OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of: **N. ETESSAM AND** **ESTATE OF DARIUSH ETESSAM**	OTA Case No. 21017118

OPINION

Representing the Parties:

For Appellants: R. Todd Luoma, Attorney

For Respondent: David Hunter, Tax Counsel IV

For Office of Tax Appeals: Linda Frenklak, Tax Counsel V

E. LAM, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19045, N. Etessam (appellant-wife) and Estate of Dariush Etessam (appellant-husband)[1] (collectively, appellants) appeal actions by respondent Franchise Tax Board (FTB) proposing additional tax of $85,814, plus applicable interest, for the 2014 tax year; additional tax of $125,583, plus applicable interest, for the 2015 tax year; additional tax of $162,664, plus applicable interest, for the 2016 tax year; and additional tax of $86,822, plus applicable interest, for the 2017 tax year.

Appellants waived the right to an oral hearing; therefore, Office of Tax Appeals (OTA) decides the matter based on the written record.

ISSUES

1. Whether appellants are entitled to claim a theft loss deduction for the 2014 tax year.
2. Whether appellants are entitled to deduct a net operating loss (NOL) carryover for the 2015, 2016, or 2017 tax year that arose from the theft loss deduction claimed for the 2014 tax year.

[1] Appellant-husband passed away on October 11, 2018.

FACTUAL FINDINGS

1. At a trustee's sale on July 28, 2008, appellant-husband successfully won a bid and purchased a leasehold interest in certain real property called the Clarion Hotel (the Rosemary sublease) for $6,330,350. An unrelated individual named A. Shingal was one of the losing bidders at the auction, who ultimately ran up appellant-husband's bid to the Rosemary sublease that began with a starting price of approximately $3.6 million.
2. Appellant-husband anticipated that the Rosemary sublease would entitle him to the right to collect monthly rental income of about $31,500. However, after the purchase of the Rosemary sublease, appellant-husband learned there were other deeds of trust encumbering the Rosemary sublease. In fact, one of the owners of the deeds of trust was A. Shingal. As a result, appellant-husband did not receive any positive rental income from the Rosemary sublease because it was subject to other senior debts that required payments that fully offset the anticipated rental income. This put appellant-husband in a situation where he needed to expend more money to pay off the outstanding loans before he could collect any income from the Rosemary sublease.[2] One of the creditors of the Rosemary sublease eventually foreclosed on the property on April 2, 2009.
3. Appellants filed a federal income tax return (Form 1040) for the 2014 tax year. On Form 4684, Casualties and Thefts, appellants reported they incurred a theft loss of business and income-producing property of $6.3 million on July 28, 2008, relating to the Rosemary sublease, which they deducted as an ordinary loss on Form 1040.[3]

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[2] OTA notes that appellant-husband was approached by A. Tyagi, another investor, to join and save appellant-husband's interest in the Rosemary sublease by buying off the senior deeds of trust. Appellant-husband wired $4.8 million to A. Tyagi to purchase two senior deeds of trust that encumbered the Rosemary sublease, but instead appellants claimed that A. Tyagi stole the money and lost it gambling in Macau.

This resulted in appellants filing a lawsuit, *D. Etessam, et al. vs. A. Tyagi, et al.*, Santa Clara County Superior Court, Case Number 109CV132312. This lawsuit concerned alleged fraud in the amount of $4.8 million by A. Tyagi. However, the joint case management statement indicated that $1.6 million had already been returned to appellants. Furthermore, on February 6, 2012, the parties settled the lawsuit and A. Tyagi agreed to pay appellants $2.5 million in installments. It also appears that A. Tyagi complied with the terms of the settlement agreement because a document entitled Acknowledgement of Satisfaction of All Terms of Settlement Agreement and Mutual Release, Case Number CC937464, was signed by appellants' attorney on March 4, 2016. However, appellants do not explain how the $4.8 million from this complaint has any relevancy to the $6.3 million at issue for the 2014 tax year, especially when there is evidence that some of the $4.8 million was returned to appellants.

[3] The $6.3 million reported on line 14 of Form 1040 requires the attachment of Form 4797, which is used to report, among other things, the involuntary conversion (from other than casualty or theft) of property used in a trade or business. There is no Form 4797 attached to appellants' 2014 federal return in the appeal record.

4. Due to the claimed theft loss, appellants reported they incurred a 2014 NOL of $5,403,849, which they carried over and deducted for the 2015, 2016, and 2017 tax years.

5. Attached to appellants' 2014 federal return was a copy of a letter signed by appellants' attorney dated July 17, 2015, detailing how appellant-husband incurred a loss of $6.3 million (the amount he paid to acquire the Rosemary sublease) because of "an elaborate scheme" set up by A. Shingal and his spouse M. Trypathi (collectively, the Shingals), which "amounts to sham foreclosure and bid rigging." Moreover, appellants contend that the Shingals stole $6.3 million from them by fraudulently inducing them to purchase the Rosemary sublease at the July 28, 2008 trustee's sale.

6. FTB audited appellants' 2014 California tax return and issued Notices of Proposed Assessment (NPAs) for the 2014 through 2017 tax years. The NPAs disallowed in full the claimed theft loss from 2014 as well as the NOL deductions claimed in 2015 through 2017 that arose from the theft loss. FTB thus proposed additional taxes, plus applicable interest, for the 2014 through 2017 tax years, and subsequently affirmed its NPAs by issuing Notices of Action for the same tax years. This timely appeal followed.

7. On appeal, appellants provide several legal complaints they filed with the Santa Clara County Superior Court (Superior Court) that they allege have substantiated their $6.3 million theft loss deduction for 2014 tax year. One complaint, *D. Etessam et al. vs. A. Shingal, et al*., Superior Court, Case Number 1-11-CV-196204,[4] indicates that it was filed by appellant-husband on March 11, 2011, and it named the Shingals as defendants. That complaint alleges causes of action for declaratory relief and unjust enrichment and disgorgement.

8. FTB also provides a copy of the Superior Court's Final Statement of Decision for Case Number 1-11-CV-196204, dated August 19, 2013, finding that the Shingals were not liable for appellants' claimed damages because appellants lost their investment of $6.3 million in the Rosemary sublease through their own actions, rather than due to theft. On September 9, 2013, the Superior Court awarded judgment to the Shingals.

[4] As noted above, OTA has reviewed and considered a different complaint from *D. Etessam, et al. vs. A. Tyagi, et al.*, Superior Court, Case Number 109CV132312, but determined that appellants failed to establish the relevancy to the 2014 tax year at issue.

DISCUSSION

Issue 1: Whether appellants are entitled to claim a theft loss deduction for the 2014 tax year.

Burden of Proof

Income tax deductions are a matter of legislative grace, and the taxpayer has the burden of proving entitlement to any claimed deduction. (*Appeal of Vardell*, 2020-OTA-190P.) Unsupported assertions are insufficient to satisfy the burden of proof. (*Ibid*.) The fact that it may be difficult, if not impossible, for the taxpayer to substantiate any claimed deduction does not relieve the taxpayer of this burden. (*Burnet v. Houston* (1931) 283 U.S. 223, 227-228; *Appeal of Lew* (73-SBE-053) 1973 WL 2786.) There is a presumption of correctness as to FTB's determinations of fact. (*Appeal of Head and Feliciano*, 2020-OTA-127P.)

Theft Loss Deduction

California conforms to Internal Revenue Code (IRC) section 165, except as otherwise provided.[5] (R&TC, § 17201(a).) As relevant to this appeal, IRC section 165 provides for a deduction for losses (including theft losses) sustained during a taxable year that are not compensated by insurance or other means. IRC section 165(c)(3) allows an individual a deduction for certain losses of property not connected with a trade or business or a transaction entered into for profit, if such losses arise from theft or other listed situations. Any loss arising from theft shall be treated as sustained during the taxable year in which the taxpayer discovers such loss. (IRC, § 165(e).)

To deduct a theft loss, a taxpayer must prove all three of the following elements: (1) that a theft occurred under the law of the jurisdiction where the alleged loss occurred; (2) the amount of the theft loss; and (3) the date the taxpayer discovered the theft loss. (*Vennes v. Commissioner*, T.C. Memo. 2021-93.) Because OTA finds that appellants have not proven a theft occurred in California, only the first element is addressed.

[5] For the 2014 tax year, R&TC section 17024.5(a)(1)(O) provides that for Personal Income Tax Law purposes, California conforms to the January 1, 2009, version of the IRC. References to the IRC are to that version.

California Law on Theft by False Pretenses

Appellants essentially contend that they suffered a loss of $6.3 million from "fraud in inducement," which is a subcategory of theft by false pretenses, to purchase the Rosemary sublease at the July 28, 2008 trustee's sale. (*Baum v. Commissioner*, T.C. Memo. 2021-46.)

Under California law, the following elements are required to establish theft by false pretenses: "'(1) the defendant made a false pretense or representation to the owner of property; (2) with the intent to defraud the owner of that property; and (3) the owner transferred the property to the defendant in reliance on the representation.'" (*Baum v. Commissioner*, *supra*, quoting *People v. Williams* (2013) 57 Cal.4th 776, 787.)

Here, appellants place great reliance on the legal argument in their complaint filed against the Shingals, arguing that it supports the conclusion that appellants are entitled to claim a theft loss deduction of $6.3 million. OTA disagrees. After conducting a trial on the merits, the Superior Court determined that appellants lost their investment of $6.3 million in the Rosemary sublease through their own actions, rather than due to theft. The allegations that appellants made in their complaint against the Shingals do not override or otherwise diminish the Superior Court's findings and conclusions of law after a trial on the merits.

Specifically, the Superior Court's Final Statement of Decision filed on August 19, 2013, found that in January 2008, the owner of Rosemary Land Company and Delta Hotel Group provided appellant-husband with the following information relating to the Rosemary sublease: income and expense statements; explanation of the different parcels comprising the property; owners of the parcels; disclosure of the Rosemary sublease's monthly rent of $31,500; and stated that if appellant-husband were to buy the Clarion Hotel, "he 'would have to pay off $12 million owed on the first and second [deeds of trust] and then $3.7 million for the land as well as pay for the Rosemary [sublease].'" The Superior Court also found that appellant-husband "caused his own losses by investing in a leasehold that was subject to two senior deeds of trust that were of record and in default," and he was not entitled to recover any rents at the time he purchased the Rosemary sublease due to the defaulted senior liens.[6] In addition, the Superior Court found that, even though "the [Shingals] were ultimately enriched by the combination of [appellant-

[6] The Superior Court further found that appellant-husband "paid approximately $6.3 million for the Rosemary [sublease] at a foreclosure auction for which no representations were made as a matter of law as to the condition or the value of the property sold," and appellant-husband "had constructive notice of the senior liens recorded against the [Rosemary sublease] that he purchased."

husband's] purchase of the Rosemary [sublease] and his subsequent loss of that leasehold from foreclosure, such enrichment was not . . . 'unjust.'" Accordingly, appellants failed to point to any credible evidence that the Shingals made a false pretense or representation to appellants for purposes of proving theft under California law.[7]

OTA thus finds the Superior Court's Final Statement of Decision as reliable and persuasive evidence that no theft occurred under California law. There is no merit to appellants' argument that "to deny the theft loss of $6.3 million in 2014 would be inconsistent with the treatment of the loss by the [IRS]," because the IRS "[o]stensibly" accepted their claimed theft loss of $6.3 million based on the July 17, 2015 letter attached to their 2014 federal return, which "sets out the scheme perpetrated by [the Shingals] to steal appellants' $6.3 million[.]" Appellants do not specifically contend that the IRS audited their claimed theft loss deduction of $6.3 million and FTB asserts that there is no indication in the record that the IRS audited appellants' 2014 and 2015 federal returns. In any event, neither FTB nor OTA is bound by IRS determinations when the evidence in the record demonstrates otherwise. (*Appeals of Lovinck Investments N.V., et al.*, 2021-OTA-294P.) Accordingly, FTB properly disallowed appellants' claimed theft loss deduction of $6.3 million for the 2014 tax year.[8]

Issue 2: Whether appellants are entitled to deduct an NOL carryover for the 2015, 2016, or 2017 tax year that arose from the theft loss deduction claimed for the 2014 tax year.

As relevant to this appeal, IRC section 172(a) provides that a taxpayer may deduct an amount equal to the NOL carryovers to the tax years at issue. California generally conforms to IRC section 172 pursuant to R&TC section 17276. A taxpayer claiming entitlement to deduct an NOL bears the burden of establishing both the existence of the NOL and the amount of any NOL that may be carried over to other tax years. (*Filler v. Commissioner*, T.C. Memo. 2021-6, citing *U.S. v Olympic Radio & Television, Inc.* (1955) 349 U.S. 232, 235.) As discussed above, OTA finds that appellants are not entitled to claim a theft loss deduction of $6.3 million for the 2014

[7] FTB produced the Superior Court's Final Statement of Decision with its reply brief and appellants had the opportunity in their supplemental brief to address the content of the Superior Court's decision, but did not.

[8] Appellants also raise the issue that OTA should determine that appellants are entitled to an increased theft loss deduction beginning in the 2016 tax year in the amount of $2.3 million due to the unrecouped portion of the $4.8 million loss due to fraud by A. Tyagi. However, appellants have not shown that they sustained such a loss.

tax year. Accordingly, appellants are not entitled to deduct an NOL carryover for the 2015, 2016, or 2017 tax year.

HOLDINGS

1. Appellants are not entitled to claim a theft loss deduction for the 2014 tax year.
2. Appellants are not entitled to deduct an NOL carryover for the 2015, 2016, or 2017 tax year that arose from the theft loss deduction claimed for the 2014 tax year.

DISPOSITION

FTB's actions are sustained.

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Eddy Y.H. Lam
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Eddy Y.H. Lam
Administrative Law Judge

We concur:

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Huy "Mike" Le
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Huy "Mike" Le
Administrative Law Judge

DocuSigned by:
Elliott Scott Ewing
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Elliott Scott Ewing
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