BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
DAVID AND CHARLOTTE E. TIGER)

For Appellants: David Tiger,' in pro. per.

For Respondent: Bruce W. Walker
Chief Counsel

Paul J. Petrozzi
Counsel

O P I N I O N

This appeal is made pursuant to section 18594 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of David and Charlotte E. Tiger against a proposed assessment of additional personal income tax in the amount of $1,461.10 for the year 1972.

The issue presented is whether David and Charlotte Tiger sustained a deductible loss during the taxable year, either as a theft loss or, in the alternative, as a worthless security loss.

We must first note that the factual situation in this matter is not entirely clear. The record before us, however, does establish that David Tiger and Jerry Slavin (hereafter for convenience collectively referred to as appellant unless otherwise indicated) borrowed $25,000 from Larco Productions, Inc. (Larco) by, executing a promissory note on May 12, 1969, payable to that corporation, and providing for repayment of the principal on or before eight months after its date, plus interest. With the proceeds, they purchased 5,000 shares of the common stock of Continental Consolidated, Inc. (Continental) from Earl Witscher and Ben Bennett, officers and directors of Continental (hereafter collectively referred to as Witscher unless otherwise indicated). They pledged the stock as security with Larco. The loan was apparently ultimately paid by David Tiger.

Continental is a holding company owning shares in several California corporations. Appellant expected to realize a profit from a subsequent sale of the stock. Subsequently, however, appellant discovered that the corporation was in poor financial condition. An officer of one of Continental's subsidiaries had apparently absconded with substantial assets of one or more of Continental's subsidiaries prior to the time of the purchase. Appellant complained to Witscher that the theft of the assets should have been disclosed before the stock transaction was consummated. Continental, a publicly held corporation, continued to carry on business operations during 1972, and as late as December 18, 1972, its stock was traded over the counter.

On February 19, 1970, subsequent to the due date of the $25,000 note payable to Larco, appellant executed a 90-day promissory note in the amount of $12,000 payable to Witscher. Two checks, each in the amount of $6,000, were issued that month to Slavin, signed by Witscher alone, and drawn on the account of Modernage Photo Service, Inc. Slavin cashed the checks and paid David Tiger $7,000 of the proceeds.

Subsequently, Witscher filed suit against appellant, seeking judgment for the amount of the $12,000 note. Appellant cross-complained on August 10, 1970, alieged fraud in the original stock transaction, and sought

rescission of the stock transaction and restoration of the consideration paid, plus damages. The trial court concluded that no fraud was committed and that Witscher was entitled to judgment on the note. The appellate court agreed with this portion of the trial court's conclusions. (Witscher v. Slavin (Oct. 23, 1973) 2 Civ. 46303 [unpub. opn.].)

By an amendment to the cross-complaint filed with leave of the trial court on August 21, 1973 at conclusion of the trial, appellant had also alleged failure of consideration in appellant's transaction with Witscher. It was alleged that Continental's issuance of the 5,000 shares of its stock to Witscher was void and of no effect because no consideration was received by Continental from Witscher for the shares, in violation of the permit requirements of the California corporate securities law. Consequently, it was claimed that appellant received nothing for the $25,000 paid to Witscher.

The appellate court concluded that if this could be proved appellant would be entitled to judgment on the cross-complaint, as amended, on the ground of failure of consideration. The court concluded that the trial court erred by not making findings of fact concerning these later allegations. It then reversed the judgment on the cross-complaint with instructions to the trial court to make findings of fact and conclusions of law concerning these new issues, and to enter a judgment in accordance therewith. Although requested to do so by respondent, David Tiger never advised respondent as to the outcome in the trial court.

David and Charlotte E. Tiger have claimed two deductible theft losses in the total amount of $17,800 for the year 1972: $12,900 thereof as a consequence of the actions of Witscher and $4,900 as a result of the conduct of Slavin. 1/ Respondent disallowed the deduction, issued its proposed assessment, and this appeal followed.

David and Charlotte maintain that the stock transfer by Witscher violated the California and federal corporate securities laws. They assert that the stock

1/ Theft losses are deductible only to the extent that they exceed $100. (Rev. & Tax. Code, § 17206, subd. (c)(3).)

was not registered as required, that it was falsely represented that the securities would be properly registered within a one-year period, and that appellant was thereby fraudulently enticed to enter into the transaction.

They urge' that even if Witscher was not aware that he was violating the criminal sanctions of California corporate securities laws (and was thereby not guilty of criminal fraud), his failure to comply with those provisions nevertheless constituted a fraud upon appellant, justifying a theft loss deduction.

They also contend that untrue statements were made by Witscher regarding the financial and operating condition of Continental, including a representation that its condition was excellent despite the embezzlement of funds by the corporate officer.

David and Charlotte maintain that the $12,000 paid to Slavin in 1970 did not constitute the proceeds of a 90-day loan by Witscher to Slavin and Mr. Tiger. They assert that the $12,000 received by Slavin was actually a return of a portion of the $25,000 purchase price. of the stock which Witscher refunded as a consequence of the subsequent complaint concerning Witscher's alleged misrepresentations.

They contend that the stock became worthless in 1972 and that the $13,000 loss caused by the fraudulent misrepresentation of Witscher ($25,000, less the $12,000 assertedly refunded) was discovered that year. They also maintain that an additional $5,000 theft loss was perpetrated by Slavin when he retained $5,000 of the alleged $12,000 refund, since David Tiger paid off the Larco loan, and was thereby entitled to all of the proceeds.

Section 17206 of the Revenue and Taxation Code provides for the deduction of theft losses sustained during the taxable year and not compensated for by insurance or otherwise: moreover, losses arising from theft are treated as sustained during the taxable year in which the taxpayer discovers such loss.

It is well settled, however, that tax deductions are a matter of legislative grace, and the taxpayer bears the burden of proof tc establish that he is entitled to a particular deduction. (New Colonial Ice Co. v. Helvering, 292 U.S. 435 [78 L. Ed. 1348] (1934); Appeal of Joseph A. and Marion Fields, Cal. St. Bd. of Equal., May 2, 1961.) In determining 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. 19561.) In California, obtaining money by false pretenses constitutes theft. (Pen. Code, § 484.) Establishing a criminal conviction is not essential in proving theft, but the taxpayer must show that the elements of the crime are present. (Arcade Realty Co., 35 T.C. 256 (1960).)

To prove the crime of theft by false pretenses, it must be shown that the defendant made false representations, that he did so with intent to defraud the owner of his property, and that the complainant was in fact defrauded and parted with his property in reliance upon the false representations. (See Callan v. Superior Court, 204 Cal. App. 2d 652 [22 Cal. Rptr. 508] (1962).)

Here, no evidence has been offered of theft by false pretenses except David's own unsupported declarations. Moreover, an appellate court has indicated that Witscher ard Bennett did not commit such a crime.

David and Charlotte have also implied that misrepresentation constituting theft, for purpose of an allowable income tax deduction, is demonstrated where stock is transferred contrary to the requirements of California corporate securities laws. The contention that fraudulent intent is automatically established where there has been a criminal violation of California securities laws has been expressly rejected. (Carroll J. Bellis, 61 T.C. 354 (1973).) Merely showing a violation of these laws is not sufficient; without evidence of guilty knowledge or intent, the taxpayer does not establish criminal fraud for income tax purposes. (Carroll J. Bellis, supra, at 357.) Appellant has not proven criminal fraud by Witscher.

Moreover, a theft loss is sustained in the year it is discovered. If any theft caused by false pretenses of the vendors occurred, it is clear that appellant discovered the loss prior to 1972. The cross-complaint alleging fraud was filed in 1970.

With respect to the other loss claimed, no showing has been made of any theft committed by Slavin. Again, only unsupported declarations have been offered. Furthermore, based on the results in the court proceeding, the $12,000 received in 1970 by Slavin from Witscher was not a partial recovery of the original $25,000 investment, but constituted a loan to appellant and Slavin.

Consequently, the duty of Slavin to turn over more than half of the proceeds to David Tiger has not been established.

We next turn to the question as to whether, in the alternative, David and Charlotte have shown that they are entitled to a deduction of a worthless security loss in the year 1972. Section 17206 of the Revenue and Taxation Code provides for a deduction where stock owned by the taxpayer becomes worthless during the taxable year and the loss is not compensated for by insurance or otherwise. The stock must become completely worthless in the year the deduction is claimed; a mere diminution in value is not sufficient. (Appeal of Everett R. and Cleo F. Shaw, Cal. St. Bd. of Equal., April 6, 1961.) The taxpayer bears the burden of proof to show that the stock had value at the beginning of the year and that it had no liquidating value or potential value at the end of the year. (Boehm v. Commissioner, 326 U.S. 287 [90 L. Ed. 781 (1945); Mahler v. Commissioner, 119 F.2d 869 (2d Cir. 1941); Paris G. Singer, 1175,063 P-H Memo. T.C. (1975), affd., 560 F.2d 196 (5th Cir. 1977).)

The record does not support their contention that they are entitled to a worthless security loss deduction for the year 1972. Continental contracted to do business throughout 1972, and as late as December 18, 1972, its stock was being traded, which would indicate that the stock was not worthless in 1972. On the other hand, in David's own cross-complaint in the court proceeding initiated by Witscher and Bennett, it is alleged that the stock was valueless when issued. If that allegation wascorrect, the stock was worthless in 1969. In either event, no showing has been made that the securities became worthless in 1972.

For the foregoing reasons, David and Charlotte Tiger have not established that they are entitled to the deduction claimed.,

Appeal of David and Charlotte E. Tiger

ORDER

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 David and Charlotte E. Tiger against a proposed assessment of additional personal income tax in the amount of $1,461.10 for the year 1972, be and the same is hereby sustained.

Done at Sacramento, California, this 27th day of September 1978, by the State Board of Equalization.

_____, Chairman

_____, Member

_____, Member

_____, Member

_____, Member