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BARTLETT V. UNITED STATES: DEDUCTION OF NONBUSINESS LOSSES NOT COMPENSATED BY INSURANCE—THE NEED FOR A SEPARATE STANDARD FOR INDIVIDUALS

Pursuant to the general rules of section 165(a) of the Internal Revenue Code of 1954, a taxpayer may claim as a deduction “any loss sustained during the taxable year and not compensated for by insurance or otherwise.”¹ The broad language of this provision has been the source of considerable litigation primarily aimed at establishing the amount and year of the deduction in situations complicated by a concurrent insurance claim.²

Another aspect of this section, however, recently has spawned considerable controversy. In *Bartlett v. United States*,³ the District Court for the District of Maryland considered the question of whether an individual taxpayer who, for personal reasons, elected not to claim compensation for a nonbusiness loss covered by a valid insurance policy was eligible for a casualty loss deduction under subsection 165(c)(3).⁴ Although recognizing that this exact issue never had been resolved, the court concluded that the “weight of available authority” supported the disallowance of the deduction.⁵ This Comment focuses upon the standard of deduction eligibility applied in *Bartlett* and tests its validity in light of the statutory purpose of subsection 165(c)(3).

1. INT. REV. CODE OF 1954, § 165(a).

2. See *Boehm v. Commissioner*, 326 U.S. 287 (1945); *Lucas v. American Code Co.*, 280 U.S. 445 (1930); *Callan v. Westover*, 116 F. Supp. 191 (S.D. Cal. 1953); *Broderick v. Anderson*, 23 F. Supp. 488 (S.D.N.Y. 1938); *Louis Gale*, 41 T.C. 269 (1963); *Coastal Terminals, Inc.*, 25 T.C. 1053 (1956).

3. 397 F. Supp. 216 (D. Md. 1975).

4. INT. REV. CODE OF 1954, § 165(c)(3). Subsection 165(c) provides, in pertinent part:

In the case of an individual, the deduction under subsection (a) shall be limited to—

- (1) losses incurred in a trade or business;
- (2) losses incurred in any transaction entered into for profit, though not connected with a trade or business; and
- (3) losses of property not connected with a trade or business, if such losses arise from fire, storm, shipwreck, or other casualty, or from theft. A loss described in this paragraph shall be allowed only to the extent that the amount of loss to such individual arising from each casualty, or from each theft, exceeds \$100

5. 397 F. Supp. at 218.

DEVELOPMENTS PRIOR TO THE REVENUE ACT OF 1964

Despite the extensive revision of the Internal Revenue Code in 1954, early decisions construing the sections of the Code dealing with loss deductions⁶ are of considerable precedential value. Although in the majority of those decisions the courts considered merely the proper year of deduction, they developed a rationale applicable to all future constructions.⁷ *Broderick v. Anderson*⁸ concerned a bank that had suffered an embezzlement loss in 1929. The loss was covered by a valid insurance policy, but because the bank was tardy in filing its claim, the insurance company rejected it in 1930. In disallowing a 1929 deduction, the court reasoned that because "the loss must be actual and present,"⁹ the deduction was proper only in 1930. The court, however, asserted in dicta that "[n]o force can be given to the plaintiff's claim that 'not compensated by insurance' does not mean 'not covered by insurance'. It means that or it is meaningless."¹⁰

In *Callan v. Westover*,¹¹ an individual businessman claimed a loss under subsection 23(e) for flood damage to his rental property. In disallowing the deduction, the court established the following general standard of deduction eligibility for losses arising from a business related activity: ". . . whether a reasonable taxpayer exercising ordinary business care and prudence would have treated the matter as a 'closed and completed' transaction . . . without regard to possible recoupment in some future year."¹² The enunciation of

6. Before the major revision of the Code in 1954, the basic income deduction provisions were amassed under section 23 of the 1939 Code. INT. REV. CODE OF 1939, § 23. The effect of the 1954 legislation was to separate section 23 into two distinct provisions: subsection 23(a) dealing with business expense deductions became section 162; subsections 23(e) and 23(f) dealing with loss deductions became subsections 165(a) and 165(c). INT. REV. CODE OF 1954, §§ 162, 165(a), (c). The Senate Finance Committee Report that accompanied the legislation stated: "The general rule for losses of individuals (sec. 23(e)) and the rule for corporations (sec. 23(f)) become subsections (a) and (c) No substantive change is made by this rearrangement" S. REP. NO. 1622, 83d Cong., 2d Sess. 198 (1954), in 1954 U.S. CODE CONG. & AD. NEWS 4833. The revision therefore provided a continuum of statutory authority that afforded precedential value to early decisions construing subsections 23(e) and 23(f).

7. Cases cited note 2 *supra*.

8. 23 F. Supp. 488 (S.D.N.Y. 1938).

9. *Id.* at 492.

10. *Id.* No precedential value has been given to that statement. See note 36 *infra* & accompanying text.

11. 116 F. Supp. 191 (S.D. Cal. 1953).

12. *Id.* at 198. Previous cases had referred to a test that was practical and flexible enough to consider all pertinent facts and circumstances. See *Boehm v. Commissioner*, 326 U.S. 287 (1945); *Lucas v. American Code Co.*, 280 U.S. 445 (1930). *Callan* merely formalized those

this standard of "ordinary business care and prudence" directly influenced the decision in 1954 to enact separate provisions for business expenses and business losses.¹³ Because Congress and the courts were preoccupied with establishing a valid standard of consideration for corporations and for individuals engaged in business activities, they failed to clarify the position of an individual suffering a nonbusiness loss under section 165(c)(3).¹⁴

THE ELECTION NOT TO CLAIM INSURANCE COMPENSATION: A REFINEMENT OF THE GENERAL STANDARD FOR BUSINESS ACTIVITIES

In 1968, the Court of Appeals for the Sixth Circuit considered several complex tax issues raised by *Kentucky Utilities Co. v. Glenn*.¹⁵ The issue pertinent to this discussion concerned a \$44,486.77 deduction claimed by the utilities company on its 1953 corporate tax return for damage done to a generator. In accordance with the provisions of the 1939 Code, the company wished to claim the amount as either an ordinary and necessary business expense¹⁶ or as an uninsured loss.¹⁷ The generator had been insured by Lloyds of London for \$200,000 subject to a \$10,000 deductible clause. The insurance company never disputed its coverage, but did intend to subrogate Westinghouse, which had supplied the generator but subsequently had denied any liability under its warranty. The total loss had been approximately \$150,000. Under the settlement among the

criteria within the scope of business activities.

13. "Ordinary business care and prudence" required the taxpayer to maintain his books in accordance with generally accepted accounting principles so that they would clearly reflect net operating income. The accounting principles demanded that nonrecurring and extraordinary losses or gains be shown separately on the income statement. AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS, ACCOUNTING RESEARCH BULLETIN No. 43 (1953). The Senate Finance Committee endorsed this concept stating: "[a] method of accounting which reflects the consistent application of generally accepted accounting principles in a trade or business will ordinarily be considered as clearly reflecting income. These provisions rearrange and clarify the provisions of the 1939 Code" S. REP. No. 1622, 83d Cong., 2d Sess. (1954), in 1954 U.S. CODE CONG. & AD. NEWS 4939.

14. The courts continued to apply the same basic standard of deduction eligibility to both business and nonbusiness activities. See *Louis Gale*, 41 T.C. 269 (1963). Moreover, the concern of Congress that Code provisions must reflect generally accepted accounting principles expressly exempted individual nonbusiness activities from consideration, but did not give any definite guidelines for evaluating the reasonableness of those activities in view of proper tax reporting procedures. See S. REP. No. 1622, 83d Cong., 2d Sess. (1954), in 1954 U.S. CODE CONG. & AD. NEWS 4940.

15. 394 F.2d 631 (6th Cir. 1968), *aff'g* 250 F. Supp. 265 (W.D. Ky. 1965).

16. INT. REV. CODE OF 1939, § 23(a).

17. *Id.* § 23(f).

three parties, Westinghouse paid \$65,550.93 and Lloyds, relinquishing its right of subrogation against Westinghouse, paid \$37,500. Kentucky Utilities was responsible for the remaining \$44,486.67, which it subsequently deducted on its tax return. Excepting the \$10,000 deductible provision, the district court held that because Kentucky Utilities voluntarily assumed \$34,486.67 of the cost of repairs to the generator to protect Westinghouse from suit by Lloyds and to avoid difficulty in obtaining insurance with Lloyds, the expenditure of \$34,486.67 did not constitute a loss or an ordinary and necessary business expense.¹⁸ Relying on a series of cases concerning both corporations and individuals engaged in business who voluntarily had assumed losses for a variety of business reasons,¹⁹ the Court of Appeals for the Sixth Circuit affirmed.

THE REVENUE ACT OF 1964

The 1964 amendment to section 165(c)(3) of the 1954 Code established a deduction eligibility standard for nonbusiness losses, providing a \$100 nondeductible "floor" for all personal, nonbusiness casualty or theft losses.²⁰ As stated in the Senate report, the purpose of the amendment was to allow the deduction only of "extraordinary nonrecurring" losses that might affect significantly an individual's ability to pay federal income taxes.²¹ The report further emphasized that the amendment was applicable only to personal losses as dis-

18. 394 F.2d at 633.

19. *Sam P. Wallingford Grain Corp. v. Commissioner*, 74 F.2d 453, 454 (10th Cir. 1934) (voluntary payment by corporation of debts of predecessor corporation), *citing* *Kornhauser v. United States*, 276 U.S. 145 (1928) (attorney's fees paid in defending partnership suit); *Stephenson v. Commissioner*, 43 F.2d 348 (8th Cir. 1930) (contributions by officer of a bank to purchase questioned assets); *Mastin v. Commissioner*, 28 F.2d 748 (8th Cir. 1928) (expenditures of stockholder advertising real estate of his corporation).

20. H.R. No. 8363, 88th Cong., 2d Sess. (1964), in 1964 U.S. CODE CONG. & AD. NEWS 49.

21. S. REP. No. 830, 88th Cong., 2d Sess. (1964), in 1964 U.S. CODE CONG. & AD. NEWS 1730. As stated in the Senate report:

[i]t is believed appropriate to limit the casualty loss deduction to those losses or thefts above a minimum amount. The minimum selected was \$100 per casualty loss, since this corresponds approximately with the "\$100 deductible" insurance carried by many individuals in the United States with respect to such losses. This means that no deduction will be allowed in the case of an ordinary "fender bending" accident or casualty, but that casualty and theft losses will continue to be deductible (over the \$100) in those cases where they are sufficient in size to have a significant effect upon an individual's ability to pay federal income taxes. S. REP. No. 830, 88th Cong., 2d Sess. (1964), in 1964 U.S. CODE CONG. & AD. NEWS 1730.

tinguished from losses involving a trade, business, or transaction for profit.²²

The unique purpose of this amendment was noted expressly in *Cox v. United States*.²³ The petitioners had purchased a tract of real estate as a long term investment. Subsequently, the discovery of an oil field caused the market value of the land to increase rapidly. Less than a month later, however, because a massive intrusion of underground salt water destroyed the oil field, the value of the land returned to its former level, inducing the taxpayers to claim a casualty loss deduction under section 165(c)(3).²⁴ Noting the absence of any controlling authority, the court "turn[ed] to a consideration of Congressional intent"²⁵ and concluded that in enacting the casualty loss deduction (as amended), Congress had intended not to provide windfalls for the taxpayer, but rather to protect the individual from extraordinary events that might so weaken his financial status as to make payment of federal income taxes difficult.²⁶ Disallowing the deduction, the court found that the taxpayers in *Cox* had not suffered any out-of-pocket expenses because they had suffered no loss from injury to the surface of the land, their only original property interest, and therefore their ability to pay income taxes was not impaired.²⁷

22. *Id.*

23. 371 F. Supp. 1257 (N.D. Cal. 1973).

24. The original profit motive had related only to the surface of the land and thus damage to the oil field did not come under subsection 165(c)(2). See note 4 *supra*.

25. 371 F. Supp. at 1260. The court quoted a Supreme Court decision that stated:

There is, of course, no more persuasive evidence of the purpose of a statute than the words by which the legislature undertook to give expression to its wishes. Often these words are sufficient in and of themselves to determine the purpose of the legislation. In such cases we have followed their plain meaning. When that meaning has led to absurd or futile results, however, this Court has looked beyond the words to the purpose of the act.

Frequently, however, even when the plain meaning did not produce absurd results but merely an unreasonable one "plainly at variance with the policy of the legislation as a whole" this Court has followed that purpose, rather than the literal words. *United States v. American Trucking Ass'n*, 310 U.S. 534, 543 (1940).

26. 371 F. Supp. at 1261. The court quoted from H.R. REP. NO. 749, 88th Cong., 1st Sess. (1963). See note 21 *supra* & accompanying text. In disallowing the deduction, the court stated: "[O]ne of the fundamental purposes of this deduction was to minimize the financial hardships of extraordinary losses; it was not intended to be a device for obtaining windfalls."

27. 371 F. Supp. at 1262.

THE DILEMMA: THE INDIVIDUAL WHO FAILS TO CLAIM INSURANCE
COMPENSATION FOR A NONBUSINESS LOSS

After the 1964 amendment to section 165(c)(3), the first case that considered an individual's personal loss and subsequent election not to claim insurance compensation was *Axelrod v. Commissioner*.²⁸ Storm damage to petitioner's boat had been covered by a valid insurance policy, but because such insurance was difficult to obtain, the petitioner had elected to deduct the loss pursuant to section 165(c)(3) rather than to file a claim. Under these circumstances, a majority of the court refused to decide the validity of the casualty loss deduction,²⁹ concluding that the damage to the sailboat was not even a casualty loss but merely the result of ordinary "wear and tear."³⁰

Two concurring opinions,³¹ however, expressly addressed the issue of casualty loss deduction eligibility and took opposing views as to the validity of such a deduction. In his concurring opinion Judge Quealy maintained that the issue of deduction eligibility should have been decided first.³² In reference to the disparity in wording between section 165(a)³³ (losses not compensated for by insurance) and the applicable regulation³⁴ (losses not made good by insurance) the opinion stated that these two statements are of the same import.³⁵ In addition, Judge Quealy distinguished the case from *Broderick*, declining to apply its broad dicta³⁶ that "not compensated by insurance" means "not covered by insurance." Rather, he reasoned that because both *Axelrod* and *Kentucky Utilities* in-

28. 56 T.C. 248 (1971).

29. *Id.* at 256. The court stated: "[W]e do not reach the issue primarily argued by the parties in their briefs of the proper meaning of the words in section 165(a) 'not compensated for by insurance or otherwise' Apparently this issue has never been considered by this court in factual circumstances comparable to those here present." *Id.* at 256 n.4.

30. *Id.*

31. *Id.* at 259 (Fay, J., concurring); *id.* at 260 (Quealy, J., concurring).

32. *Id.* at 260. As stated by Judge Quealy: "[B]efore attempting to decide whether the petitioner sustained his burden of proof with respect to the facts, we should determine whether the alleged facts were sufficient to establish a casualty loss." *Id.*

33. See note 1 *supra* & accompanying text.

34. Treas. Reg. § 1.165-1(a) (1965). The regulation states in pertinent part: "[S]ection 165(a) provides that, in computing taxable income under section 63, any loss actually sustained during the taxable year and not made good by insurance or some other form of compensation. . . ."

35. 56 T.C. at 261.

36. *Id.* at 263. This was the first time any reported opinion had referred to the *Broderick* dicta. See note 10 *supra*.

volved taxpayers who failed to file insurance claims to avoid future difficulty in obtaining insurance, *Kentucky Utilities* should control.³⁷ Under Judge Quealy's analysis, because the petitioner made a "deliberate" choice not to claim insurance compensation, any loss so incurred was not a deductible casualty loss, but rather merely a "disadvantage" resulting from his purely personal choice not to pursue the right he had.³⁸

In an opinion by Judge Fay, however, three judges challenged that position, responding with a fresh consideration of the issue.³⁹ Judge Fay attacked the view that the voluntary surrender of a valid insurance claim always justified disallowing a loss deduction;⁴⁰ rather, he contended that because of the realities of the insurance world, an individual at times could be compelled to waive his insurance rights.⁴¹ Although he did not note specifically the legislative intent of section 165(c)(3),⁴² he reasoned that such a forced waiver constituted an actual loss.⁴³ The taxpayer, therefore, could validly claim a loss deduction in that no windfall benefit resulted.⁴⁴ Because the lack of individual discretion precluded any voluntary decision, the practical value of the individual's insurance coverage was ne-

37. *Id.* at 262.

38. *Id.* at 263.

39. *Id.* at 259 (concurring opinion).

40. *Id.* The opinion dismissed such a view as being "highly artificial and divorced from reality." *Id.*

41. *Id.* at 260. The fear of policy cancellation and prohibitive rate increases was, and still is, a definite problem in the area of personal automobile insurance. Vanderbeek & Reinmuth, *The Reinsurance Facility: A New Approach to The Residual Auto Insurance Market Problem*, 22 *DRAKE L. REV.* 768 (1973), quoting U.S. DEP'T OF TRANSP., *INSURANCE ACCESSIBILITY FOR THE HARD-TO-PLACE DRIVER*, REPORT OF THE FEDERAL TRADE COMMISSION TO THE DEP'T OF TRANSP. 23 (1970). Although all states have adopted some form of an assigned risk plan for otherwise uninsurable drivers, the results are not all favorable. For a critique of assigned risk plans, see *id.* For an example of an assigned risk plan, see MD. ANN. CODE art. 48A, § 243 (Repl. Vol. 1972).

Moreover, there is no requirement that insurers provide insurance to all those in the "residual market." The assigned risk plans were designed to eliminate this problem, but "either by a lack of commitment by the insurers or by the unworkability of the system, the market was neither ready nor willing to accept 100 per cent of the demand for coverage." Lee & Formisano, *Residual Markets in Automobile Insurance: A Comparative Analysis*, 1975 *INS. L.J.* 143, 144.

42. 56 T.C. at 259. The language, however, is similar to that used by the Cox court in stating the purpose of subsection 165(c)(3). See note 26 *supra* & accompanying text.

43. *Id.* To buttress his position the judge asserted a due process issue of de facto discrimination, reasoning that as the loss suffered by one forced to forego insurance benefits was an actual loss equal to that suffered by an uninsured person, the tax benefit should be the same in each instance. This issue, however, was dismissed summarily in *Bartlett*. See note 60 *infra*.

44. 56 T.C. at 260.

gated under those circumstances.⁴⁵ Judge Fay thus concluded that the statute contemplated separate consideration of any individual who, "for valid practical reasons,"⁴⁶ had been forced to relinquish his insurance claim.

The deduction eligibility of a taxpayer who elected not to file an insurance claim constituted the central issue in *Bartlett v. United States*.⁴⁷ In 1971, the petitioner's son had been involved in a single car accident with the family automobile; the damage sustained totaled \$1,725.00. Although the damage was covered by a valid insurance policy (\$100 deductible), the plaintiffs elected not to claim reimbursement from the insurance company and on their 1971 tax return attempted to deduct the damage as a casualty loss under subsection 165(c)(3). Applying a two-step analysis to the issue of whether the taxpayer's failure to claim compensation from the insurance company barred a subsequent casualty loss deduction, the court reasoned that: (1) because the taxpayers had voluntarily assumed the expenses, the loss resulted from their decision not to claim reimbursement and not from a casualty, and (2) any loss sustained was covered by a valid insurance policy and therefore was "compensated by the insurance or otherwise."⁴⁸

Recognizing that this exact issue had not been decided previously,⁴⁹ the court nonetheless looked to the "weight of available authority" and adopted the concurring opinion of Judge Quealy in *Axelrod*,⁵⁰ subscribing to his view that *Kentucky Utilities*, in which the taxpayer was a corporation, should control.⁵¹ In arriving at that decision, however, the court in *Bartlett* expressly noted that the purpose of 165(c)(3) was to "cushion the hardship occasioned by sudden extensive economic losses caused by physical forces outside of the taxpayer's control,"⁵² but then distinguished the case under consideration as a nonhardship situation because the loss arose not from a casualty but from the taxpayer's deliberate choice not to collect insurance.⁵³ The court reasoned that the allowance of a loss

45. *Id.* See note 41 *supra*.

46. *Id.*

47. 397 F. Supp. 216 (D. Md. 1975).

48. *Id.* at 220.

49. *Id.* at 218.

50. *Id.* at 220. See notes 32-38 *supra* & accompanying text.

51. 56 T.C. at 262. See 397 F. Supp. at 218-20.

52. 397 F. Supp. at 218.

53. *Id.* In reasoning that the individual had voluntarily assumed the loss, however, the court concluded that no external circumstances could mitigate the result. *But see* note 41 *supra*.

deduction under circumstances in which the taxpayer voluntarily assumed the costs of the casualty would, contrary to the design of the statute, create an optional insurance coverage guaranteed by the federal government.⁵⁴

The determination of what constituted a voluntary action had been the primary concern of the three-judge concurrence in *Axelrod*. In that opinion, Judge Fay, by distinguishing *Kentucky Utilities*, implied that a separate standard must be used to determine whether an individual's action as opposed to a corporation's was voluntary or merely an involuntary reaction to forces outside his control.⁵⁵ Taking judicial notice of the operation of the insurance market,⁵⁶ Judge Fay reasoned that a voluntary decision by a corporation might be equivalent to an individual's involuntary response caused by factors beyond his control.⁵⁷ The alternative proposed was a test to measure the extent of an individual's freedom of choice: Would a reasonable individual, mindful of the realities of the insurance world, consider himself compelled to relinquish his insurance rights to protect himself from personal hardship?⁵⁸ An insured indi-

54. 397 F. Supp. at 218. There appears to be an inconsistency in this argument. The net effect of any transaction between the insured and the insurer will not substantially change the position of the government. If the individual does make a claim against his insurance company, the amount of that claim will be deducted by the company as an ordinary and necessary business expense pursuant to INT. REV. CODE OF 1954, § 162. In addition, because of the progressive tax structure, the government actually will realize a net loss compared to what would have been realized as taxable income if the individual had been allowed to claim the loss deduction.

55. 56 T.C. 248, 259-60 (Fay, J., concurring). See note 41 *supra*; notes 77-80 *infra* & accompanying text.

56. 56 T.C. 259. See note 41 *supra*; notes 77-79 *infra* & accompanying text.

57. 56 T.C. at 259-60. If a separate standard were adopted by the court, a taxpayer could argue that an involuntary forfeiture of insurance rights constituted an abandonment of his claim. Treas. Reg. § 1.165-1(d)(2)(i) (1971) provides, in pertinent part:

If a casualty or other event occurs which may result in a loss . . . no portion of the loss with respect to which reimbursement may be received is sustained, for purposes of section 165, until it can be ascertained with reasonable certainty whether or not such reimbursement will be received. . . . Whether or not such reimbursement will be received may be ascertained . . . by an abandonment of the claim. When a taxpayer claims that the taxable year in which a loss is sustained is fixed by his abandonment of the claim for reimbursement, he must be able to produce objective evidence of having abandoned the claim, such as the execution of a release.

The lack of any claim may be construed as objective evidence of having abandoned the claim. See I.A. Edens, ¶ 74, 309 P-H Memo T.C. (1974). The claim, under those circumstances, would be a "worthless" interest thus fulfilling the requirements for an abandonment. See *Commissioner v. McCarthy*, 129 F.2d 84, 86 (7th Cir. 1942).

58. Cf. 56 T.C. at 260; note 41 *supra*.

vidual confronting that decision was deemed to be in the same position as an uninsured individual and therefore eligible for the casualty loss deduction.⁵⁹ By rejecting this argument,⁶⁰ however, the *Bartlett* court rejected any separate standard based on the status of the taxpayer, and instead designated as appropriate in all circumstances, the single standard of deduction eligibility applied in *Kentucky Utilities*, thus agreeing with Judge Quealy that failure to file an insurance claim for losses admittedly covered by a valid insurance policy always precludes any deduction for such losses under section 165(c)(3).⁶¹

ANALYSIS OF THE "WEIGHT OF AVAILABLE AUTHORITY"

In determining the meaning of "not compensated for by insurance" the primary function of the Court in *Bartlett* was to ensure that the interpretative standard used to construe that ambiguous clause vindicated the statutory purpose of section 165(c)(3).⁶² Although the court specifically noted the purpose of that section,⁶³ it found the provision inapplicable to a taxpayer who voluntarily assumed a loss.⁶⁴ Such a distinction between voluntary and involuntary was unnecessary, however, because the court already had negated the primary purpose of the casualty loss deduction by applying to an individual taxpayer suffering a nonbusiness loss the single standard of *Kentucky Utilities*, in which a corporate taxpayer sustained a business loss. The court in *Bartlett* thus was stating in effect that a "reasonable taxpayer exercising ordinary business care and prudence"⁶⁵ would not have considered the loss to be uninsured; the authority cited in *Kentucky Utilities* consisted exclusively of corporations and individuals who, for *business* reasons, had assumed voluntarily their respective losses.⁶⁶ Yet in 1964 Congress

59. 56 T.C. at 260.

60. 397 F. Supp. at 220. The court in *Bartlett* also rejected the constitutional issue that had been raised by Judge Fay in *Axelrod*. *Id.* at 221. See note 43 *supra*.

61. 397 F. Supp. at 220.

62. The Supreme Court has stated: "[A] taxpayer is not obliged to pursue a course of action giving rise to a greater tax liability if another is open which will give rise to a lesser. But the question for determination is whether what was done, apart from the tax motive, was the thing which the statute intended." *Gregory v. Helvering*, 393 U.S. 465, 469 (1935). See *Zellerebach v. Helvering* 293 U.S. 172, 178 (1934).

63. 397 F. Supp. at 218.

64. *Id.* The term "voluntary" was used to preclude any plea that the taxpayer had abandoned his claim. See *Treas. Reg. § 1.165-1 (d)(2)(i)* (1971); *But see* note 57 *supra*.

65. 116 F. Supp. 191, 198. See note 12 *supra*. *Contra*, note 58 *supra* & accompanying text.

66. See note 19 *supra*.

amended section 165(c)(3) for a specific purpose: to minimize the financial hardship of extraordinary *nonbusiness* losses that otherwise would impair an individual's ability to pay taxes,⁶⁷ thus establishing the *nonbusiness individual* as a unique classification requiring separate consideration. This action is significant in that "[w]hen Congress [chooses] to deal with a particular classification in a statutory section, this classification [is] removed from the application of the general language of the section which would cause a result contrary to the application of the specific language."⁶⁸

The focus of Judge Fay's concurrence in *Axelrod* was that such separate consideration by Congress mandated that the courts apply a separate standard to all individuals. Had Judge Fay narrowed the scope of his argument, rather than including *all* individual losses, perhaps the court in *Bartlett* would have been more receptive to his opinion. A standard that applies to all individual losses, however, is too broad for it encompasses both business⁶⁹ or profit related⁷⁰ activities and nonbusiness activities.⁷¹ Because the separate classification created by the 1964 amendment applies only to *individual nonbusiness* losses, courts should limit separate consideration to that category alone. Thus, the proper distinction is not only between the status of the taxpayer (corporate vs. individual), but also between the nature of the activities of the individual⁷² (business or profit related vs. nonbusiness).

Such a distinction is consistent with other provisions of the Code and treasury regulations.⁷³ A business can deduct its insurance premiums as an ordinary and necessary business expense⁷⁴ but personal insurance premiums are nondeductible.⁷⁵ Accordingly, to preclude intentional tax avoidance, a stricter standard of deduction

67. See notes 21-26 *supra* & accompanying text.

68. 1 J. MERTENS, THE LAW OF FEDERAL INCOME TAXATION § 3.17, at 35 (1974).

69. INT. REV. CODE OF 1954, § 165(c)(1).

70. *Id.* § 165(c)(2).

71. *Id.* § 165(c)(3).

72. In 1973 the Circuit Court of Appeals for the Seventh Circuit held that a corporation may deduct any loss regardless of the nature of the activity. That decision overruled a Tax Court holding that the loss must come from an activity related to the corporation's trade or business. *International Tracing Co. v. Commissioner*, 484 F.2d 707 (7th Cir. 1973), *rev'g* 57 T.C. 455 (1971). *Contra*, *Reis v. Commissioner*, 57 T.C. 469 (1971). The tax court, in all probability, only will treat the *International Tracing Co.* decision as precedent within the Seventh Circuit. *Golsen v. Commissioner*, 54 T.C. 742, 757 (1970).

73. See Treas. Reg. §§ 1.165-7(a)(5), 1.165-7(b)(1), 1.165-7(b)(4)(iv) (1975).

74. INT. REV. CODE OF 1954, § 162.

75. *Id.* § 262.

eligibility is necessary for business activities.⁷⁶ The validity of a distinction based both on the taxpayer's status and on the nature of the taxpayer's activities also is evinced by the relative ability of businesses and individuals to manage the problem of insurance coverage.⁷⁷ A business merely treats rate increases as another deductible business expense with the costs usually absorbed by the consumer; personal policy rate increases, however, represent an out-of-pocket cost to the individual.⁷⁸ Furthermore, if insurance coverage is cancelled, a business activity often may be in a position to accumulate sufficient assets to provide adequate self-insurance, but few individuals can afford to do this.

These differences corroborate Judge Fay's contention in *Axelrod* that for "valid practical reasons"⁷⁹ an individual may be forced to relinquish his right to insurance compensation, in other words, that a voluntary corporate decision might be equivalent to an individual's involuntary response caused by factors beyond his control. Moreover, if the scope of his concurrence is restricted to nonbusiness individual losses, his opinion is consistent with the purpose of section 165(c)(3). Because the *Kentucky Utilities* standard, however, excludes consideration of differences in taxpayer status and in types of activities, its application in a situation concerning as in *Bartlett* an individual's nonbusiness loss is invalid and could well result in "unjust and oppressive consequences."⁸⁰

76. If a business were allowed to deduct the cost of insurance premiums and file a loss deduction instead of claiming its insurance compensation, the result would lead to tax avoidance on a large scale. See *Gregory v. Helvering*, 293 U.S. 465 (1935).

77. Cf. note 41 *supra*.

78. The out-of-pocket expense associated with maintaining the value of one's interest was considered essential to a valid casualty loss deduction in *Cox*. 371 F. Supp. 1257, 1262.

79. 56 T.C. at 260.

80. The Supreme Court has stated: "[T]axation is an intensely practical matter, and the laws in respect of it should be construed and applied with a view of avoiding, so far as possible, unjust and oppressive consequences." *Farmers Loan & Trust Co. v. Minnesota*, 280 U.S. 204, 212 (1930).