OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of: **D. FUSI**	) OTA Case No. 20035916)))))

OPINION

Representing the Parties:

For Appellant:	Susan Gyor, CPA D. Fusi
For Respondent:	Desiree Macedo, Tax Counsel David Hunter, Tax Counsel IV
For Office of Tax Appeals:	Oliver Pfost, Tax Counsel

J. LAMBERT, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19045, D. Fusi (appellant) appeals an action by respondent Franchise Tax Board (FTB) proposing additional tax of $58,726.00, an accuracy-related penalty of $11,745.20, and applicable interest, for the 2013 tax year.

Office of Tax Appeals Administrative Law Judges Josh Lambert, Richard Tay, and Daniel K. Cho held an oral hearing for this matter in Cerritos, California, on June 15, 2022. At the conclusion of the hearing, the record was closed, and this matter was submitted for decision.

ISSUES

1. Whether appellant has shown error in FTB's disallowance of his reported theft loss.
2. Whether the accuracy-related penalty should be abated.

FACTUAL FINDINGS

1. Appellant and Y. Kim married on December 31, 1999, in Nevada.
2. Appellant and Y. Kim jointly executed a post-nuptial agreement (Agreement) on July 20, 2001, effective as of the date of their marriage.[1] The Agreement provides a list of their separate assets and liabilities at the commencement of the marriage -- such as appellant's California law practice -- but does not include any jewelry. The Agreement states that "[e]ach party acknowledges that the other may own property which may have been inadvertently excluded from the attached balance sheets." In addition, the Agreement states that "[t]he parties may not alter, amend, terminate or modify this Agreement except by an instrument in writing executed and acknowledged by both."
3. The Agreement states that "[a]ll property…belonging to [appellant] at the commencement of the marriage, including assets acquired by him in his separate name while the parties lived together outside the martial relationship…and all property acquired by [appellant] after the commencement of the marriage by gift, devise, bequest, inheritance…shall remain the sole, separate and personal estate and property of [appellant]." The Agreement provides the same terms for Y. Kim.[2]
4. The Agreement states that "[a]ll property acquired by [appellant] out of the proceeds or income for his separate property or attributable to appreciation in the value of said property…shall remain the sole, separate and personal estate and property of [appellant]." The Agreement also states that "[a]ll earnings and accumulations resulting from [appellant's] personal services, skills, efforts, and work and from other businesses and investments [appellant] now owns or may own in the future, together with all property

[1] The Agreement states that it shall be governed by, construed, and enforced in accordance with the laws of the State of Nevada, and that the parties choose the Eighth Judicial District Court of the State of Nevada as the forum and venue for all proceedings hereunder and herewith submit to the jurisdiction thereof. The Agreement states that this is a binding choice of law, forum, and venue.

[2] The Agreement states that: "Any bank accounts, savings accounts, credit union accounts…existing in [appellant's] name, as of the date of marriage, shall remain the separate property of [appellant]." The Agreement provides the same terms for Y. Kim.

acquired or income and earnings derived therefrom, shall be the separate property of [appellant]." The Agreement provides the same terms for Y. Kim.[3]

5. The Agreement states under the "Transmutation" section, that "property or interests now owned or hereafter acquired by the parties, which by the terms of this Agreement is classified as the separate property of one of them, can become the separate property of the other or the parties' community property only by written instrument executed by the party whose separate property is thereby reclassified." The Agreement also states that "either party may, by appropriate written instrument only, transfer, convey, devise or bequeath any property to the other…."

6. A Decree of Divorce (Decree) was issued on January 12, 2012, by a Nevada district court, which ended the marriage of appellant and Y. Kim. An attached Joint Petition for Summary Divorce (Joint Petition) provides the division and distribution of assets and debts, which is ratified into the Decree. The Joint Petition, signed by appellant and Y. Kim, provides a list of community property to be distributed, but does not include jewelry. The Joint Petition states that appellant and Y. Kim certify that they have disclosed all community assets and debts and there are no other community assets or debts to be divided.

7. A police report states that police responded to a report of a robbery at appellant's house in California on September 3, 2013. The report states that the police interviewed those present at the house during the robbery, which included Y. Kim and her daughter and niece, ages 19 and 26, respectively. Appellant was not present at the house during the robbery.[4] The report indicates that Y. Kim stated she was wearing an engagement ring and Rolex watch at the time of the robbery. The police noted that there was evidence of rummaging through the rooms and drawers, a scratch on Y. Kim's face from the barrel of the handgun, and a purse of Y. Kim's daughter outside on the street. Y. Kim provided to

[3] The Agreement also states that "[a]ny contributions, whether financial or in kind, made by [Y. Kim] to any of [appellant's] separate property…shall be deemed a gift to [appellant] from [Y.. Kim], who shall acquire no interest therein and no right to reimbursement and which shall be and forever remain the sole and separate property of [appellant]."

[4] Appellant asserts that he was not at the house because he was visiting his daughter. Appellant also states Y. Kim did not live at the house, but that she happened to be there because she was visiting her daughter, who lived at the house.

the police a list of 15 items of jewelry that were stolen, among other items, and their estimated values.[5] Y. Kim reported to the police the value of the jewelry was $263,000, which included an engagement ring valued at $100,000, and a couple items for which she did not know the value. There was no insurance policy on the jewelry.

8. Appellant received appraisals dated September 16, 2013, for 18 items of jewelry taken during the robbery. The appraisals were performed by S. Lee of Avanti jewelers, which was the jeweler that sold the jewelry to appellant. A letter from P. Chan, owner of Avanti, dated December 7, 2016, states that S. Lee is a GIA [Gemological Institute of America] gemologist and certified appraiser who worked for Avanti from June 2006 to October 2013.

9. The appraisals are for 18 items of jewelry with a description of each item for a total appraised value of $606,000, including a woman's diamond engagement ring appraised at $210,000. The appraisals describe in detail the type, number, size, color, clarity, and cut of the gems and the type and quality of the precious metals of the jewelry. The appraisals include most of the same items of jewelry as indicated on the police report, but also include three additional items not reflected in the police report, such as appellant's wedding ring, and values some items as worth more than as indicated by Y. Kim in the police report.

10. Another letter from P. Chan dated February 27, 2017, states: "This is to verify that [appellant] did purchase the indicated items during the timeframe of 1997-2006. We do not have records of these purchases anymore however we do estimate that the total purchase price was approximately between $550,000-600,000. The sales invoices are beyond 10 years old and we do not keep them anymore but due to the items sold, we do remember these pieces and approximate costs. [Appellant] had purchased these items at tradeshows. I do recollect [appellant] as he was one of [my] best clients and always wanted to buy the best items we had." The letter also states that "[appellant] became a very good client of ours for many years. [Appellant] haggled and negotiated better than anyone, so he is definitely someone who we would never forget."

11. Y. Kim states in an email to appellant's tax preparer dated July 28, 2014, that she gave the appraisals and police reports to the tax preparer. She also states when the police

[5] Y. Kim's daughter and niece also provided a list of stolen items that belonged to them.

asked her the about the value of the jewelry, she did not know the current value and appreciation, and had to estimate, and that the jewelry was purchased by appellant long ago.

12. On September 11, 2014, appellant filed a 2013 California Resident Income Tax Return (Form 540), reporting a theft loss deduction of $528,713. Appellant reported a cost basis of $606,000 and a fair market value (FMV) before theft of $606,000. The reported basis/FMV of $606,000 was reduced by $100, pursuant to Internal Revenue Code (IRC) section 165(h)(1), and by $77,187, or 10 percent of appellant's federal adjusted gross income, pursuant to IRC section 165(h)(2)(A).
13. FTB issued a Notice of Proposed Assessment (NPA) that disallowed the theft loss deduction and proposed an assessment of additional tax of $58,726.00 and imposed an accuracy-related penalty of $11,745.20, plus interest.
14. Appellant protested the NPA and FTB issued a Notice of Action, affirming the NPA.
15. This timely appeal followed.

DISCUSSION

Issue 1: Whether appellant has shown error in FTB's disallowance of his reported theft loss.

Income tax deductions are a matter of legislative grace, and the taxpayer bears the burden of proving entitlement to them. (*New Colonial Ice Co., Inc. v. Helvering* (1934) 292 U.S. 435, 440; *Appeal of Dandridge*, 2019-OTA-458P.) When FTB disallows a deduction, its determination is generally presumed correct. (*Appeal of Vardell*, 2020-OTA-190P.) Unsupported assertions by the taxpayer are not sufficient to satisfy the burden of proof. (*Appeal of Morosky*, 2019-OTA-312P.) In the absence of credible, competent, and relevant evidence showing an error in FTB's determination, FTB's determination must be upheld. (*Ibid*.)

IRC section 165 authorizes an income tax deduction for losses resulting from theft that are not compensated for by insurance or otherwise.[6] To qualify for a theft loss deduction, a taxpayer must prove: (1) the occurrence of a theft;[7] (2) the amount of the theft loss; and (3) the

[6] California conforms to IRC section 165, except as otherwise provided. (See R&TC, § 17201(a).)

[7] A robbery is a "theft" within the meaning of IRC section 165. (Treas. Reg. § 1.165-8(d).) The courts look to the law of the state where the loss occurred to determine whether a loss constitutes a theft loss. (*Bellis v. Commissioner* (9th Cir. 1976) 540 F.2d 448, 449, affg. (1973) 61 T.C. 354.) A theft loss does not require proof of a conviction. (*Leslie v. Commissioner*, T.C. Memo. 2016-171.)

year in which the taxpayer discovers the theft loss. (IRC, §165(a), (c), (e); see also *McNely v. Commissioner*, T.C. Memo. 2019-39.) In addition, to prove entitlement to a theft loss deduction, the taxpayer must prove ownership of the stolen property. (*Whiteman v. Commissioner*, T.C. Memo. 1973-124, citing *Draper v. Commissioner* (1950) 15 T.C. 135.) For a theft loss, a taxpayer may deduct the lesser of: (1) the FMV of the property immediately before the theft, less the FMV immediately after the theft; or (2) the adjusted basis of the property as determined under IRC section 1011.[8] (IRC, § 165(b); Treas. Reg. §§ 1.165-7(b)(1), 1.165-8(c).) In applying Treasury Regulation section 1.165-7(b), the FMV of the property immediately after the theft is zero. (Treas. Reg. § 1.165-8(c).)

Proof of Ownership of the Stolen Jewelry

FTB does not dispute the occurrence of the theft of the jewelry, or the year in which appellant discovered the theft loss.[9] FTB only contends that appellant did not own the jewelry at the time of the theft and that he has not provided sufficient documentation to establish his ownership of the jewelry. In addition, FTB argues that Y. Kim was the owner of the jewelry purchased during the marriage because the Agreement states that all property acquired by her after the commencement of the marriage shall remain her separate property.

Appellant contends that he provided sufficient evidence to show ownership of the jewelry. Appellant testified that he personally purchased the items of jewelry that were stolen, and appellant and Y. Kim both testified that she gave all the jewelry back to him after he discovered that Y. Kim spent a substantial amount of his money without his knowledge. Appellant asserts that this transfer was not put in writing and was not included in the divorce

[8] Appellant had no insurance policy on the jewelry and did not receive any insurance reimbursement for the jewelry.

[9] OTA notes, however, that as to substantiating the items stolen, appellant provides the testimony of himself and Y. Kim, statements and appraisals from the seller of the jewelry, photos of himself and Y. Kim from 2005 through 2010, where Y. Kim is wearing items of jewelry, and the police report. (See *Prescott v. Commissioner*, T.C. Memo. 1969-76.) [loss allowed where jewelry promptly reported stolen, and testimony is reliable]; *Moser v. Commissioner*, T.C. Memo. 1959-25 [reporting the loss to the police at the time of the alleged theft tends to corroborate the existence of the loss].) Therefore, given this evidence and that FTB does not dispute that the theft occurred, if appellant is found to own the jewelry claimed to have been stolen, then there is no dispute that such jewelry was stolen in the robbery during the 2013 tax year.

settlement because the exchange had already occurred, and he did not want to document the circumstances surrounding the exchange.[10]

Appellant states that his annual income was substantial and that he is "someone who made enough money to afford fine jewelry." Appellant asserts that the jewelry he acquired prior to the marriage, i.e., the engagement ring and appellant's wedding ring, and the jewelry that he purchased using his substantial income during the marriage, remained his separate property. Appellant states that Y. Kim had "access to the jewelry, but [he] got everything based on the Post-Nuptial Agreement."

The Agreement states that it shall be governed by, construed, and enforced in accordance with the laws of the State of Nevada, and that the parties choose the Eighth Judicial District Court of the State of Nevada as the forum and venue for all proceedings hereunder and herewith submit to the jurisdiction thereof. The Agreement states that this is a binding choice of law, forum, and venue. Therefore, OTA will examine Nevada law in construing the Agreement.

In general, under Nevada law, all property, other than that stated in Nevada Revised Statute (NRS) section 123.130, acquired after marriage by either spouse or both spouses, is community property unless otherwise provided by: (1) an agreement in writing between the spouses; (2) a decree of separate maintenance issued by a court of competent jurisdiction; (3) NRS § 123.190; or (4) a decree issued or agreement in writing entered pursuant to NRS section 123.259. (NRS § 123.220.) It is presumed that all property acquired by either spouse during the marriage is community property until it has been clearly shown to have been transmuted into the separate property of one of the spouses. (*Milisich v. Hillhouse* (1924) 48 Nev. 166.) All property of a spouse owned by him or her before marriage, and that was acquired by him or her afterwards by gift, bequest, devise, descent or by an award for personal injury damages, with the rents, issues and profits thereof, is his or her separate property. (NRS § 123.130.)

Appellant and Y. Kim entered into an agreement in writing, i.e., the Agreement, which may create an exception to the presumption that property acquired after marriage is community property. (See NRS § 123.220.) Nevada law allows appellant and Y. Kim to enter such a written agreement to alter their legal relations as to property. (See NRS §§ 123.070, 123.080, 123A.050.) There is no dispute as to the validity of the Agreement.

[10] Y. Kim was wearing some of the jewelry at the time of the theft; however, the jewelry was at appellant's house during the robbery. Appellant stated he did not know or approve of Y. Kim wearing the jewelry.

The Agreement states that all property belonging to appellant before the marriage will remain his separate property. Specifically, the Agreement states that "[a]ll property…belonging to [appellant] at the commencement of the marriage…shall remain the sole, separate and personal estate and property of [appellant]." Appellant and Y. Kim testified that the engagement ring and appellant's men's wedding ring were the only stolen items not purchased during their marriage. Appellant states that he acquired those items when a spouse from a previous marriage passed away. OTA finds that the engagement ring and appellant's wedding ring acquired by appellant before the marriage were appellant's separate property at the commencement of the marriage, pursuant to the Agreement.

OTA also finds that appellant's separate property includes the jewelry purchased by appellant during the marriage. The Agreement states that "[a]ll property acquired by [appellant] out of the proceeds or income for his separate property or attributable to appreciation in the value of said property…shall remain the sole, separate and personal estate and property of [appellant]." The Agreement also states "[a]ll earnings and accumulations resulting from [appellant's] personal services, skills, efforts, and work and from other businesses and investments [appellant] now owns or may own in the future, together with all property acquired or income and earnings derived therefore, shall be the separate property of [appellant]." Therefore, the Agreement states that property purchased using appellant's separate property income during the marriage remains his separate property.

The evidence indicates that the jewelry purchased during the marriage by appellant was purchased using his separate property income. Appellant and Y. Kim testified that appellant purchased the jewelry for Y. Kim. Also, FTB stated at the hearing it is undisputed that the jewelry was purchased for Y. Kim. In addition, property purchased by appellant using income from his "personal services, skills, efforts, and work and from other businesses and investments," such as income from his separate property California law practice, remained his separate property. Appellant also earned income that would allow him to purchase the jewelry, whereas the record indicates that Y. Kim did not have the funds necessary to purchase the jewelry.

Appellant states that he made substantial income over the years as compared to Y. Kim.[11] Therefore, OTA finds that the jewelry was purchased using appellant's separate property income and, therefore, the jewelry was appellant's separate property.

The parties agree that, whether acquired by appellant before or during the marriage, all the jewelry at issue was given to Y. Kim during her marriage with appellant, except for the men's wedding ring that appellant acquired before the marriage.[12] In general, property acquired by gift during marriage is separate property pursuant to NRS section 123.130 and, therefore, is not community property pursuant to NRS section 123.220. (*Kerley v. Kerley* (1996) 112 Nev. 36, 37.) However, appellant and Y. Kim executed a contract to alter the general default rule described above, by entering into the Agreement, which includes terms controlling the rights and disposition of their property.

The Agreement states under the "Transmutation" section, that "property or interests now owned or hereafter acquired by the parties, which by the terms of this Agreement is classified as the separate property of one of them, can become the separate property of the other or the parties' community property only by written instrument executed by the party whose separate property is thereby reclassified." Therefore, the Agreement states that a written instrument is required for the separate property of appellant to become the separate property of Y. Kim.

Without transmutation, appellant's separate property cannot become Y. Kim's separate property. (*Sprenger v. Sprenger* (1994) 110 Nev. 855, 858 ["absent a transmutation of the property, the stock is his separate property"].) One way to transmute property is by gift. (See e.g., *Petition of Fuller* (1945) 63 Nev. 26, 36 ["a husband may convey all his interest in community property to his wife … by way of gift. But the evidence necessary to show a transmutation of community property into separate property must be of a clear and convincing character"].) Here, the Agreement required a written instrument to effectuate any transmutation; therefore, a gift without a written instrument was ineffective to transmute the property.

[11] For example, appellant's 2013 California income tax return indicated that appellant had federal adjusted gross income exceeding $700,000, whereas Y. Kim's 2013 California income tax return reflected $100 of income. Y. Kim testified that "he's the one mostly working to make the money." In addition, the Agreement indicates that appellant had significant separate property assets, including his California law practice, from which he would earn separate property income, whereas the Agreement shows that Y. Kim had significant debt.

[12] Appellant's previous wife died in 1998. Appellant testified he gave Y. Kim the engagement ring five years later, although they were married in 1999.

Consequently, since appellant purchased the jewelry with his separate property income, and did not gift the jewelry to Y. Kim by written instrument, the jewelry remained his separate property.

The Agreement also states that "either party may, by appropriate written instrument only, transfer, convey, devise or bequeath any property to the other…." Again, the Agreement requires a written instrument for appellant's property to be properly transferred to Y. Kim. An effective gift requires a transfer. As stated in *Schmanski v. Schmanski* (1999) 115 Nev. 247, 252, "[a] valid inter vivos gift requires an intention on the part of the donor to make a present *transfer*, actual or constructive delivery of the gift to the donee, and acceptance by the donee." (Emphasis added.) (See also *Pryor v. Pryor* (1987) 103 Nev. 148, 150 ["it does not create separate property unless the transfer to [the spouse] is by gift, devise or bequest"].)[13] Because the Agreement requires a written instrument to transfer property, and a gift of jewelry from appellant to Y. Kim would require such a transfer, there is no gift of jewelry to Y. Kim because there is no written agreement, and appellant retained ownership of the jewelry in spite of the purported gift to Y. Kim.

As stated by appellant during protest, Y. Kim had "access to the jewelry, but [appellant] got everything based on the Post-Nuptial Agreement." OTA agrees with appellant's position that appellant, not Y. Kim, was the owner of the jewelry at the time of the theft. However, contrary to appellant's position, OTA finds that appellant never relinquished ownership of the jewelry by the attempted gifts. Rather, pursuant to the express terms of the Agreement, the jewelry was not transmuted into Y. Kim's separate property and continued to be appellant's separate property both during and after the marriage. Therefore, appellant was the owner of the jewelry at the time of the theft and the claimed in the theft loss deduction.

Amount of Deductible Loss

For a theft loss, a taxpayer may deduct the lesser of: (1) the FMV of the property immediately before the theft, less the FMV immediately after the theft; or (2) the adjusted basis of the property as determined under IRC section 1011. (IRC, § 165(b); Treas. Reg. §§ 1.165-7(b)(1), 1.165-8(c).) Property acquired from a decedent generally has a basis equal to its FMV on the date of death of the decedent. (IRC, § 1014(a); see also *Prescott v. Commissioner*,

[13] See also NRS section 132.150 ["Gift" means a gratuitous transfer of property to a recipient for less than full market value]; *Sather v. Commissioner* (8th Cir. 2001) 251 F.3d 1168, 1174 ["The words 'transfer ... by gift' and 'whether ... direct or indirect' are designed to cover and comprehend all transactions ... whereby ... property or a property right is donatively passed"].

T.C. Memo. 1969-76.) The FMV of property immediately before the loss shall generally be ascertained by competent appraisal. (Treas. Reg. § 1.165-7(a)(2)(i).) This appraisal must recognize the effects of any general market decline affecting undamaged as well as damaged property which may occur simultaneously with the theft, in order to reflect the actual loss resulting from damage to the property. (*Ibid*.) The adjusted basis for determining the gain or loss from the sale or other disposition of property is the cost or other basis prescribed in IRC section 1012 or other applicable provisions. (Treas. Reg. § 1.1011-1.)

If there is sufficient evidence indicating a taxpayer incurred a deductible expense or loss, but the precise amount cannot be determined, a fact finder may approximate the amount of the deduction, bearing heavily against the taxpayer whose inexactitude is his or her own making. (*Cohan v. Commissioner* (2d Cir. 1930) 39 F.2d. 540, 543-544.) This is known as the *Cohan* rule. Nevertheless, there must be some evidentiary basis on which an estimate may be made. (*Vanicek v. Commissioner* (1985) 85 T.C. 731, 743.) Without such evidence, any allowance would amount to unguided largesse. (*Williams v. United States* (5th Cir.1957) 245 F.2d 559, 560.)

FTB argues that appellant has not established the FMV or adjusted basis of the jewelry because the appraisals were not performed by a certified appraiser and there was no physical inspection of the jewelry, and the appraisals were instead based on solely P. Chan's memory from several years prior. On the other hand, appellant argues that the appraisals are competent because they were performed by the same company that sold him the jewelry, with the assistance of P. Chan, who recollected selling the jewelry to appellant.

Appellant does not provide documentation or records as to the value of the jewelry, such as receipts, certificates of authenticity, or insurance documents. In the police report, Y. Kim estimated the value of the jewelry to total $213,000 and indicated that she was unsure of the value of a couple items. P. Chan, the owner of Avanti, provides a list of jewelry that he recalls being purchased by appellant, which is the same jewelry in the appraisals. P. Chan estimated the cost of the jewelry to total between $550,000 and $600,000, and the appraisals value the jewelry at $606,000 in total.

The jewelry indicated on the police report, the appraisals, and P. Chan's letter, are similar in certain respects to several item descriptions.[14] However, the appraisals include more items than the police report, and several of the item descriptions do not match those on the police report.[15] In addition, the appraisals provide different values for some items with the largest difference being the engagement ring which Y. Kim estimated a value of $100,000 in the police report but the appraisal valued at $210,000. Y. Kim states in an email dated July 28, 2014, that she did not know the current value and appreciation of the jewelry, and had to estimate the value, and that the jewelry was purchased by appellant long ago.[16]

As to FTB's contention that the appraisals were not performed by a qualified appraiser, the appraisals were performed by S. Lee of Avanti, who worked for P. Chan beginning in June 2005, and who, according to P. Chan, is a GIA gemologist and certified appraiser, which is sufficient for finding he can make a qualified appraisal. (*Cunningham v. Commissioner*, T.C. Memo. 1987-298 [graduate gemologist with formal jewelry appraisal training and experience in jewelry industry is sufficient].) There is no evidence indicating that Avanti would intentionally misrepresent the qualifications of the appraiser, the grade and quality of the items of jewelry, or the appraised value of the items.[17]

FTB also contends that the appraisals are not reliable because they are based on purchases made many years ago, and not based on a physical inspection or documentation. It is reasonable to conclude, however, that the jeweler who initially sold the items subsequently could be able to accurately remember and estimate the cost or value of such items. Appellant asserts that the items were custom-made to his specifications, that he was a regular customer over the years, and that Avanti is a low-volume, high value jeweler. In addition, given appellant's considerable income during the relevant time period, it is reasonable to believe his testimony that he purchased items of jewelry ranging in prices from $5,000 to $40,000. Nevertheless, there is

[14] For instance, the police report describes a "white gold ring with a ruby stone in the center" valued at $20,000, and the appraisal includes a "Burma ruby ring" that is set with diamonds in white gold valued at $40,000.

[15] For instance, the appraisals include diamond and emerald earrings and an Omega watch, which were not included on the police report.

[16] Some of the items valued higher are jewelry with precious gems, such as emeralds or rubies, or those with certain brand names, which may reasonably result in a higher value than estimated by Y. Kim.

[17] OTA notes that the appraisals do not use the highest grades for the color and clarity for each piece, but rather mid-grades.

also a lack of supporting documentation and records, and given the circumstances, the appraisals may not be entirely accurate. As noted by FTB, the appraisals are not based upon a physical inspection, but rather based primarily upon the memory of P. Chan. In addition, there are discrepancies between jewelry descriptions and valuations set forth in the police report and the appraisals.

Nevertheless, the evidence in the record does not indicate that the loss should be zero, as FTB contends. Appellant provides evidence to support a deductible loss, including a police report indicating Y. Kim's estimate of the value of the stolen items, statements and appraisals from the seller of the jewelry, photos of the jewelry, and testimony of appellant and Y. Kim.

Accordingly, the *Cohan* rule will be applied to make a reasonable estimate of the stolen jewelry's cost basis and fair market value. (See *Moser v. Commissioner*, T.C. Memo. 1959-25 [jewelry without appraisal valued using testimony]; *Furnish v. Commissioner*, T.C. Memo. 2001-286 [deductions allowed based on testimony where no documentation provided]; *Ginesky v. Commissioner*, T.C. Memo. 1994-551 [allowing 50 percent of claimed deductions].) It is well settled that valuation is necessarily an approximation; it is not necessary that the value arrived at is a figure for which there is specificity, if it is within the range of figures that properly may be deduced from the evidence. (*Hamm v. Commissioner* (1963) 325 F.2d 934, 939-940.) And as stated in *Cohan v. Commissioner*, *supra*, 39 F.2d. at p. 544, it "is not fatal that the result will inevitably be speculative; many important decisions must be such."

With regard to the jewelry that appellant acquired during the marriage, appellant would be entitled to a theft loss deduction for the lesser of the FMV or the cost of the property. (See IRC, § 165(b); Treas. Reg. § 1.1011-1.) Appellant did not differentiate between cost and FMV in his return, reporting both as $606,000. P. Chan estimated a cost of the jewelry to be between $550,000 to $600,000. It is reasonable to assume, given no other information is provided by appellant, that the $550,000 estimate of cost for the jewelry that is less than the estimated FMV, is more reasonable when compared to $600,000, which is almost the same as the estimate of FMV. As to the jewelry acquired by appellant from his deceased spouse before the marriage, the basis of the jewelry would be equal to its FMV on the date of death of the decedent. (See IRC, § 1014(a).) Appellant's previous wife died in 1998 and, therefore, it appears that P. Chan's estimate of cost for the jewelry purchased before the marriage would be based on a date closer in time to when appellant's previous wife passed away in 1998, than the appraisals of FMV in

2013, and therefore would be a more reliable estimate of FMV for that jewelry in 1998. As a result, OTA may rely on P. Chan's estimate of cost of the jewelry acquired before the marriage as a reasonable estimate of its FMV at the time appellant's previous wife passed away; which would constitute appellant's adjusted basis in that jewelry. As a result, OTA relies, as a starting point, on P. Chan's cost estimate of $550,000 in determining the amount of appellant's theft loss deduction.

In summary, appellant provided some evidence to support a loss, although significantly he did not provide contemporaneous documentation to establish the FMV of the jewelry. Furthermore, the appraisals have not been shown to be entirely reliable. As stated by appellant at the hearing, he could "see [himself] having a problem with the value" and that a determination that the "valuation is a little high" and should be reduced is "fair because [he] didn't keep the receipts or lost the receipts…." Accordingly, OTA finds that appellant is entitled to theft loss of 50 percent of $550,000, or $225,000. This amount is closer to Y. Kim's contemporaneous estimate of value of $213,000, as was promptly reported to the police -- as opposed to the full cost estimated by P. Chan of $550,000 to $600,000, or the appraisals estimating value at $606,000. These higher estimates are less reliable because they were done without a physical inspection of the jewelry, and also because they are based only upon P. Chan's recollection from several years prior.

In determining the allowable loss for a theft loss of $225,000, the following adjustments must be made. First, $100 must be deducted from the total amount of allowable loss under IRC section 165(h)(1). Second, under IRC section 165(h)(2)(A), appellant is allowed a deduction only to the extent that the amount allowable exceeds 10 percent of his adjusted gross income, which is $77,187. Therefore, the total theft loss amount allowable is $147,713.

Issue 2 - Whether appellant is liable for the accuracy-related penalty.

IRC section 6662, incorporated by R&TC section 19164, provides for an accuracy-related penalty of 20 percent of the applicable underpayment. IRC section 6662(b) provides, in relevant part, that the penalty applies to the portion of the underpayment attributable to any substantial understatement of income tax. A substantial understatement of tax exists if the understated amount exceeds the greater of 10 percent of the tax required to be shown on the return or $5,000. (IRC, § 6662(d)(1)(A).) An "understatement" is defined as the excess of the amount of tax required to be shown on the return for the tax year over the amount of the tax

imposed which is shown on the return, reduced by any rebate. (IRC, § 6662(d)(2).) The accuracy-related penalty shall not be imposed with respect to any portion of an underpayment if it is shown that there was reasonable cause for the portion and the taxpayer acted in good faith with respect to the portion. (IRC, § 6664(c)(1).)

The determination of whether a taxpayer acted with reasonable cause and in good faith is made on a case-by-case basis, considering all pertinent facts and circumstances. (Treas. Reg. § 1.6664-4(b).) Relevant factors include the taxpayer's efforts to assess his proper tax liability, including the taxpayer's reasonable and good faith reliance on the advice of a professional such as an accountant. (*Higbee v. Commissioner* (2001) 116 T.C. 438, 448-449.) Reliance on a preparer excuses a taxpayer from an accuracy-related penalty if the adviser was a competent professional with sufficient expertise to justify reliance, the taxpayer provided necessary and accurate information to the adviser, and the taxpayer actually relied on the adviser's judgment in good faith. (*Niemann v. Commissioner*, T.C. Memo. 2016-11; *Appeal of Summit Hosting, LLC*, 2021-OTA-216P.)

An accuracy-related penalty may also be reduced or abated if there is substantial authority for the tax treatment of a particular item of income. (IRC, § 6662(d)(2)(B)(i).) A penalty may also be reduced if the tax treatment of a particular item of income was adequately disclosed to the taxing agency, such as in the return itself or in a statement attached to the return, and there was a reasonable basis for the tax treatment. (IRC, § 6662(d)(2)(B)(ii)(I)-(II).)

Appellant took steps to properly compute his tax due on his return. The record includes support for his claimed loss, including the police report documenting the stolen items, as well as an appraisal from the seller of the jewelry that was obtained for the purpose of preparing the tax return. The record includes evidence that the appraisals and police report were provided to appellant's tax preparer, a CPA, for use in completing the return. There was a lack of recordkeeping; however, as discussed above, there are numerous court cases that have allowed a theft loss based on evidence similar to, or less than, the evidence presented in this appeal. Therefore, appellant acted with reasonable cause and in good faith and had substantial authority for the position taken on the return. Accordingly, appellant has established that the accuracy-related penalty should be abated.

HOLDINGS

1. Appellant has shown error in FTB's disallowance of his reported theft loss in the amount of $147,713.
2. The accuracy-related penalty should be abated.

DISPOSITION

FTB's action is reversed as to $147,713 of the reported theft loss and reversed as to the accuracy-related penalty. FTB's action is otherwise sustained.

DocuSigned by:
Josh Lambert
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Josh Lambert
Administrative Law Judge

We concur:

DocuSigned by:
F8E81582726F448...

Richard Tay
Administrative Law Judge

DocuSigned by:
Daniel Cho
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Daniel K. Cho
Administrative Law Judge

Date Issued: 9/22/2022