destroyed in the 1960 casualty. Petitioners have made no showing of what amount of file basis ill the timber, if any, should be allocated to the pulpwood. It may well be that upon proper allocation the basis of the pulpwood destroyed in the freeze added to the basis of the saw timber computed by reducing the basis of all saw timber on the tract by the basis allocated to the pulpwood on the tract would be no greater, or even less than, the basis of the timber lost by the joint venture as determined by respondent by allocating the entire basis of the joint venture in the timber to saw timber. In any event petitioners have made no showing to the contrary. Under these circumstances we accept respondent 's determination of the basis of the joint venture in the timber as being the basis as computed by him of the saw timber.

Decisions will be entered under Rule 50.

1 Sec. 1.165-7 (b)(1) and (2), Income Tax Regs. provides as follows:

(b) Amount deductible---(1) General rule. In the ease of any casualty loss whether or not incurred in a trade or business or in any transaction entered into for profit, the amount of loss to be taken into account for purposes of section 165(a) shall be the lesser of either-

"(i) The amount which is equal to the fair market value of the property immediately before the casualty reduced by the fair market value of the property immediately after the casualty; or

"(ii) The amount of the adjusted basis prescribed in section 1.1011-1 for determining the loss from the sale or other disposition of the property involved.

However, if property used in a trade or business or held for the production of income is totally destroyed by casualty, and if the fair market value of such property immediately before the casualty is less than the adjusted basis of such property, the amount of the adjusted basis of such property shall be treated as the amount of the loss for purposes of section 165(a).

"(2) Aggregation of property for computing loss. (i) A loss incurred in a trade or business or in any transaction entered into for profit shall be determined under subparagraph (1) of this paragraph by reference to the single identifiable property damaged or destroyed. Thus, for example in determining the fair market value of the property before and after the casualty in a case where damage by casualty has occurred to a building and ornamental or fruit trees used in a trade or business the decrease in value shall be measured by taking the building and trees into account separately and not together as an integral part of the realty and separate losses shall be determined for such building and trees."