October 6, 1977

REVENUE REGULATIONS NO. 12-77, as amended[1]

SUBJECT: Substantiation requirement for losses arising from casualty, robbery, theft or embezzlement.

TO : All Internal Revenue Officers and Others Concerned:

Pursuant to the provisions of Section 326 in relation to Section 4 of the National Internal Revenue Code of 1977, these regulations are hereby promulgated to govern the manner of reporting losses arising from casualty, robbery, theft, or embezzlement, for income tax purposes.

Section 1. **Nature of deductible losses.** — Any loss arising from fires, storms or other casualty, and from robbery, theft or embezzlement, is allowable as a deduction under Section 30 (d) for the taxable year in which the loss is sustained. The term "casualty" is the complete or partial destruction of property resulting from an identifiable event of a sudden, unexpected, or unusual nature. It denotes accident, some sudden invasion by hostile agency, and excludes progressive deterioration through steadily operating cause. Generally, theft is the criminal appropriation of another's property for the use of the taker. Embezzlement is the fraudulent appropriation of another's property by a person to whom it has been entrusted or into whose hands it has lawfully come.

Section 2. **Requirements of substantiation.** — The taxpayer bears the burden of proving and substantiating his claim for deduction for losses allowed under Section 30 (d) and should comply with the following substantiation requirements:

(a) A declaration of loss which must be filed with the Commissioner of Internal Revenue or his deputies within a certain period prescribed in these regulations after the occurrence of the casualty, robbery, theft or embezzlement.
(b) Proof of the elements of the loss claimed, such as the actual nature and occurrence of the event and amount of the loss.

Section 3. **Declaration of loss.** — Within forty-five days after the date of the occurrence of casualty or robbery, theft or embezzlement, a taxpayer who sustained loss therefrom and who intends to claim the loss as a deduction for the taxable year in which the loss was sustained shall file a sworn declaration of loss with the nearest Revenue District Officer. The sworn declaration of loss shall contain, among other things, the following information:

(a) The nature of the event giving rise to the loss and the time of its occurrence;
(b) A description of the damaged property and its location;
(c) The items needed to compute the loss such as cost or other basis of the property; depreciation allowed or allowable if any; value of property before and after the event; cost of repair;

[1] Amended by Revenue Regulations No. 10-79 dated December 12, 1979.

(d) Amount of insurance or other compensation received or receivable.

Evidence to support these items should be furnished, if available. Examples are purchase contracts and deeds, receipted bills for improvements, and pictures and competent appraisals of the property before and after the casualty.

Section 4. Proof of loss. — (a) **In general.** The declaration of loss, being one of the essential requirements of substantiation of a claim for a loss deduction, is subject to verification and does not constitute sufficient proof of the loss that will justify its deductibility for income tax purposes. Therefore, the mere filing of a declaration of loss does not automatically entitle the taxpayer to deduct the alleged loss from gross income. The failure, however, to submit the said declaration of loss within the period prescribed in these regulations will result in the disallowance of the casualty loss claimed in the taxpayer's income tax return. The taxpayer should therefore file a declaration of loss and should be prepared to support and substantiate the information reported in the said declaration with evidence which he should gather immediately or as soon as possible after the occurrence of the casualty or event causing the loss.

"For purposes of pre-audit, a taxpayer claiming deduction for casualty, theft, robbery, or embezzlement loss shall attach to his return a copy of his declaration of loss (showing the imprint of the date of receipt thereof by the revenue receiving office). Failure to attach a copy of his declaration of loss will result in the disallowance of the loss in the pre-audit of his income tax return, without prejudice, however, to the said loss being taken up upon investigation of the return." (As amended by Section 1 of Revenue Regulations No. 10-79 dated December 12, 1979.)

(b) Casualty loss. – Photographs of the property as it existed before it was damaged will be helpful in showing the condition and value of the property prior to the casualty. Photographs taken after the casualty which show the extent of damage will be helpful in establishing the condition and value of the property after it was damaged. Photographs showing the condition and value of the property after it was repaired, restored or replaced may also be helpful.

Furthermore, since the valuation of the property is of extreme importance in determining the amount of loss sustained, the taxpayer should be prepared to come forward with documentary proofs, such as cancelled checks, vouchers, receipts and other evidence of cost.

The foregoing evidence should be kept by the taxpayer as part of his tax records and be made available to a revenue examiner, upon audit of his income tax return and the declaration of loss.

(c) Robbery, theft or embezzlement losses. — To support the deduction for losses arising from robbery, theft or embezzlement, the taxpayer must prove by credible evidence all the elements of the loss, the amount of the loss, and the proper year of the deduction. The taxpayer bears the burden of proof, and no deduction will be allowed unless he shows the property was stolen, rather than misplaced or lost. A mere disappearance of property is not enough, nor is a mere error or shortage in accounts.

Failure to report theft or robbery to the police may be a factor against the taxpayer. On the other hand, a mere report of alleged theft or robbery to the police authorities is not a conclusive proof of the loss arising therefrom.

Section 5. **Determination of amount deductible.** (a) **In general.** — The amount of casualty loss deductible is limited to the difference between the value of the property immediately preceding the casualty and its value immediately thereafter, but shall not exceed an amount equal to the cost or other adjusted basis of the property, or depreciated cost in the case of property used in business, reduced by any insurance or other compensation received.

(b) **Method of valuation.** (i) The fair market value of the property immediately before and immediately after the casualty for purposes of determining the amount of casualty loss deductible under this section shall be ascertained by an impartial but competent appraisal. This appraisal must recognize the effects of any general market decline affecting undamaged, as well as damaged property, which may occur simultaneously with the casualty in order that any deduction under this section shall be limited to actual loss resulting from damage to property.

(ii) The cost of repairs to the property damaged is acceptable as evidence of the loss of value if the taxpayer shows that (1) the repairs are necessary to restore the property to its condition immediately before the casualty, (2) the amount spent for such repairs is not excessive, (3) the repairs do not cover more than the damage suffered, and (4) 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.

(c) **Examples.**

The application of this section may be illustrated by the following examples:

Cost or adjusted basis	₱18,000.00
Value of property before casualty	15,000.00
Value of property after casualty	10,000.00
Insurance recovered	3,000.00

The casualty loss is computed as follows:

(i) **Property not used in business:**

Value of property before casualty	₱15,000.00
Value of property after casualty	10,000.00
Difference	₱ 5,000.00

Loss to be taken into account for purposes of Section 30 (d): lesser amount of property actually destroyed (₱5,000) or adjusted basis of property actually/destroyed (₱18,000)	₱ 5,000.00
Less: Insurance received	3,000.00
AMOUNT OF LOSS DEDUCTIBLE	₱ 2,000.00

(ii) **Property used in business:**

(A) **Total destruction.** In case of losses arising from total destruction of property used in business (ordinary asset) the net book value (cost less accumulated depreciation) immediately preceding the casualty should be used as the basis in claiming losses, also to be reduced by any amount of insurance or compensation received.

To illustrate:
Assume that —

Acquisition cost of property	₱10,000
Accumulated depreciation	5,000
Insurance recovered	2,500

Amount deductible is computed as follows:

Acquisition cost	₱10,000
Less: Accumulated depreciation	5,000
Amount of loss suffered	₱ 5,000
Less: Amount recovered through insurance	2,500
AMOUNT DEDUCTIBLE	₱ 2,500

(B) Partial destruction. In case of losses arising from partial damages of property used in business, the replacement cost to restore the property back to its normal operating condition should be used for purposes of computing deductible losses, but in no case shall the deductible loss be more than the net book value of the property as a whole immediately before the casualty. The excess over the net book value immediately before the casualty should be capitalized subject to depreciation over the remaining useful life of the property.

To illustrate:
Assume:

Acquisition cost	₱100,000
Accumulated depreciation	90,000
Net book value	₱ 10,000
Estimated remaining useful life	5 years
Replacement cost of damaged portion	₱ 20,000

In the above example, the loss deductible for tax purposes would be limited to P10,000 which is equal to the net book value of the whole property:

Net book value	₱ 10,000
Replacement cost	20,000
Excess of replacement cost to be capitalized	₱ 10,000

Consequently, the new cost basis subject to depreciation charges over the remaining useful life of the property which is five (5) years, would be P20,000 as shown hereunder:

Net book value before casualty	₱ 10,000
Add: Excess of replacement cost over book value	10,000
New cost basis	₱ 20,000

Yearly depreciation —

$$\frac{₱20{,}000}{5 \text{ years}} = ₱4{,}000$$

(iii) Farm losses. — In the case of losses sustained by farmers, the following rules shall apply:

(a) **Loss of livestock.** — The loss sustained in the death of livestock shall be allowed as a deduction to the extent of the acquisition cost only if no inventories are taken into account in determining the income from the business of farming.

If inventories are taken into account in determining the income from the trade or business of farming, no deduction shall be allowed for losses sustained during the taxable year upon livestock or other products, whether purchased for resale or produced on the farm, to the extent such losses are reflected in the inventory on hand at the close of the taxable year.

(b) **Other farm losses.** — Where ground is prepared and planted or stocked as in case of sugar, coconut and other agricultural plantations, orchards, fishponds and other farms and its value is completely destroyed by the overflow or seepage of water from natural causes, the cost of the preparation and planting or stocking up to the time of the disaster shall be deductible loss in the year in which it is incurred.

Section 6. **Determination of amount deductible — robbery, theft and embezzlement losses.** — The amount deductible in respect of robbery, theft and embezzlement loss shall be determined consistently with the manner prescribed in the preceding section for determining the amount of casualty loss allowable as a deduction. In applying the provisions of the preceding section for this purpose, the fair market value of the property immediately after the theft shall be considered to be zero. This section does not apply to losses reflected in the inventories of the taxpayer.

Example:

In 1969, B purchases for personal use diamond brooch costing P40,000. On November 30, 1975 at which time it has a fair market value of P35,000 the brooch was stolen. The brooch was fully insured against theft. A controversy develops with the insurance company over its liability in respect of the loss. However, in 1976, B has a reasonable prospect of recovery of the fair market value of the brooch from the insurance company. The controversy is settled in March, 1977, at which time B receives ₱20,000 in insurance proceeds to cover the loss from theft. No deduction for loss is allowable for 1975 or 1976; but the amount of the deduction allowable for the taxable year 1977 is ₱15,000, computed as follows:

Value of property immediately before theft	₱35,000
Less: Value of property immediately after theft	— o —
Loss to be taken into account (₱35,000 but not to exceed adjusted basis of P40,000 at the time of theft)	₱35,000
Less: Insurance received in 1977	20,000
Deduction allowable for 1977	₱15,000

Section 7. **Year of deduction.** — If a casualty occurs which may result in a loss and, in the year of such casualty or event, there exists a claim for reimbursement with respect to which there is a reasonable prospect of recovery, no portion of the loss with respect to which reimbursement may be received is sustained until it can be ascertained with reasonable certainty whether or not such reimbursement will be received. Whether a reasonable prospect of recovery exists with respect to a claim for a reimbursement

of a loss is a question of fact to be determined upon an examination of all facts and circumstances. Whether or not such reimbursement will be received may be ascertained with reasonable certainty, for example, by a settlement of the claim, by an adjudication of the claim, or 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 his having abandoned the claim, such as the execution of a release.

Section 8. Effectivity. — These regulations shall be applicable to losses sustained or arising from casualties, robbery, theft or embezzlement occuring on or after the approval of these regulations.

With respect however to such losses arising before the approval of these regulations, the declaration of loss required under these regulations should be filed within forty-five days from the approval of these regulauions.

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RECOMMENDED BY:

(SGD.) EFREN I. PLANA
Acting Commissioner