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memorandum

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subject: Whether collision damages to rental vehicles arise from a casualty

This Chief Counsel Advice responds to your request for assistance. This advice may not be used or cited as precedent.

LEGEND

Taxpayer
A
B
C
D

E

Date 1
Date 2
a
b
c
d

e
f
g
h
i

ISSUE

Whether collision damages to the Taxpayer's rental vehicles arise from a casualty within the meaning of § 165 of the Internal Revenue Code.

CONCLUSION

Collision damages to the Taxpayer's rental vehicles do not arise from a casualty within the meaning of § 165 of the Internal Revenue Code because they are not unusual in the ordinary course of the Taxpayer's business of renting vehicles.

FACTS

The Taxpayer operates a vehicle rental company. The Taxpayer offers customers who rent a vehicle the opportunity to purchase a waiver. The waiver waives the Taxpayer's right to seek recovery from the customer or the customer's insurance company for damage to the vehicle while the vehicle is in the customer's custody. If a customer declines the waiver and the vehicle is damaged, the Taxpayer obtains a third-party estimate of the cost to repair the damage and seeks recovery for the damage from the customer or the customer's insurance company.

If one of the Taxpayer's vehicles is damaged and the customer purchased a waiver, the Taxpayer's B estimates the cost to repair the vehicle damage and works with the Taxpayer's C to determine, based on this estimate, whether to repair the vehicle or to sell it in damaged condition. The Taxpayer only repairs vehicles it intends to keep in its fleet. The Taxpayer does not repair damage to vehicles it determines should be disposed of through a sale or its A. If the cost to repair the vehicle, including D, the Taxpayer will not generally repair the vehicle. The Taxpayer does not purchase any insurance coverage on its rental vehicles.

This Chief Counsel Advice only addresses a subset of the collision damages in which the Taxpayer's vehicles are involved. This advice does not address vehicles that are damaged and that the Taxpayer repairs; vehicles that are damaged and for which the Taxpayer can seek recovery from its customer or the customer's insurance company because the customer did not purchase a waiver; and vehicles that are damaged for which the customer purchased a waiver and that the Taxpayer chooses to dispose of other than through its A. It addresses only damaged vehicles where the customer purchases a waiver, which

the Taxpayer disposes of through its A, and for which the Taxpayer claimed a casualty loss.

At any point in time during the taxable years ending Date 1, and Date 2, the Taxpayer owned approximately a vehicles. The following numbers are only for the subset of damaged vehicles at issue in this Chief Counsel Advice, namely vehicles for which the Taxpayer could not seek recovery from its customer or the customer's insurer because a waiver was purchased, and that were disposed of through the Taxpayer's A. During the taxable years ending date 1, and date 2, the number of vehicles damaged totaled b and c, respectively, for a daily average of d and e. The Taxpayer estimated the cost to repair the damage to these vehicles in the aggregate was $f, and $g, respectively.[1] The Taxpayer claimed a casualty loss under § 165 in the amount of its own estimate of the cost to repair the damage to these vehicles.

LAW AND ANALYSIS

Section 162(a) of the Internal Revenue Code allows a deduction for all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business.

Section 165(a) allows a deduction for losses sustained during the taxable year and not compensated by insurance or otherwise.

Section 1.165-7(a)(1) of the Treasury Regulations provides that any loss arising from fire, storm, shipwreck, or other casualty is allowable as a deduction under section 165(a) for the taxable year in which the loss is sustained.

Section 1.165-7(a)(3) discusses casualty losses for damage to automobiles. It provides, in part, that an automobile owned by the taxpayer, whether used for business purposes or maintained for recreation or pleasure, may be the subject of a casualty loss, including losses arising from fire, storm, or other casualty. In addition, a casualty loss occurs when an automobile owned by the taxpayer is damaged and if:

- (i) The damage results from the faulty driving of the taxpayer or other person operating the automobile but is not due to the willful act or willful negligence of the taxpayer or of one acting in the taxpayer's behalf, or

- (ii) The damage results from the faulty driving of the operator of the vehicle with which the automobile of the taxpayer collides.

Rev. Rul. 72-592, 1972-2 C.B. 101, provides that in order for a loss to qualify as a casualty loss under § 165, the loss must result from some event that is (1) identifiable, (2) damaging to property, and (3) sudden, unexpected, and unusual in nature. To be

[1] The approximate total cost to repair all of the Taxpayer's vehicles damaged (whether or not actually repaired) for the taxable years ending date 1, and date 2, was $h and $i, respectively.

"sudden" the event must be one that is swift and precipitous and not gradual or progressive. To be "unexpected" the event must be one that is ordinarily unanticipated, which occurs without the intent of the one who suffers the loss. To be "unusual" the event must be one that is extraordinary and nonrecurring, one that does not commonly occur during the activity in which the taxpayer was engaged when the destruction or damage occurred, and one that does not commonly occur in the ordinary course of day-to-day living of the taxpayer.

The damages at issue meet the first two requirements of Rev. Rul. 72-592. At issue is whether collision damages commonly occur during the activity in which the taxpayer was engaged when the destruction or damage occurred and if they commonly occur in the ordinary course of day-to-day-living of the taxpayer. For the reasons that follow, we conclude that collision damages of rental vehicles are not unusual, as they commonly occur during the business activity in which the Taxpayer was engaged when the destruction or damage occurred and that they commonly occur in the ordinary course of the day-to-day business of the Taxpayer.

Courts have examined facts similar to the Taxpayer's facts for years prior to the repeal of the excess profits tax and determined that certain events such as vehicle accidents were not unusual for that taxpayer's business and that they were an ordinary and necessary expense of doing business. The tax treatment of damages from a vehicle collision as a casualty loss under § 165 or as a business expense for the cost of the repairs under § 162 made a difference prior to the repeal of the excess profits tax. Casualty losses could reduce the excess profits tax while business expense deductions did not.

In *Atlantic Greyhound Corporation v. U.S.*, 125 Ct. Cl. 115, 111 F. Supp. 953 (Ct. Cl. 1953), the court had to determine if the costs of repairing collision damages to the taxpayer's buses were ordinary and necessary business expenses or were casualty losses. The court noted that, during 1938, the taxpayer had an average of 243 buses in service averaging 8,029 bus miles per month per bus operated. This amounted to almost 2,000,000 miles per month during that year. The court held that "[u]nder such circumstances, accident collision damage was expected, normal, and inevitable, and the cost of repairing such damage was an ordinary and necessary expense of doing business." *Id*. at 955-56. Buttressing the court's holding was its finding that over three years the costs to repair the buses remained relatively consistent. The court noted that "[s]uch consistency, indicating a normal and recurring expense, is the antithesis of what Congress intended to provide for when it enacted [the predecessor of section 165] as it relates to casualty losses." *Id*. at 956. The court cited to a House Report which provides "[t]he adjustment of income to take care of these unusual and nonrecurring items makes for equity and the removal of hardships which otherwise would occur." H.R. Rep. No. 76-2894, at 8 (1940).

Similarly, in the instant case, the Taxpayer operates a business in which it rents a large number of vehicles. The number of vehicles damaged, just in the subset at issue,

remained relatively consistent. When considered in the context of the overall approximate annual cost to repair damage to the Taxpayer's vehicles, it is clear that accidents are not unusual and nonrecurring items and that they are an ordinary and necessary expense of engaging in the Taxpayer's line of business. [2]

The Tax Court also considered a similar issue in *Consolidated Motor Lines, Inc. v. Commissioner*, 6 T.C. 1066 (1946), *acq*. 1946-2 C.B. 2. In *Consolidated Motor Lines*, the taxpayer, a freight transporter by motor, argued that it should be able to deduct as losses damages to cargo due to such events as theft, fire, turnover, collision and rain, as well as property damage that arose from accidents in which its vehicles were involved. The court noted that the taxpayer was a motor carrier of freight that operated on a large scale and over several states. The court held that all the expenses at issue were normally incident to the business of the taxpayer and did not involve any concept of abnormality. The amounts expended were all for recurring expenses that were ordinary and necessary business expenses. The court found that this result applied not only because of the character of the taxpayer's business and operations but also because of the large amounts involved. The court held "[a] common carrier constantly shipping freight over the public highways may not reasonably be said to suffer unusual casualty or abnormal 'loss' as a result of the matters here being considered." *Id*. at 1079.

Similarly, in the instant case, the Taxpayer operates E. The amount of the overall repair costs for damaged vehicles is large. The Taxpayer did not suffer unusual casualty or an abnormal loss because it is normal and expected that its vehicles will be damaged when it rents such vehicles to numerous customers to be operated over public highways.

Accordingly, we conclude that the collision damages do not arise from a casualty for purposes of § 165 because they are not unusual in the context of the Taxpayer's business of renting large numbers of vehicles per year. Crashes and collisions involving the Taxpayer's vehicles are common, and are neither extraordinary nor nonrecurring.

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS

[2] The Taxpayer cannot deduct the cost of the vehicle repairs under § 162 as it did not pay or incur any costs to make the repairs for the subset of vehicles at issue in this Chief Counsel Advice.

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