BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
ABE AND CONSTANCE C. COOPERMAN)

Appearances:

For Appellants: Vernon K. Deming
Attorney at Law

For Respondent: Kathleen M. Morris
Counsel

O P I N I O N

This appeal is made pursuant to section 18593 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Abe and Constance C. Cooperman against proposed assessments of additional personal income tax in the amounts of **$1,104.00** and $58.82 for the years 1972 and 1973, respectively.

The issue presented is whethtr appellants are entitled either to a theft loss or business loss deduction as a consequence of a loss incurred in 1972. (The taxable year 1973 is involved in this appeal only because appellants used income averaging.)

In 1966 appellant Abe Cooperman sold his business in the State of New York and moved to California, where he became actively engaged in buying, selling and managing his own securities on a full time basis. He derived most of his income from such investments.

During the fall of 1969 appellant became interested in a new corporation, Trans-International Computer Investment Corporation ("TCI"). Its three principal officers were then offering its stock for sale. They represented that the corporation would engage in selling computer services and equipment. Appellant saw a promising future for TCI and he had numerous conversations with the chairman of its board of directors, who was also acting president. Appellant was told by the president that he could obtain a position as his special assistant when the corporation "went public" and began doing business. Appellant was advised that to obtain this position he would have to invest in the corporation, as well as assist in certain "pre-employment" projects. The president explained that it was expected appellant would contact his friends and associates, and others active in the stock market, and promote the stock of TCI. He told appellant that the stock would be "going public" in approximately 90 days and that his efforts would assist in increasing its value.

The president of TCI also assured appellant that the corporation already owned an asset of substantial value, i.e., stock of a subsidiary, Computer Timesharing Corporation ("CTC"), which he emphasized was a financially sound computer company. He represented that there was CTC stock in escrow worth at least 'one million dollars "up front" to absorb any possible losses incurred by TCI, which would protect investors in TCI. He represented that the TCI stock being sold to investors would increase at least five times in value within 18 months and that if appellant, or any other early investor, decided to sell his interest in TCI at a much earlier date, such person would nevertheless recover his investment, plus a substantial profit.

Based upon these representations and those of other officers, in September of 1969 appellant invested **$25,000** in TCI, paying that amount for 25,000 shares of the corporation. The shares evidencing the interest were to be delivered later. He was then given his first "pre-employment" assignment, which was to gather information concerning the value of CTC stock. Upon investigation, appellant learned, however, that "insiders" of CTC were selling CTC short and that the stock's value would continue to decline. This information was reported to the president, who told him that he would have "an opportunity to invest another $25,000." Subsequently, in November of 1969, appellant invested an additional $25,000.'

In 1970, appellant performed an additional "pre-employment" assignment by unsuccessfully endeavoring to obtain a **$2,500,000** loan from the Bank of Montreal for TCI. Appellant was assured by the president, however, that he would be paid for his past and future services when TCI "went public" and became active.

Despite these representations, appellant never received a share of stock, nor obtained employment with TCI. TCI and its three principal officers became bankrupt in 1972, and none of the $50,000 investment was ever recovered by appellant.

It was discovered in 1971 that TCI only had a limited offering permit from the California Commissioner of Corporations (hereinafter Commissioner) to sell its stock to seven designated persons. Notwithstanding the prohibition against selling TCI stock to others, the three principal officers, including the acting president, illegally obtained money from approximately 850 persons, including appellant, by selling shareholding interests to them in violation of the provisions of the limited offering permit. These three officers ultimately pled "nolo contendere" to criminal charges of selling shareholding interests in TCI, knowingly and willfully in violation of the provisions of the California Corporate Securities Law. (Corp. Code, **§** 25000 et seq.) The defendants were imprisoned in addition to being fined, because of the seriousness of the violations.

Moreover, the underlying CTC stock, represented to appellant as "up front" and worth at least one million dollars and of sufficient value to absorb

losses, was found to be only of nominal value. Specifically, it was discovered that these CTC shares, like those of TCI, were not transferable because of a restrictive permit precluding such transfers, and were consequently of little value.

Appellant and other stock subscribers brought civil actions for fraud against the three principal officers and TCI. Appellant discontinued his suit, however, upon learning that the officers and TCI were without any funds to pay general creditors.

On their joint 1972 personal income tax return, appellants reported the $50,000 loss as a deductible ordinary business loss. Respondent determined that it constituted a capital loss, thereby limiting the amount of the deduction to $1,000. As one alternate basis for the deduction, appellant urges that it is deductible as a theft loss on the ground that the loss resulted from fraudulent representations. Respondent contends, however, that appellant has not established the presence of all the elements of criminal theft, and therefore he is not entitled to a theft loss deduction.

After reviewing the entire record, we conclude that the deduction did qualify as a theft loss. A deduction is allowed for losses by theft of property to the extent that they exceed one hundred dollars, provided the loss is not compensated for by insurance or otherwise. (Rev. & Tax. Code, § 17206, subds. (a) & (c)(3).) The applicable federal statute is similar. (Int. Rev. Code of 1954, § 165.)

In determining for purposes of an income tax deduction, whether the requisite elements to constitute theft are present we must look to the law of the jurisdiction where the loss is sustained.' (Edwards v. Bromberg, 232 F.2d 107 (5th Cir. 1956); Michele Monteleone, 34 T.C. 688 (1960); Morris Plan Co. of St. Joseph, 42 B.T.A. 1190 (1940).) The taxpayer must prove that his loss resulted from an illegal taking of property under the laws of the state where it occurred, and that the taking was done with criminal intent. (Rev. Rul. 72-112, 1972-1 Cum. Bull. 60; Rev. Rul. 71-381, 71-2 Cum. Bull. 126; see Appeal of David and Charlotte E. Tiger, Cal. St. Bd. of Equal., Sept. 27, 1978.) For purposes of the claimed deduction, the word "theft" is, however, a word of general and broad connotation intended to cover any criminal appropriation of another's property, particularly including theft by

false pretenses, swindling and any other form of guile. (Edwards v. Bromberg, supra.) It is not necessary for the taxpayer to establish that there has been a criminal conviction of the crime of theft. (Michele Monteleone, supra.)

Under California law, persons who knowingly and designedly, by any false or fraudulent representation or pretense, defraud any other person of money are guilty of theft. (Pen. Code, § 484; see Evelyn Nell Norton! 40 T.C. 500 (1963), affd., 333 F.2d 1005 (9th Cir. 1964).) Consequently, the elements of the crime constituting theft by false pretenses are: (1) intent to defraud; (2) the commission of actual fraud; (3) false pretenses, and (4) causation, i.e., reliance on the false representation. (See People v. Jordan, 66 Cal. 10 [4 P. 7731 (1884).)

Turning to the pertinent facts before us, it was represented to appellant that CTC stock "up front" in escrow had a fair market value of at least one million dollars, and that this underlying CTC stock would protect him against loss. Testimony at the hearing in this appeal established that this was a knowingly false representation which was intentionally made to induce appellant's investment. This statement of value was not merely an expression of opinion as to value, nor a statement concerning future value, nor a non-fraudulent "puffing" statement of a vendor. It was a deliberate misrepresentation which became a substantial factor leading to the investment and subsequent loss. When combined with the other statements made to appellant, and subsequent events, clearly all the elements of the crime of theft by false pretenses have been established. (See People v. Hamilton, 108 Cal.App. 621 [291 P. 866] (1930); see also People v. Schwarz, 78 Cal.App. 561 [248 P. 990] (1926); People v. Bryant, 119 Cal. 595 [51 P. 960] (1898); Rev. Rul. 71-381, supra.)

Moreover, there was a misrepresentation made to appellant with respect to the existence of authority to sell TCI stock. In this regard, the three officers, including the chairman of the board of TCI, were criminally convicted of willingly'and knowingly selling TCI stock without first applying for and securing the requisite permit from the Commissioner to sell the stock as required by section 25110 of the Corporations Code. (See Corp. Code, § 25540.)

Respondent relies upon two decisions upholding denial of theft deductions, notwithstanding violations of the Corporate Securities Law. (See Carroll J. Bellis, 61 T.C. 354 (1973), affd., 540 F.2d 448 (9th Cir. 1976); Appeal of David and Charlotte E. Tiger, supra.) Those cases are clearly distinguishable factually. In Bellis, the court emphasized that the California sanctions against selling stock without the requisite permit apply strictly whether or not such selling is done with guilty knowledge or intent. It was stressed by the court that without evidence of such knowledge or intent, a taxpayer does not reach the threshold point of the broad definition of theft. In Bellis and in Tiger, there was no evidence of such guilty knowledge or intent. In the record of the appeal before us, however, guilty knowledge and intent have clearly been established.

For the foregoing reasons, we find that appellant is entitled to a theft loss deduction. As a consequence, a deduction in the amount of $49,900 ($50,000 minus $100) should be allowed.

Appellant has also argued that the entire $50,000 was deductible as a business loss because, allegedly, his dominant purpose in expending the money was to acquire employment with TCI in an executive position. In addition, he contends that the TCI stock did not constitute a capital asset because he was in the trade or business of buying and selling securities. Upon reviewing the record in this appeal, however, we conclude that it does not adequately support either of these two contentions.

Appeal of Abe and Constance C. Cooperman

O R D E R

Pursuant to the views expressed in the opinion of the board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section 18595 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of Abe and Constance C. Cooperman against proposed assessments of additional personal income tax in the amounts of $1,104.00 and $58.82 for the years 1972 and 1973, respectively, be and the same is hereby reversed except to reflect the $100.00 theft loss exclusion.

Done at Sacramento, California, this 30thday of March, 1981, by the State Board of Equalization, with Members Dronenburg, Bennett and Nevins present.

Ernest J. Dronenburg, Jr., Chairman

William M. Bennett, Member

_____, Member

_____ Member

_____ Member