OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

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

OPINION ON PETITION FOR REHEARING

Representing the Parties:

For Appellant: Susan Gyor, CPA
D. Fusi

For Respondent: Desiree A. Macedo, Tax Counsel

J. LAMBERT, Administrative Law Judge: Appellant appealed 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. The additional tax was based on FTB's denial of appellant's claimed theft loss deduction of $528,713.00. On September 22, 2022, the Office of Tax Appeals (OTA) issued an Opinion which reversed FTB's action as to $147,713 of the reported theft loss and abated the accuracy-related penalty. FTB's action was otherwise sustained. Appellant filed a timely petition for rehearing (PFR) under Revenue and Taxation Code (R&TC) section 19048.

A rehearing may be granted where one of the following six grounds exists, and the substantial rights of the filing party are materially affected: (1) an irregularity in the appeal proceedings that occurred prior to issuance of the Opinion and prevented fair consideration of the appeal; (2) an accident or surprise that occurred during the appeal proceedings and prior to the issuance of the Opinion, which ordinary caution could not have prevented; (3) newly discovered, relevant evidence, which the filing party could not have reasonably discovered and provided prior to issuance of the Opinion; (4) insufficient evidence to justify the Opinion; (5) the Opinion is contrary to law; or (6) an error in law in the appeals hearing or proceeding. (Cal. Code Regs., tit. 18, § 30604(a)(1)-(6).)

Internal Revenue Code (IRC) section 165 authorizes an income tax deduction for losses resulting from theft that are not compensated for by insurance or otherwise.[1] For a theft loss, a taxpayer may deduct the lesser of: (1) the fair market value (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).) The FMV of property immediately before the loss shall generally be ascertained by competent appraisal. (Treas. Reg. § 1.165-7(a)(2)(i).)

In his 2013 California income tax return, appellant reported a theft loss from jewelry stolen in a home robbery. The return reported that the jewelry had a cost basis of $606,000 and a FMV before the theft of $606,000. In the return, the reported basis/FMV of $606,000 was reduced by $100, pursuant to 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), resulting in a claimed theft loss deduction of $528,713. FTB disallowed the deduction and appellant appealed to OTA.

During the original appeal, appellant provided a police report stating that there was a report of a robbery at appellant's house in 2013. The report included a police interview with Y. Kim, who was present at the house during the robbery.[2] Y. Kim provided to the police a list of items of jewelry that were stolen and their estimated values, which totaled $263,000, including a women's engagement ring valued at $100,000. After the robbery, appellant received appraisals in September 2013, for the items of jewelry taken during the robbery, which were used as the basis for the claimed theft loss deduction. The appraisals were performed by S. Lee of Avanti jewelers, which was the jeweler that sold the jewelry to appellant, and provided a total appraised value of $606,000, including the engagement ring appraised at $210,000. The appraisals were not based upon a physical inspection of the jewelry, but on P. Chan's memory of these items from their initial sale to appellant. P. Chan, who owned Avanti jewelers, stated in a letter that appellant purchased the jewelry from him between 1997 and 2006. Appellant also testified at the hearing that he purchased the jewelry from P. Chan.

In its Opinion, OTA stated that appellant provided some evidence to support a loss, although significantly he did not provide contemporaneous documentation to establish the FMV

[1] California conforms to IRC section 165 per R&TC section 17201.

[2] Appellant was not present at the house during the robbery.

of the jewelry. OTA noted that, when 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 a taxpayer whose inexactitude is of his or her own making. (See *Cohan v. Commissioner* (2d Cir. 1930) 39 F.2d. 540, 543-544.) OTA's Opinion stated that this is called the *Cohan* rule and should be applied to make a reasonable estimate of the stolen jewelry's cost basis and fair market value. OTA also noted that 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* (8th Cir. 1963) 325 F.2d 934, 939-940.) OTA also stated that it "is not fatal that the result will inevitably be speculative; many important decisions must be such," citing *Cohan v. Commissioner*, *supra*, 39 F.2d. at p. 544.

In applying the *Cohan* rule, OTA found that appellant is entitled to theft losses of $225,000, and that the total theft loss amount allowable is $147,713, after deducting $100 pursuant to IRC section 165(h)(1), and allowing a deduction only to the extent that the amount allowable exceeds 10 percent of appellant's adjusted gross income, pursuant to IRC section 165(h)(2)(A).

In his PFR, appellant only disputes OTA's calculation of the amount of the deductible loss. Appellant asserts that, in applying the *Cohan* rule, OTA relied too heavily on Y. Kim's estimate of the jewelry items because she did not know their value and was not present during their purchase. Appellant contends that OTA discounted appellant's, P. Chan's, and S. Lee's valuations, which should be considered more relevant because appellant purchased the jewelry, P. Chan sold the jewelry to appellant, and S. Lee, who did the appraisal, worked for P. Chan. Appellant asserts that the loss should have been reduced by 15 or 20 percent, instead of 50 percent.

Appellant appears to argue that there is insufficient evidence to justify the Opinion. To find that there is an insufficiency of evidence to justify the Opinion, OTA must find that, after weighing the evidence in the record, including reasonable inferences based on that evidence, OTA clearly should have reached a different opinion. (*Appeals of Swat-Fame, Inc*., *et al.*, 2020-OTA-045P.)

OTA determined that the cost should be reduced because the appraisals and P. Chan's estimates were less reliable due to the lack of supporting documentation and records and because

the estimates were not based upon a physical inspection of the stolen jewelry, but upon P. Chan's memory of it from several years prior. In addition, the appraisals and P. Chan's estimates were much higher than the contemporaneous estimates of Y. Kim. And as noted in the Opinion, appellant stated at the hearing that 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 reduced the cost estimate to account for various factors which made P. Chan's estimate unreliable (summarized above).

As a supplement to the appraisals, P. Chan provided a total cost estimate of the jewelry of $550,000 to $600,000, which was slightly less than the total FMV provided in the appraisals. As a starting point, OTA used the cost indicated by P. Chan because for a theft loss, a taxpayer may deduct the lesser of the FMV of the property immediately before the theft or the adjusted basis of the property. (IRC, § 165(b); Treas. Reg. §§ 1.165-7(b)(1), 1.165-8(c).) To account for the various factors which made P. Chan's estimate unreliable and based on Y. Kim's contemporaneous estimate of value, OTA determined that appellant is entitled to a theft loss of 50 percent of the cost of $550,000, or $225,000. The Opinion stated that, after the 50 percent reduction, the amount is closer to Y. Kim's contemporaneous estimate of value of $213,000, as was promptly reported to the police. Therefore, OTA determined that a 50 percent reduction was reasonable.

Appellant contends that OTA should have placed more reliance on the memory of P. Chan because the jewelry was purchased from him. For instance, a letter from P. Chan supplementing the appraisals states: "This is to verify that [appellant] did purchase the indicated items during the timeframe of 1997-2006." However, the item which has the most value, the engagement ring, was not purchased from P. Chan. At the hearing, Y. Kim stated that appellant had the ring from a previous marriage and did not purchase the ring from P. Chan. Y. Kim stated that P. Chan only reset the stone in the ring because she did not like the design. Therefore, the engagement ring was not purchased from P. Chan, contrary to statements made by P. Chan and appellant. The Opinion noted that the largest difference between the appraisals and the police report is the engagement ring which Y. Kim estimated a value of $100,000 in the police report but the appraisal valued at $210,000. Accordingly, the appraisal, which valued the ring at $210,000, an amount approximately twice the estimate provided by Y. Kim, is even less reliable when it comes to the engagement ring, as it was not purchased from P. Chan. This calls into

question the reliability of the appraised value and cost, as well as P. Chan's statements and recollection.

Appellant also asserts that Y. Kim's estimates should have been given less weight, and that OTA should have relied on appellant's recollection instead of Y. Kim's recollection. However, Y. Kim's estimates and the appraisals had many similar items and amounts. And it is reasonable that Y. Kim may be able to estimate the value or cost of the jewelry, given her experience and familiarity with the items. In addition, appellant appears to have forgotten that the engagement ring was not purchased from P. Chan, when he stated that he purchased all of the jewelry from P. Chan. At the hearing, after Y. Kim stated that the ring was not purchased from P. Chan, appellant stated that "[Y. Kim] would know better than I did about it because I just made her anniversary gifts and birthday gifts…" Appellant also stated that he needed Y. Kim's assistance in determining when the jewelry was purchased. Appellant stated: "Remember, I didn't wear – other than my diamond wedding ring, that is not even listed, I never wore this jewelry ever." Appellant also stated, "I relied on Ms. Kim because I don't have any recollection of what came from where because it's on this list diamond ring. And I'm not – I'm not sure what diamond ring that is, and she knows." These statements downplay the reliability of appellant's recollection and offer more credibility to Y. Kim's recollection. That OTA's determination of the theft loss was closer to her contemporaneous estimate demonstrates that OTA's estimate was within the range of figures that properly may be deduced from the evidence. (*Hamm v. Commissioner*, *supra*, 325 F.2d at pp. 939-940.) Therefore, it was reasonable for OTA to reduce the theft loss to an amount closer to Y. Kim's contemporaneous estimate of the value of the jewelry.

Accordingly, appellant has not shown that there is insufficient evidence to justify the Opinion, or that any other ground exists such that a rehearing should be granted. Consequently, the petition for rehearing is denied.

DocuSigned by:
Josh Lambert
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Josh Lambert
Administrative Law Judge

We concur:

DocuSigned by:
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Andrew J. Kwee
Administrative Law Judge

DocuSigned by:
Veronica I. Long
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Veronica I. Long
Administrative Law Judge

Date Issued: 2/23/2023