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Memorandum

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to: Deborah S. Shanku, Revenue Agent (Gulf States Area)
(Small Business/Self-Employed

from: Travis T. Vance III
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(Small Business/Self-Employed)

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subject: Theft Loss Advisory

This memorandum responds to your request for assistance dated January 22, 2007. This advice may not be used or cited as precedent.[1]

LEGEND

TP	=
Individual A	=
Individual C	=
Individual M	=
Individual T	=
Individual J	=
Individual Z	=
Individual K	=
Individual G	=
Individual D	=
Individual V	=
Corporation G	=
Corporation X	=
Corporation Y	=

[1] Section 6110(j)(3) of the Internal Revenue Code.

Corporation K =
Corporation D =
Corporation P =
Corporation V =
Date 1 =
Date 2 =
Date 3 =
Date 4 =
Date 5 =
Date 6 =
Date 7 =
Date 8 =
Date 9 =
Date 10 =
Date 11 =
Date 12 =
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Year 11 =
Year 12 =
Year 13 =
$AA = $
$BB = $
$CC = $
$DD = $
$EE = $
$FF = $
$GG = $
$HH = $

$JJ = $
$LL = $
$PP = $
$RR = $
$TT = $
$VV = $
$WW = $
$XX = $
¢A = ¢
¢P = ¢
#V =
#B =
R =
#G =
#Q =
#U =
%M =
%U =

ISSUE

Whether (TP) is entitled to claim a theft loss under I.R.C. § 165 for tax year (Year 11).

CONCLUSION

We conclude that TP is not entitled to a theft loss deduction for losses related to the exercise of stock options in Year 11.

FACTS

This case arises from the precipitous decline in the value of (Corporation X) stock and the resultant pecuniary loss to TP. Corporation X was a publicly traded company engaged in the industry. After announcing irregularities in Year 11, Corporation X filed bankruptcy. At issue is whether a former employee and shareholder of Corporation X may claim a theft loss under §165 of the Code for investment losses due to the purported fraud or misconduct of his investment company and broker. The following facts are relevant.

TP accepted a sales position at (Corporation K), a predecessor of Corporation X in (Year 1). Before working at Corporation K, TP earned a bachelor's degree in education, a master's degree in guidance counseling, and worked for more than nine years in a range of sales capacities (e.g. sales representative, district sales manager, vice president of operations, vice president of sales, national sales director) for various other employers in the

industry.

During the first four years of his employment at Corporation K, TP reported directly to (Individual A), CEO of Corporation X. In (Year 2), Individual A created a plan to permit a group of senior executives to purchase shares of Corporation K stock. Those selected were not required to purchase the stock, but could do so by negotiating a loan with Individual A at a low rate of interest. This offer led TP to execute a promissory note in favor of Individual A, and the opening of a brokerage account at (Corporation Y). Using his margin privileges, TP leveraged the loan proceeds to purchase Corporation K stock, which doubled the amount of the loan proceeds. (Individual C) was the Corporation Y broker who assisted TP and other executives in opening brokerage accounts and purchasing Corporation K stock. Through this transaction, TP and Individual C first met. In (Year 3), TP sold off his initial Corporation K position, and paid off the loan to Individual A.

In August of (Year 4), Individual C left Corporation Y and joined (Corporation D), formerly known as (Corporation G). TP and several other executives followed Individual C. TP identified his investment objective as growth, and risk tolerance as allowing for speculation, both of which were prominently displayed on his account statements. TP did not change or alter his investment objectives or risk tolerance.

In (Year 5) and (Year 6), TP sold some his Corporation K stock for a profit of ($FF), and invested in other positions. Between Year 6 and (Year 8), TP wrote covered calls against several of those positions to generate income, but was not a frequent trader.

TP managed the Region of Corporation K, which was renamed as Corporation X, as Vice President of Sales before he was forced to resign on (Date 2), following the consolidation of management that ensued after the merger with . TP's resignation included the acceptance of an offer of a severance package that included the vesting of incentive stock options (ISO).[2] TP voluntarily elected to exercise a large number of ISOs in connection with his departure. Each option allowed TP to purchase a specified number of shares of Corporation X stock at a specified price. TP acquired (#R) shares of Corporation X stock, all of which were electronically deposited into TP's account at (Corporation P), which maintained Corporation X's stock financing platform.[3] TP maintained the account at Corporation P from (Date 1) until March of Year 8. No evidence was presented to

[2] TP exercised his non-qualified stock options, and purchased the shares directly from Corporation X in lieu of compensation from Year 2 through Year 8. The difference in value between the option price and the market price was treated as taxable compensation. The ISOs were granted to TP at various times during his employment, and all shares vested on or before he separated from Corporation X on Date 2.

[3] On or about Date 1, TP opened an account with Corporation P.

corroborate TP's claim that Corporation D, Individual C, or Corporation X made specific representations to induce him to exercise his stock options.

Corporation X did not withhold and pay Federal income and state taxes associated with the exercise. TP had full legal title, beneficial ownership, and the right to receive dividends on the purchased stock. As a shareholder, he also possessed the right to vote on matters subject to shareholder approval. None of the shares were subject to any restrictions, and were freely transferable. TP could have sold his concentrated Corporation X position and pocketed his profits if he had been so inclined.

Following the preparation of a hypothetical profit chart and negotiating a discounted commission rate of (¢A) per share or options contract with Corporation D, TP, on (Date 3), deposited (#Q) (*adjusted for splits*) shares of Corporation X stock in an ordinary, non-discretionary account with Corporation D, managed by Individual C. The stock had a value of ($PP) at that time. Since the account was not fee based and controlled exclusively by the TP, Individual C received commissions only when TP bought or sold securities in the account.

Three months after the deposit of the #Q shares into the account maintained by Corporation D, the price of Corporation X stock peaked at its all time high of ($ TT) on (Date 5). On that date, the value of TP's Corporation X stock was worth ($BB). TP's account was nearly (%M) concentrated in Corporation X stock at that time. During Year 8 and (Year 9), TP wrote covered calls against his Corporation X position for exercise prices far in excess of the price that the stock was trading, but did not express an intention or willingness to sell his stock.

TP closely followed the trading of Corporation X stock, and often commented to Individual C his intentions to sell when Individual A made a move.[4] TP further maintained close contact with members of the Corporation X inner circle, and monitored news, gossip and rumors regarding the company's plans and possible mergers. In early Year 9, Corporation X stock declined along with the rest of the technology and sectors of the stock market.

Corporation X's stock price was influenced by a series of negative developments concerning the company. A much-anticipated merger with fell through in the summer of Year 9, and Corporation X's earnings failed to meet expectations, which ultimately caused Corporation X stock to trend downward. The period between August of Year 9 and March of (Year 10) was volatile. The NASDAQ index and Corporation X's share price dropped (% U) of their respective values during this

[4]TP argues that an intimate link between Corporation D, Individual A, and the Corporation X stock and sufficiently support the allegations claimed. TP contends that Corporation D's broker (Individual C) was unanimously known as "one of [Individual A's] main brokers." According to TP, Individual A not only referred him to Individual C but many of the other Corporation X executives, who acquired millions through Corporation X stock options.

seven-month period.[5] TP did not address how these business conditions and other factors played a role in the decline of Corporation X's stock in the market.

In November of Year 10, TP rolled over (#G) shares of Corporation X stock into an IRA, also managed by Corporation D that he held in a 401(k) at Corporation X worth ($WW) at the time of the transfer. In (Year 11), the vast majority of TP's stock was sold at (¢P) per share.

In of Year 11, Corporation X revealed that it had . Corporation X's stock, which peaked in of Year 8 at around ($RR) a share, steadily plummeted to the point where it no longer traded on the NASD market, having been delisted after the company filed for bankruptcy on (Date 8), in the wake of a massive irregularities. Several Corporation X executives ultimately .[6]

TP claims he lost in excess of ($HH), in reliance on false and misleading Corporation X stock reports issued by Corporation P, which allegedly caused him to exercise his ISOs at an artificially inflated price. TP did not identify specific reports or indicate whether the subject reports consisted of pure fact, expressions of opinion, or a combination of both. No evidence regarding the cautionary language in the reports was presented or discussed. TP did not claim to have actually read the allegedly false reports, and provided no evidence that the alleged misrepresentations caused the stock's decline in value or his loss.[7]

TP further contends that he suffered losses in Corporation X securities as a result of the improper investment advice and strategies of Corporation D and Individual C. According to TP, Corporation D and Individual C intentionally operated under a joint conflict of interest that ultimately lead to the gross mismanagement and neglect of his investment portfolio. In sum, TP's argument proceeds under a theory that Corporation D concealed the extent of its conflicted relationship with Corporation X, Individual A, and Corporation X's true financial condition, and that this conflict caused Corporation D to make improper recommendations to its clients.

Characterizing the sequence of events leading up to his loss, TP alleges that Corporation D not only failed to perform its fiduciary duties, but also intentionally defrauded him by protecting its own best interests at his expense. TP specifically

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[5] For an comprehensive analysis of the Dow Jones Index, see Dow Jones & Co. Dow Jones Indexes (2007), at http://djindexes.com. For comparable information on the NASDAQ, see NASDAQ Stock Market, Inc., NASDAQ Market Statistics, at http://www.nasdaqu.com/newsroom/stats/main.stm.

[6] The history of Corporate X's downfall and ensuing litigation has been described in several opinions issued by the . See, e.g

[7] The Corporation X stock experienced a sharp decline in value in Year 9, which was well before the substance and content of the Corporation P reports became known.

complains that Corporation D had a conflict of interest in that Corporation X was a huge client of Corporation D, and that they failed to inform him of the financial allegiance afforded to Corporation X. In support of this position, TP explains that Corporation D managed the brokerage accounts of Individual A from Year 6 to Year 9 valued between ($DD) and ($EE).[8] TP alleges that Corporation D had motive and opportunity to make false and misleading statements because of its relationship with Individual A, and that Corporation D had an economic incentive to manipulate the stock price.

TP argues that Corporation D sabotaged proper account management by prioritizing Individual A's interests over his as well as those of other clients, and that Corporation D advocated a buy and hold strategy to protect the value of (#B) shares of Corporation X stock pledged as collateral for a ($CC) loan extended to Individual A. TP asserts that Corporation D misrepresented the financial condition of Corporation X, neglected to provide an honest assessment of the value of Corporation X securities, and maintained a bullish position of Corporation X to protect itself from a freefall in the price of the stock and forced margin calls.

TP contends his losses were also attributable to the actions of Individual C, who allegedly maintained a close relationship with Individual A, while managing his account. To establish a direct relation between his injury and the wrongful conduct of Corporation D, TP asserts that Individual C's misrepresentations and omissions of the true financial picture of Corporation X permitted the stock to trade at an inflated price. According to TP, Individual C was very loyal to Individual A for his brokerage referrals, and acted as one of his main brokers. Because of this close relationship, TP claims that Individual C steered him away from diversifying his holdings and provided unsuitable advice about borrowing on margin to cover all tax liabilities. He contends that Individual C wrongfully advised him to take out a home equity line of credit to cover margin loans. Further, he accuses Individual C of using the fact that he was personally buying and holding Corporation X stock in order to convince him to hold it. TP did not provide any evidence proving that Individual C had a reason to disbelieve published market reports on the performance of Corporation X, or that he received excessive commissions based on the advice rendered.

TP did not provide any evidence of his theory that the risks associated with ownership of Corporation X securities materialized before its irregularities were made public. TP did not present any evidence establishing that Corporation D or Individual C had knowledge of Corporation X's unreported, internal financial condition prior to disclosure, and neither produced any documents nor pointed to any specific information in Corporation D's possession, which could have caused or contributed to the drop in

[8] TP relies upon the findings of the in support of his allegation that Individual A conducted a vast majority of his brokerage business with Corporation D, and had on deposit with Corporation D between $DD and $EE.

the price of Corporation X's securities. TP did not state whether or not he attempted to investigate Corporation X's performance during this time period.[9]

On (Date 9), a Notice of Class Action was sent to TP regarding claims against Corporation P for losses associated with Corporation X stock.[10] The Notice described the class claims against Corporation P, including conflict-of-interest allegations regarding Corporation P. The Notice defined the class as "[a]ll persons and entities who purchased or otherwise acquired publicly traded securities during the period beginning (Date 4), through and including (Date 7), and who were injured thereby." The Notice made clear that if a plaintiff pursuing separate litigation did not request exclusion, that plaintiff would be precluded from pursuing his individual Corporation X action. TP timely submitted a Request for Exclusion From the Class on (Date 10).

With respect to his dissatisfaction with Corporation D, TP was advised by legal counsel that any claim against Corporation D and Individual C would have to be brought in arbitration because of TP's brokerage agreement with Corporation D. The agreement required TP to arbitrate any disputes through the National Association of Securities Dealers ("NASD"). Accordingly, on (Date 11), TP, through (Individual M), filed a Statement of Claim (the Claim) with the Arbitration Department of the NASD against Corporation D alleging that he suffered losses on investments in Corporation X securities as a result of Corporation D's misconduct.[11]

In his Statement of Claim, TP set forth five causes of action for purported violations of federal securities laws. The first and fifth causes of the multi-count complaint included fraudulent misrepresentation and omissions of Corporation X's true financial condition and Corporation D's conflict of interest. The second, third, and fourth asserted negligent misrepresentation, negligence in making disclosures, and failure to supervise.[12] The essence of TP's suit was that Corporation D provided inappropriate investment advice and failed to advise him of a perceived conflict of interest.

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[9] The alleged fraud by TP is the concealment of Corporation X's financial condition. TP has not pinpointed any materialization of any risk concealed that caused his losses. TP has no evidence proving that the decline in the value of the Corporation X stock he purchased between Year 2 and January of Year 8 was caused by the alleged fraudulent acts of Corporation D or Individual C.

[10] The Corporation X Securities Litigation proceeded on the theory that Corporation X engaged in massive fraud. That fraud did not become apparent until the early part of Year 11. See (the earliest identified partial disclosure of fraud was (Date 20).

[11] TP requested ($XX) in compensatory damages, but received only ($LL).

[12] TP claims that Individual A was very close to a margin call as of (Date 6). His (# B) shares had a total value of ($AA) at that time.

On (Date 12), Corporation D filed its Statement of Answer (Answer), including twelve affirmative defenses, to TP's statement of claim. Corporation D argued in response that (1) a securities firm has no duty to disclose to a customer the margin balances of other clients who own the same stock, and such a disclosure would violate SEC Regulation S-P, which was promulgated in the Gramm-Leach-Bliley Financial Modernization Act of 1999, 15 U.S.C. § 6801, *et seq*., to protect the private financial information of customers of financial institutions; (2) Individual C did not dissuade TP from selling his Corporation X shares; it was TP who made all decisions about the stock; (3) there was no effort by Corporation D to control the market in Corporation X and prevent clients from selling the stock, and the sale of TP's (#V) share position in Corporation X that traded an average of (#U) shares per day at that time would have had no effect on the price of the stock; (4) there was no conspiracy between Corporation D and the other named Wall Street firms as set forth in the claim; (5) TP's non-discretionary, commission-based account with Corporation D did not create a fiduciary obligation on the part of the broker; (6) Corporation D had no legal duty to monitor TP's investments or keep him abreast of financial information that may impact his portfolio; (7) Corporation D did not make any unsuitable investments for TP as all Corporation X options were exercised at Corporation P; (8) Corporation D acted in good faith in supervising Individual C; (9) Corporation D did not commit fraud against TP, and there is no evidence of false representations by Corporation D; scienter; intention to induce TP from acting or refraining from acting, justifiable reliance by TP, and damage to TP; (10) Corporation D did not have a duty to act with respect to TP's account other than to execute transactions that TP requested; and (11) Corporation D had no duty to advise about over concentration, no duty to diversify, no duty to hedge, and no duty to TP other than the duty to enter TP's transactions as authorized.

Both TP and Corporation D agreed to arbitrate their dispute in accordance with the rules and procedures of the NASD. On (Date 13), the parties executed a Settlement Agreement reached at mediation. The terms of the settlement have been kept confidential.

Having reached a resolution in the NASD arbitration, TP now claims that he sustained a loss on the sale of the Corporation X stock under I.R.C. §165 because of the purported fraud committed by Individual C and Corporation D. Accordingly, TP and his wife amended their U.S. Individual Income Tax Return (Form 1040X) for Year 11, and claimed a theft loss relative to the depreciated value of TP's Corporation X stock.[13] They further seek to carry the loss back, and request a refund for the five prior tax years. TP and his wife's joint Year 11 return as originally filed reflected the Corporation X loss as a long-term capital loss on Schedule D. The total amount claimed on the joint 1040X for Year 11 is ($JJ), which is based on a reclassification of the long-term capital loss to an ordinary loss in the amount of ($GG).

[13] TP and his wife timely filed their joint return for tax year with the assistance of their accountant. At the conclusion of the NASD arbitration, relying on the advice of , they filed a Form 1040X, Amended U.S. Individual Income Tax Return, amending their return to reflect TP's assertion that the loss sustained was an ordinary loss rather than a long-term capital gain loss.

To support his claims of theft loss, TP offered legal opinions with memorandums of law (initial and supplemental memorandums of law), forensic analysis of investment portfolio and case summary by (Individual T)[14], newspaper articles, Fraud opinion by (Individual J) of (Corporation V), Memorandum by (Individual Z), and the Answer and Statement of Claim (the Claim), submitted on behalf of TP, in the Matter of the Arbitration between TP and Corporation D. TP's argument is summarized, in part, on page one of the Claim, in paragraph two, which states:

> *The fundamental basis for [TP's] claim is [Corporation D's] breach of their fiduciary duties vis-à-vis the intentional deception of [TP] by concealing the very material conflicts of interest that ultimately lead to the gross mismanagement and intentional neglect of the [TP's] investment portfolio.*

The first memorandum of law (memorandum of law), dated (Date 16), which is authored by (Individual K), incorporates the facts in TP's NASD Claim[15], an affidavit executed by TP on (Date 15) [16], and the (Date 14), analysis of Individual J, of the V Corporation. It contains no reference to the Answer filed with the NASD or Corporation D's position relative to the allegations contained in the Claim. The facts as set forth in memorandum of law allege that TP's injuries resulted from fiduciary breaches and other wrongdoing beginning in Year 2. It was during that time that TP first began to work with Individual C., who was then employed by Corporation Y. According to the memorandum of law, Corporation D's conduct fits within five potential criminal violations (securities fraud) as set forth in Code § . This is so, the memorandum of law rationalizes because Corporation D misrepresented facts, engaged in fraudulent conduct, intentionally "over concentrated" TP's assets, and failed to protect TP. The memorandum of law concludes that TP "is entitled to the protection and use of Internal Revenue Code § 165" because [Corporation D's] conduct broke laws, both in such a manner and with such intent, that its conduct fits precisely within the Criminal Code.

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[14] Mr. 's report was prepared for the NASD arbitration matter. The focus of the report is to establish to what extent Individual C failed in his fiduciary duty to prudently manage the accounts owned by clients other than Individual A.

[15] TP claimed that Corporation D's actions and inactions damaged him and constituted claims for:

1. Fraud;
2. Negligence;
3. Breach of Fiduciary Duty;
4. Failure to Supervise a Registered Agent;
5. Misrepresentation and Omissions.

[16] TP argues that Individual C failed to disclose material conflicts of interest regarding the $CC loan from Corporation D to Individual A, and that its special loyalty to Individual A violated and Federal laws. TP contends that Individual A shared information about Corporation X with Individual C.

On (Date 18), Individual Z, Founding Member, Corporation V, submitted a memorandum referencing the "Applicability of IRC Section 165 for Taxpayers That Suffered 'Exercise and Hold' Theft Losses related to Corporation D/ Corporation G's self-interest, tainted advice and misrepresentations, including Corporation X's and Corporation P's working in tandem, fraudulent conduct, misrepresentations and omissions" in support of the conclusions reached in his separate (Date 17) opinion. In his memorandum, Individual Z fuses facts contained in the NASD Statement of Claim and the memorandum of law, but does not reference or undertake the arguments set forth in Corporation D's Answer, which was filed in the arbitration proceeding.

Relying on the legal analysis of Individual K, Individual Z makes novel factual allegations and reasons that the "actions of [Corporation X, Corporation P, and Corporation D/Corporation G, clearly violated the Laws of [based on the foregoing:]"

A. Material facts were falsified, and/or not disclosed.
B. Promises, representations, and predictions were made dishonestly, and in bad faith
C. Devices, and schemes, intended to defraud were utilized.
D. [Corporation X, Corporation P, and Corporation D/Corporation G} all engaged in acts, and practices in their course of business with [TP] that operated as a fraud or deceit upon him.

According to Individual Z, Corporation X, Corporation P, and Corporation D/Corporation G engaged in various practices to manipulate the market for Corporation X stock thereby perpetrating a theft upon TP.[17] As a result, Individual Z maintains that a theft loss is available under §165 and law. Factually distinguishing the instant case from IRS Notice 2004-27 and FAA 20055201F, Individual Z concludes that under the Jobs Creation and Workers Assistance Act of 2002, Public Law No. 107-147, TP is entitled to carry back net operating losses for 5 years.[18]

On (Date 19), Individual K submitted a supplemental memorandum of law (supplemental memorandum) to augment his prior opinion, incorporating the facts

[17] TP claims that Corporation D was aware that four major investment banks also made loans to Individual A that aggregated over ($VV), which were collateralized by Individual A's pledged Corporation X stock; that the undisclosed exposure to the risk of a freefall in the price of Corporation X shares due to the loans meant the investment banks had to work in tandem to ensure that a large number of sell orders in Corporation X stock would not result in margin calls for the sale of stock pledged by Individual A as collateral. TP did not present evidence that he filed individual suit against Corporation P or Corporation X individually even though he opted out of the class action.

[18] Individual Z determined that Year 11 is the appropriate year to claim the theft loss. He bases his opinion on the theory that there was no reasonable prospect for recovery from Corporation X in Year 11, and that after expenses, TP could only hope to secure a de minimis recovery.

therein by reference. In the supplemental memorandum, Individual K concludes that Corporation D violated Code §§ "in taking/fraud/deceit in the course of its dealings with Taxpayer, to the detriment of the Taxpayer via his substantial loss of money. Moreover, there is no reasonable likelihood of recovery. As such, Taxpayer is entitled to recovery under § 165."

The Internal Revenue Service is receiving numerous refund claims from taxpayers claiming theft losses for the full amount of their investment losses. Investors are filing amended returns for tax Year 11, in particular, to claim carry losses back for five years.[19]

LEGAL ANALYSIS

Section 165(a) of the Code allows a deduction for "any loss sustained during the taxable year and not compensated for by insurance or otherwise." To be deductible, the loss must be evidenced by a closed and completed transaction, fixed by an identifiable event(s), and actually sustained during the tax year. Treas. Reg. § 1.165-1(b). Boehm v. Commissioner, 326 U.S. 287, 293 (1945), reh'g den., 326 U.S. 811 (1946). Identifiable events that operate to contradict or severely limit the existence of potential value include: liquidation of the corporation, cessation of business, bankruptcy, or the appointment of a receiver to take over the company's assets and business. Steadman v. Commissioner, 50 T.C. 369, 377, aff'd, 424 F.2d 1 (6th Cir.), cert. denied, 400 U.S. 869 (1970). However, none of these events, alone, is outcome determinative. Boehm v. Commissioner, 326 U.S. 287, 293 (1945), reh'g den., 326 U.S. 811 (1946). No deduction is allowed under Section 165(a) solely on account of a decline in the stock value when the decline is due to a market fluctuation or to another similar cause. Treas. Reg. § 1.165-4(a).

Section 165(c)(3) restricts non-business and non-profit seeking losses by individuals to those arising from casualty or theft.[20] No statutory definition of "theft" exists; however, the regulations provide that "theft" includes, but is not limited to, larceny, embezzlement, and robbery. Treas. Reg. § 1.165-8(d). Courts have defined "theft" as "a word of general and broad connotation, intended to cover and covering any criminal appropriation of another's property to the use of the taker, particularly including theft by swindling, false pretenses and any other form of guile." Edwards v. Bromberg, 232 F.2d 107,110 (5th Cir. 1956). To claim a theft loss, a taxpayer must prove that the loss resulted from an illegal, wrongful taking under the laws of the state where the loss was sustained, and that the taking was done with criminal intent. Id. at 111; Paine v. Commissioner, 63 T.C. 736, 740 (1975), aff'd without published opinion 523 F.2d 1053 (5th Cir. 1975); Rev. Rul. 72-112, 1972-1 C.B. 60. While the factual existence of the theft may be established by

[19] Under I.R.C. § 172 (d)(4)(C), the deduction for theft losses is allowed in computing a net operating loss carryover or carry-back.

[20] The burden is on the taxpayer to establish both a deductible loss and the year in which it was sustained. Boehm, 326 U.S. at 294. The taxpayer also bears the burden of proving the amount of the claimed loss deduction. Amey & Monge, Inc. v. Commissioner, 808 F. 2d 758, 761 (11th Cir. 1987).

criminal conviction under the law of jurisdiction where the theft occurred, the deduction is not contingent upon whether the thief has been prosecuted or convicted. Vietzke v. Commissioner, 37 T.C. 504, 510 (1961); Monteleone v. Commissioner, 34 T.C. 688, 692 (1960).

Taxpayers have been denied a theft loss for stock purchased on the open market. In Paine v. Commissioner, 63 T.C. 736, 742-743 (1975), aff'd without published opinion 523 F.2d 1053 (5th Cir. 1975), the taxpayer was a stockbroker who purchased stock on the open market. Subsequently, the Securities and Exchange Commission halted trading due to insider manipulation of the market price. Id. Several corporate officers were indicted for violating securities laws, and an investigation disclosed fraudulent misstatements of the corporation's actual and projected earnings. Id. The Tax Court rejected theft loss treatment, and held that the taxpayer did not purchase the stock from the persons making the misrepresentations, but from prior owners of the stock who may or may not have been aware of the false statements. Id. at 742. The Tax Court further determined that no theft loss could be allowed because it was impossible to ascertain the amount by which the stock declined because of the illegal activities of the corporate officers versus market forces such as business risks or poor management. Id. at 743.

The Tax Court faced this issue again in Barry v. Commissioner, T.C. Memo. 1978-215, and held that where, under New York law, corporate officers were guilty of fraud and filing of false financial statements, taxpayers who acquired and sold at a loss the corporation's stock on the open market could not claim a theft loss under I.R.C. § 165. Id. Applying the definition of theft under New York law, the Court concluded that there was no evidence that the officers had the specific intent to obtain the taxpayer's property. Id. The Tax Court observed in Barry that even if a theft occurred on the date the taxpayers sold their stock at a loss, it would be impossible to verify what portion of the decline in stock value was attributable to the "theft" activities as opposed to other factors such as business risk, poor management, and market fluctuation. See De Fusco v. Commissioner, T.C. Memo. 1979-230 (same result under California law). In an earlier decision, Bellis v. Commissioner, 61 T.C. 354 (1973), aff'd 540 F.2d 448 (9th Cir. 1976), the Tax Court refused a theft loss to a surgeon who purchased his stock directly from the corporation because the president lacked felonious intent and offered no proof that the loss was sustained as a result of false or fraudulent representations. Distinguishing Bellis, the De Fusco Court determined that the fatal flaw in De Fusco's case was the lack of a direct buyer-seller relationship linking the taxpayer and the defrauders, as a result of the open-market framework of the stock purchase. See also Singerman v. Commissioner, T.C. Summ. Op. 2005-4 (taxpayer who purchased stock on the open market failed to prove intent to defraud due to lack of privity between alleged defrauder and taxpayer).

In MTS International, Inc. v. Commissioner, T.C. Memo. 1996-118, aff'd 169 F.3d 1018 (6th Cir. 1999), the sole shareholder and president of MTS (taxpayer) purchased all of his stock in another corporation on a public exchange following favorable reviews in national publications and on television. Id. After selling his first block of stock in the

other company at a profit in excess of $100,000, he purchased additional shares, which he later sold at a $600,000 loss. The Court denied his theft loss under Kentucky law because the taxpayer relied on outside reviews, rather than the misrepresentations made by the company's president, in deciding to purchase the stock, because neither the president nor the company received any of the taxpayer's property when he purchased the shares on the open market. MTS International, Inc., T.C. Memo. 1996-118, 169 F.3d at 1022.

In this case, of course, the TP alleges the fraud and misconduct was perpetrated by Corporation D and Individual C even though he purchased the majority of his stock, which was sold at a loss, through Corporation P. Nonetheless, the principles as established in Paine, De Fusco, Bellis, and MTS International, Inc. are the same and still apply. TP based his decisions to purchase Corporation X stock on mandated disclosures and no one-on-one discussions. Even if he convinces a court that he relied on the conduct of Individual A, Corporation X executives, Corporation P, Corporation D, and Individual C, he did not surrender his funds in reliance on any false representations. As discussed below, all alleged fraudulent activity occurred after he purchased Corporation X stock.

Courts have also analyzed allegations of theft loss by investors against their stockbrokers. In Marr v. Commissioner, T.C. Memo. 1995-250, taxpayers alleged a theft loss against their stockbroker, as well as an officer of the corporation, in connection with the sale of stock that the broker recommended the taxpayers purchase. The taxpayer alleged that the corporate officer made false representations regarding the financial condition of the company to the brokers and the brokers conveyed this information to the taxpayers. The Court held that there was no theft under California law which requires an appropriation by the defrauder of the victim's property, since neither the broker nor the officers of the corporation obtained the taxpayers' property (with the exception of commissions) when the taxpayers purchased the stock. The Court also noted that it was not aware of any authority allowing a taxpayer a theft loss as a result of a representation by a corporate officer which caused the taxpayer not to sell the stock.

In Yoakum v. Commissioner, T. C. Memo 2004-191, the taxpayer alleged that his broker committed securities fraud, negligence, and breach of fiduciary duty by supplying the taxpayer with alcohol during meetings with the broker and allowing the taxpayer to make unwise investments that benefited the broker through higher commissions. The Court held that the taxpayer failed to meet his burden of proof that theft occurred under state law, as well as the amount of the loss and the date of discovery. See also Lombard Brothers, Inc. v. United States, 893 F.2d 520 (2d Cir. 1990) (taxpayer not entitled to theft loss for failure to prove that investment firm intended to deprive taxpayer of its money, as required by state larceny statute).

On the other hand, the Tax Court, in Nichols v. Commissioner, 43 T.C. 842 (1965), allowed taxpayers a theft loss where the taxpayers' investment company obtained their

money by false pretenses under state law by falsely representing to them that it would purchase bonds and notes with the taxpayers' money. Id. at 884, 886.

In the present case, Corporation D and Individual C were not the ultimate recipients of the money paid by TP for the Corporation X stock. Moreover, even though Individual A and other executives of Corporation X pled guilty to crimes in connection with the Corporation X stock, there is no direct connection between Corporation D and Individual C regarding the internal financial information of Corporation X, which was concealed until Year 11. In addition, there is no link between the actions of Corporation X executives, Individual A, and Corporation P and any amount of particular loss suffered by TP here. In contrast to the Nichols case, TP has provided no evidence that Corporation D or Individual C failed to execute any trades that TP requested. TP's claimed theft loss for the difference between the market value of Corporation X stock when he purchased it and the market value of the stock when he sold it is simply not supported by the evidence.

When taxpayers have purchased stock outside of the open market, the courts have used the same approach and analysis in determining whether a theft deduction is allowable. In Vietzke v. Commissioner, 37 T.C. 504 (1961), the taxpayer was a doctor who claimed a loss for $25,000 advanced to a corporation for stock subscriptions, which was subsequently stolen. Id. The two individuals who enticed the taxpayer to invest in the venture used the money for personal expenditures, and were later convicted of violating state securities laws in selling the stock. Id. at 507. The Tax Court held that the taxpayer's theft loss was deductible because the incorporators had felonious intent to appropriate and obtained the taxpayer's property when they sold him the stock. Id. at 511. The Court further held that the corporate entity was merely a device to swindle investors and not a well-intentioned attempt to start a corporation. Id. at 511-512.

In Vietzke, the entire investment was a device which the promoters used to steal for their own personal gain. Here, Corporation X was a legitimate company and the investments were legitimate, but the irregularities occurred at the expense of the investors. There is evidence that Individual A and some executives knew that the methods were improper, and did not impart this information to investors. Nonetheless, there is no evidence that the TP's property was obtained by false pretenses or stolen after being obtained. In addition, to qualify as theft, TP must demonstrate more than a criminal act occurred under state law resulting in a loss. He must prove criminal intent. In Vietzke, the incorporators acted with the intent to defraud. TP has not proven that any of the alleged wrongdoers, including Corporation D and Individual C, acted with felonious intent to deprive him of his property.

In Boyko v. Commissioner, T.C. Memo. 1998-67, the taxpayer was an attorney who received stock from a computer software company as compensation for legal services rendered to the corporation in his capacity as outside and general counsel. Subsequent to an investigation, the taxpayer determined that the stock was worthless. Rejecting his claim that the investment qualified for a theft loss deduction, the Tax Court held that

regardless of the close personal relationship and dealings between the taxpayer and the corporation's president there was no evidence that the president made any false statements with the intent of obtaining the taxpayer's property in connection with issuing the shares or that the loss was related to any false representations. Id.

Boyko is applicable to the instant case on several counts. First, TP has failed to allege that the price paid to acquire Corporation X stock from year 2 through Date 2, was not equal to a fair price. Accordingly, it is reasonable to conclude that TP not only parted with something of value for which he received equal value, but also did not incur a theft loss. Without a criminal appropriation of a taxpayer's property, there can be no theft or stolen property transfer. Thus, TP's claim is a non-starter. Moreover, TP's retention of Corporation X stock in reliance on alleged material misrepresentations or omissions cannot form the basis for a securities fraud claim, as it is not in connection with any purchase or sale. See Krim v. BancTexas Group, 989 F.2d 1435, 1443 (5th Cir. 1993) (analyzing federal securities law) (citing Blue Chip Stamps, 421 U.S. 723, 95 S.Ct. 1917, 44 L.Ed.2d 539).

TP's claims of misrepresentation or omission concerning Corporation X stock require proof that the truth allegedly concealed by Corporation D and Individual C entered the marketplace. Arguably, with such evidence, TP's trading loss was caused by a prior misrepresentation. In the absence of such a disclosure, the alleged misrepresentations or omissions simply permitted the Corporation X stock to trade at an inflated price. Until the concealed information was disclosed, a drop in the price may have reflected a number of conditions, but did not reflect the impact of the alleged misrepresentations or omissions in the stock price. These principles are noteworthy when considering the downturn in the stock market in Year 9 and the lack of proof that Corporation D and/or Individual C had access to the internal financial information of Corporation X prior to public dissemination. Thus, just like the taxpayer in Boyko, TP has not produced any evidence that Corporation D or Individual C played a role in the decline of the Corporation X's stock price, or acted with the intent to defraud.

Only one reported case exists where a taxpayer purchased stock through an employee stock option plan and later claimed a theft loss. In De Fusco v. Commissioner, T.C. Memo. 1979-230, the taxpayer was employed as a part-time agent for Equity Funding Corporation of America ("EFCA"), and acquired 104 of his 684 shares directly from a stock option plan that allowed agents to purchase stock under a formula at the market price on the day when the agent became entitled to a commission in conjunction with the sale of an insurance policy or other investment offered by EFCA. The taxpayer claimed that his purchases were primarily induced by glowing prospects given to sales representatives at meetings in company offices. All of the officers were later convicted of criminal violations in selling EFCA stock. The taxpayer asserted that the loss eliminated his life savings when he had to repay the bank loan for which the EFCA stock was no longer acceptable collateral. The De Fusco Court held that the IRS agreed on brief that EFCA's officers had the specific intent to deprive the taxpayer of his property and did in fact obtain his property by making false representations regarding

the stock's value, but disallowed the deduction on a different ground, reasoning that there was a reasonable prospect of some recovery for the taxpayer's loss in the year the deduction was claimed.

De Fusco is distinguishable from the facts in this case. TP did not purchase any Corporation X stock based on false representations made by Corporation X executives, Corporation D, Individual C, or Corporation P regarding Corporation X's financial statements or the company's performance. Likewise, he was not granted ISOs based on any false representations by or about Corporation X. TP did not purchase any Corporation X stock, nor was he granted any ISO shares, during any period of wrongdoing at Corporation X. A class action lawsuit against Corporation X, which settled on or about (Year 13), included investors who purchased or acquired publicly traded shares, bonds, or notes of Corporation X, Inc. between Date 4 and Date 7. This class period demonstrates that the wrongdoing at Corporation X did not occur before Date 4. Additionally, the criminal indictments of several Corporation X officers show that the scheme to defraud occurred between of Year 9 and on or about of Year 11.[21] Based on the class action lawsuit and the criminal indictments, it is clear that the earliest period of wrongdoing by Corporation X officers occurred on or about Date 4, and the taxpayer has not shown that either Corporation D or Individual C could have possibly been aware of those circumstances until the matter became public knowledge.

Similarly, all of the ISO stock was granted to TP prior to Date 4, the earliest date in which wrongdoing by Corporation X officers was alleged. TP included a chart in his NASD complaint, which shows when the stock was purchased, granted, and vested. The information provided by TP shows that TP's ISO stock also vested before Date 4. TP has not submitted any evidence that shows he was in any way prohibited from selling the stock as soon as it vested. Thus, his argument that a theft loss occurred in regards to this ISO stock fails.

TP's broad undifferentiated allegations of manipulation are insufficient to establish a scheme to inflate Corporation X's stock. TP does not allege facts probative of intent to defraud or criminally appropriate TP's money at the time of the alleged misrepresentations. There is no evidence that the alleged misrepresentations were made in connection with the purchase of any stock or that the loss was related to any of the alleged misrepresentations. Thus, TP's claim that Corporation D and/or Individual C deceived him by concealing information to inflate the price of the stock for the purpose

[21] The indictment of (Individual G) (Corporation X's CFO) and (Individual D) (Corporation X's Director of General Accounting) provides that the scheme to defraud occurred "in or about [Year 9] through in or about of [Year 11]," and the indictment of Individual A (Corporation X's CEO) alleges that the scheme to defraud occurred "in or about September [Year 9] through in or about June [Year 11]." The criminal information filed against (Individual V), (Senior Vice President, and Controller of Corporation X) provides that the wrongdoing occurred "from in or about [Year 9] through in or about [Year 11]."

of protecting a loan misses the mark. These findings are bolstered by the relevant cases addressing the state criminal statutes cited by TP in support of his position.

law

The determinative issue is whether TP sustained a theft loss within the meaning of I.R.C. §§ 165(a) and 165(c)(3) during the tax Year 11. Because the alleged thefts took place in , we must look to law to determine whether TP sustained a theft loss. TP contends the conduct of Corporation D and Individual C violated at least eight criminal laws in : §§ (, ( ), ( ), and ( ).

Common Law Fraud

The elements of common-law fraud are: (1) false representation; (2) scienter; (3) intention to induce one to act or refrain from acting; (4) justifiable reliance; and (5) damages. . In order to take action on a theory of fraud, there must evidence to support each of the elements. Here, TP acquired Corporation X stock by exercising his options, and deposited those shares with both Corporation D and Corporation P. For the period beginning in Year 2 and ending in (Year 7), there is no evidence that Corporation D or Individual C knew of Corporation X's internal financial condition beyond published reports. Likewise, there is no proof that Individual C or Corporation D was aware of the irregularities at Corporation X before or after TP exercised his stock options in Year 8. There is no substantiation that Corporation D and Individual C had access to this information, which was not revealed until Year 11, in order to make false representations. Any recommendations or opinions rendered were based on the future prospects of Corporation X rather than an existing or prior event. Corporation D and Individual C's lack of knowledge regarding the financial and irregularities negates a finding of willful misrepresentation of material fact. As such, they were not in a position to induce TP to act. Even if TP were to convince a court otherwise, TP's argument fails because there is no proof that Corporation D or Individual C ever acted with intent to deceive.

(. § et seq.)

TP maintains that Corporation D and Individual C made fraudulent and negligent misrepresentations to induce him to hold Corporation X securities in violation of the of , . (the " "). TP's claims are rooted in assertions that Corporation D, Individual C and other Wall Street firms concealed information regarding the financial condition of Corporation X by means of a TP further contends that both Corporation D and Individual C failed to disclose the conflict of interest which allegedly affected the

advice and representation provided relative to his investment portfolio. According to TP, Corporation D and Individual C's acts, practices, and course of conduct operated as a fraud or deceit upon him thereby forming an additional basis for theft under common law fraud. Securities fraud relates to securities transactions, and common-law fraud relates to circumstances in general.

TP's conclusory claims against Corporation D and Individual C are deficient in alleging a securities fraud claim, as well as the tacked on conspiracy theory allegations. TP simply has not provided independently cognizable proof to support even a charge under the proposed theories.

."

. § makes it unlawful for a person

. Generally, prosecutions for violations of the

. § . Pursuant to § (of), a person convicted of securities fraud is guilty of a felony and subject to both a fine and imprisonment.

Pursuant to § , "

." . Because scienter is an element of securities fraud, evidence of a deceptive intent must be established to sustain a criminal action for securities fraud. In Ernst & Ernst v. Hochfelder, 425 U.S. 185, 96 S.Ct. 1375, 47 L.Ed. 2d 668 (1976), the Supreme Court addressed the issue of whether an action can exist under §10(b) of the Securities Act of 1934, after which § is patterned, in the absence of an allegation of intent to deceive, manipulate, or defraud on the defendant's part. Id. at 193, 96 S.Ct. 1375, 47 L.Ed. 2d 668. The Court held that it could not, and in doing so, defined scienter as "a mental state embracing intent to deceive, manipulate, or defraud." Id. at 193, 96 S.Ct. 1375, 47 L.Ed. 668.

TP relies on the conviction of Individual A, other executives of Corporation X, the analyst at Corporation P, and the class action lawsuits against other Wall Street firms to support his claim that what happened to him amounts to theft under law. He further relies on the SEC orders and litigation releases along with findings of the Corporation X bankruptcy examiner in alleging that Corporation D and Individual C made false claims about the value of Corporation X stock and manipulated

the price of Corporation X stock. TP cited no specific examples of misrepresentations upon which he relied in exercising his options to purchase Corporation X stock in between Year 2 and (Year 12), and submitted no proof of an ongoing between Corporation D and other Wall Street firms. See (court affirmed investment broker's conviction for violations); (court affirmed conviction under § .

Only a seller or purchaser of a security may bring a cause of action under . TP's arguments fall short as to Corporation D and Individual C on multiple counts. It is undisputed that the majority of TP's claimed losses resulted from his Year 8 exercise of stock options through Corporation P, which transaction did not accrue to the benefit of Corporation D or Individual C., *i.e*. no fees or commissions were paid to Corporation D or Individual C as a result of that transaction. TP sought the assistance of Corporation D and Individual C only to retain the stock he purchased at the time of exercise in his investment account. No evidence exists to prove that TP relied upon material misrepresentations or omissions by Individual C or Corporation D, which would form the basis of a securities fraud claim criminal action for the purchase or sale of Corporation X stock. The stock was acquired absent any representations by Individual C or Corporation D, and there is no support for the assertion that Individual C aided or assisted Individual A and Corporation X in concealing the internal financial condition of the company. Central Bank of Denver, N.A. v. First Interstate Bank of Denver, 511 U.S. 164, 114 S.Ct. 1439, 128 L.Ed.2d 119 (1994). Central Bank is relevant to the case at hand for its determination of what distinguishes primary liability from aiding and abetting liability. Individual C did not knowingly engage in misconduct. Accordingly, there is no basis to conclude that Individual C and Corporation D made false statements to TP with the intent to defraud.

TP made no claims that Corporation D or Individual C used his money to cover personal or business expenses, or made unauthorized purchases or transfers of Corporation X stock in his account. It is difficult to understand how TP can claim that Corporation D and Individual C stole the money he paid to purchase Corporation X stock when that money was paid directly to Corporation P in Year 8 and Corporation X in other relevant years. TP did not assert that he ever paid for Corporation X stock that he did not receive, or that the Corporation P brokers, Corporation D, or Individual C ever refused to execute a sell order, or that they did not remit to him the proceeds of sales of his securities, in contrast to Nichols v. Commissioner, 43 T.C. 842 (1965), and Willey v. Commissioner, T.C. Memo. 1998-58, where the Tax Court found that the taxpayers were entitled to a theft loss of money that was supposed to be invested on the taxpayers' behalf.

Although TP's sales of Corporation X stock were processed by Corporation D through Individual C, and Individual C therefore had temporary possession of the money TP paid for the stock, those proceeds were ultimately turned over to TP and not retained by Individual C or Corporation D. Under law, temporary possession of the

proceeds does not rise to the level of common-law fraud or constitute securities fraud under . There is no evidence that Individual C or Corporation D intended to or ever did retain possession of TP's funds for an extended period of time.

During the entire period that TP bought and sold Corporation X stock, from Year 2 through Year 12, numerous transactions were profitable, particularly in Year 3, Year 5, and Year 8. TP received some benefit from the actions of Corporation D and Individual C because he was able to sell some of his shares for a profit and write covered calls. TP's claimed theft loss for federal tax purposes does not take into account the sales or other investment gains that were profitable to him, but appears to focus only on the sales in which he divested himself of his Corporation X stock at a loss.

TP contends that he discovered the theft loss in Year 11. TP stated that information made public through restated financial reports and the bankruptcy led him to this conclusion. TP provided no additional detail regarding his independent investigation or what other information he considered to charge Corporation D and Individual C with wrongdoing. When TP received notice of the class action lawsuit against Corporation X and its brokerage firms, he opted out of the lawsuit. He then pursued claims against Corporation D through the Arbitration Department of the NASD. If true, TP's discovery of the loss in Year 11 triggered the statute of limitations. At the time he filed his claim, any course of action available under law had expired § .

Thus, even assuming arguendo that Corporation D and Individual C did not fully advise TP on the risks of holding such a highly concentrated position in Corporation X stock, TP's reliance on common-law fraud, the , and conspiracy theories to support his claim of theft through false pretenses lacks merit. TP has not provided any documents or evidence that Individual C or Corporation D intended to deceive or defraud him.

(§)

A person commits the offense of when

. § . The phrase " " is broad enough to encompass provided in § and described in detail below. Thus, in , a person may be indicted for but convicted of . See ; .

The documents and information submitted in support of the refund claim fail to provide a plausible explanation for the amount that TP now claims as a theft loss. He never

specifies exactly what property was stolen, therefore making it difficult to determine a credible basis for the amount of the claimed loss in Year 11. There are no allegations that Individual C or Corporation D possessed the necessary criminal intent to take property from the TP. Instead, he alleges that the property stolen was the diminution in the value of his Corporation X stock between the time he began investing and the date that all of his shares were sold. The diminution in value does not prove that there was a theft. At a minimum, TP should be able to specify what personal property was taken.

TP contends that he is entitled to a theft loss of $GG, but his computations do not take into account any fluctuations in the value of the stock. As previously stated, TP has also failed to establish any link between market manipulations and improper conduct outlined in the Security and Exchange Commission releases, the bankruptcy court examiner's findings, and his purchases of Corporation X stock. TP's records indicate that he exercised his options and acquired #R shares in Year 8, but falls short of establishing that his stock was part of the manipulation revealed in Year 11 or the existence of any unauthorized transactions involving his account. Nonetheless, TP is claiming a loss not only with respect to this block of shares but with respect to all shares he acquired from Year 2 through the end of Year 7.

As previously discussed, the evidence does not show that Corporation D or Individual C took any property from TP. There are no allegations that Corporation D or Individual C came into possession of TP's funds and used them for a purpose other than investing on the taxpayer's behalf. As a result, there is no basis to support a finding of in connection with the actions of Individual C or Corporation D during the years in issue. See generally (defendant convicted of where evidence showed a criminal intent to deprive another of property); (same). Compare (no proof beyond a reasonable doubt of intent to defraud).

( )

The felony of

. § provides that a person commits

The statute defines five ways in which an accused may be found to have intentionally "deceived" another, including those instances where

§ .

With these legal principles in mind, there is insufficient evidence to support a conviction under any of these provisions. First, with regard to the allegations under , the evidence unequivocally shows that the stock purchased by TP was received by Corporation D, deposited into TP's account, and used to generate income for the payment of taxes arising from the TP's exercise of his ISOs in Year 8. TP makes no allegations that Individual C or Corporation D disguised a theft by giving him false financial statements or reporting fictitious gains and losses. There is no evidence that Corporation D or Individual C appropriated the stock, its dividends, or gains, or that Corporation D or Individual C received any benefit from any of the funds invested. Similarly, neither Corporation D nor its brokers used information or their knowledge to induce TP to open an account, create false impressions regarding their qualifications, or make investments. Indeed, the record indicates that TP sustained a decline in the value of his stock due to downward trends in the market and the restatement of financial data by Corporation X. Accordingly, TP failed to provide any evidence to prove that Corporation D or Individual C " " of another as required by § .
(state failed to prove defendant engaged in).

Second, a conviction under § is authorized only when there is a deceitful misrepresentation regarding " ," and a false promise of future performance cannot be the basis for a conviction.
. " '

" ' [Cit.]" .

In this case, TP presented no independent evidence that he relied on statements or representations made by Corporation D or Individual C concerning the specifics of Corporation X's existing or past financial status. TP did not make separate inquiries or form his investment decisions on the advice of Corporation D or Individual C based on past information or existing facts. Rather he accepted the opinions of Corporation D and Individual C regarding the long-term position of Corporation X as it was published to the entire investment community. Neither Corporation D nor Individual C had access to the inside financial information of Corporation X or knowledge that its financial statements were subject to revision or restatement in Year 11. While Corporation D and its brokers could have counseled TP on the importance of diversification, that alone cannot be the basis for a conviction under .
;
. Moreover, any promises, reassurances, or representations that Corporation D or its brokers made regarding the anticipated future performance of Corporation X and its stock can not as a matter of law constitute .
. This is so because the false impression created must be as to an existing fact, not as to a future event.

TP has not cited any empirically verifiable statement by Individual C that can be affirmatively disproven. As a result, there is no foundation upon which to conclude that statements by Individual C or Corporation D are actionable under law. Expressions of opinion, hope, and expectation without special knowledge of their veracity are not sufficient to prove fraud under law. See . Consequently, the evidence as provided in support of TP's allegations is not enough to sustain a charge, much less a conviction, of .

( )

A person commits the offense of when,

…" § . The purpose of this statute is to punish fraudulent conversion, not breach of contract, and in a criminal action, the State must prove fraudulent intent. . "

'[Cit.]"
.

In this case, there is insufficient evidence to establish that Corporation D or Individual C knowingly converted TP's stock or funds to their use with fraudulent intent. TP has only established that Individual C and Corporation D managed his non-discretionary investment account and failed to provide him with information which was unknown to the securities industry until Year 11. TP suggests that the required scienter can be inferred from the convictions of Individual A, SEC reports, the findings of the bankruptcy examiner's report, and the alleged close relationship among Individual A, Individual C, and Corporation D, but ignores the fact that his intangible interest, as represented by the electronic shares in his account, was never removed or converted by Corporation D or Individual C. This is further borne out by the fact that TP is not claiming a deduction for stock that became worthless because he was able to sell his Corporation X stock on the open market.

TP produced no evidence that Corporation D or Individual C were aware of and actively participated in the Corporation X irregularities, resulting in an inflated stock price. There is no evidence that Individual C sold large amounts of his own Corporation X stock at the inflated levels, at a time when TP alleges he knew that Corporation X's financial statements were false and misleading. TP has yet to identify the material non-public information Individual C and Corporation D allegedly withheld concerning the true status of Corporation X's financial situation. To allow criminal intent to be inferred from

nothing more than a possible breach of fiduciary duty, which was not established, would undermine the distinction between fraudulent conversion and breach of contract made in and . See ; (conviction reversed for lack of proof of). The conduct of Individual C and Corporation D simply does not equate to the crime of .

In , the Court of Appeals reversed a conviction for . In , the defendant rented equipment from a store and failed to return it. The store was unable to successfully contact him, even after he was served with a criminal warrant. The Court held that this evidence was not sufficient because

." Id. at .

Here, as in , there is no evidence that Individual C or Corporation D took possession of TP's stock or funds, and no evidence to even suggest that Individual C or Corporation D was involved in adjusting or concealing Corporation X's internal financial information prior to TP's disposition of his stock. Thus, a jury could not properly infer fraudulent intent from the fact that Corporation D made a loan to Individual A or maintained his brokerage accounts or other findings resulting from Individual A's conviction or Corporation X's bankruptcy. TP has not provided undisputed transcripts, depositions, or affidavits relative to conversations he allegedly had with Individual C or any other broker employed by Corporation D. Moreover, there is nothing beyond TP's allegations that Individual C or Corporation D affected his decision to buy and hold Corporation X stock. Accordingly, if this case were to proceed to trial, a jury could not infer fraudulent intent from TP's arguments that Individual C and Corporation D concealed information and operated under a conflict of interest because Individual A had accounts with the firm. See

.

In the absence of competent admissible evidence beyond TP's allegations of conversion, the State of would be unable to prove that Corporation D and Individual C committed the predicate act of . There is no evidence that Corporation D or Individual C obtained TP's stock or money with the intention of depriving him of those funds, or that Corporation D or Individual C knowingly converted the stock or funds to its own use in violation of law. Indeed, the information provided showed that once Corporation D or Individual C received TP's money or stock, it posted the additions to his discretionary investment account. It was not until Year 11 that Corporation D and Individual C were put on notice of the irregularities at Corporation X. As TP's claims are not supported by the information and documents provided, there is not colorable evidence upon which to bring a charge for in . See

(

by insurance broker not proven where there was no evidence broker obtained money by deceitful means with intent to deprive taxpayer of funds or knowing conversion of funds to its own use).

Burden of proof as to amount and timing of loss

Under Section 165(e), a theft loss "shall be treated as sustained during the taxable year in which the taxpayer discovers" the loss. Treas. Reg. §§ 1.165-1(d)(3), 1.165-8(a). A theft loss is not deductible in the year in which the theft occurs "unless that is also the year in which the taxpayer discovers the loss." Treas. Reg. § 1.165-8(a)(2). See Gale v. Commissioner, 41 T.C. 269, 275 (1963).

TP bears the burden of proving the amount of the theft loss he is claiming, which necessitates proof of the difference between the fair market value of the asset before and after the theft. Treas. Reg. §§ 1.165-7(b)(1) and 1.165-8(c). The Tax Court has held that if reasonable inferences from the evidence point to theft, then the taxpayer is entitled to prevail, but if reasonable inferences point to another conclusion then the taxpayer must fail. Campbell v. Commissioner, T.C. Memo 1979-411; Eby v. Commissioner, T.C. Memo. 1963-207. Even if TP's calculation of his loss for the amount he paid for the Corporation X shares was acceptable, there is no evidence from which to compute the amount of the stock's loss in value allegedly attributable to Corporation D and Individual C.

As in the cases involving malfeasance by corporate officers, such as Barry and Paine, it is not possible to ascertain how much of the diminution in value was caused by the fraudulent or criminal actions of Individual A or Corporation X executives. The volatile swings in the price of the stock coupled with the overall downturn in the market during Year 9 makes it very difficult to determine the true value of Corporation X stock at any particular time. The unfavorable performance of sectors in Year 9 and Year 10 coupled with the unconsummated merger may have also been factors in the collapse of the price of Corporation X stock. Those particular aspects of the market as well as other more general market forces should be taken into account in TP's attempt to quantify his loss from the sale of Corporation X stock that could be attributed to the irregularities at Corporation X. Accordingly, TP has not met his burden and is not entitled to a theft loss deduction. See J.J. Dix, Inc. v. Commissioner, 223 F.2d 436, 437 (2d Cir. 1955) (no theft loss deduction where taxpayer failed to prove the amount of funds embezzled or in what year(s) it occurred).

A reasonable prospect of recovery exists when the taxpayer has a bona fide claim of recoupment from third parties or otherwise, and there is a substantial likelihood that such claims will be decided in his favor. National Home Products, Inc. v. Commissioner, 71 T.C. 501, 522, 525-526 (1979). The benchmark is one of foresight, pinpointing what was a "reasonable expectation" as of the close the taxable year for which the deduction is claimed. Id. at 522. The inquiry necessitates a practical approach, all pertinent facts

and circumstances being open to inspection and consideration apart from their objective or subjective nature. See Boehm, 326 U.S. at 292-293. Factors to consider include whether the taxpayer has filed a claim or lawsuit against third parties to recover the loss. Julicher v. Commissioner, T.C. Memo. 2002-55 (filing of lawsuit to recover loss gives rise to an inference of a reasonable prospect of recovery); Concord Instruments v. Commissioner, T.C. Memo. 1994-248 (taxpayer's pursuit of a claim for reimbursement from insurer precluded a deduction in the years at issue).

TP bears the burden of proving that his loss could have been ascertained with reasonable certainty as of the year that his loss would never be recovered. Jeppsen v. Commissioner, 128 F.3d 1410, 1418 (10th Cir. 1997). Thus, if TP's probability of recovery was "simply unknowable" at the end of Year 11, then he would not be entitled to claim a theft loss deduction in Year 11. Id at 1418.

In the present case, TP contends that there was no reasonable prospect of recovery of any of the claimed theft losses at the end of Year 11. We disagree. In the case of a theft loss, if "there exists a claim for reimbursement with respect to which there is a reasonable prospect of recovery, no portion of the loss with respect to which reimbursement may be received is sustained …until it can be ascertained with reasonable certainty whether or not such reimbursement will be received." Treas. Reg. § § 1.165-1(d)(3) and 1.165-8(a)(2). Thus, when a taxpayer possesses a claim for reimbursement in the year the theft is discovered, a theft loss is not sustained for purposes of § 165(a) as long as and to the extent there remains a reasonable prospect of recovery with respect to the claim. Treas. Reg. § 1.165-1(d)(3).

At the end of Year 11, TP still had a reasonable hope of recovering at least a portion of the money he lost on his Corporation X transactions. At that point, the SEC proceedings against Individual A and other Corporation X employees were just beginning. Corporation X filed for bankruptcy in of Year 11, and was in the process of having an examiner review the company's debts and assets.[22] TP was given notice of his right to join in a class action lawsuit on Date 9, but opted out in Year 12. TP elected to seek recovery from Corporation D based on theories of fraud and negligent misrepresentation in Year 12. TP contends that he did not seek redress against others on Wall Street because filing such a suit would be hard to do. Despite his reluctance to pursue legal remedies against the offending parties, the fact remains that TP had the legal ability at the end of Year 11 to file claims or lawsuits against those parties whom he accuses of wrongdoing. TP presented no evidence to show that he would not have had a reasonable prospect of recovery at the end of Year 11 through the bankruptcy or via separate payouts had he bothered to file a claim or initiate separate legal action beyond the NASD arbitration matter.

[22] Bankruptcy precludes a determination that proceedings are completed. Schnurr v. Commissioner, T.C. Memo. 1989-275, In re Steffen, 2003-1 USTC ¶ 50,454 (Bankr. M.D. Fla. 2003).

In Jeppsen, 128 F.3d 1410, the Tenth Circuit refused a theft loss deduction to a taxpayer who, at the time he claimed the theft loss, still had a feasible claim against the stockbroker who churned his account and made numerous unauthorized trades on his behalf. The taxpayer in Jeppsen was resolute on bringing his suit in spite of the fact that both brokerage firms at which the offending broker worked denied any culpability. The attorney, who eventually represented the taxpayer, advised that the litigation would be lengthy and expensive with no assurance of success. The Court held that even though the taxpayer faced a "substantial risk" in pursuing the litigation, there was some prospect of his obtaining legal restitution and, therefore, "it could not be ascertained with reasonable certainty" at the end of the year in which he claimed his theft loss that he would not be reimbursed for his losses. Id. at 1419.

The instant case is analogous to Jeppsen with respect to the analysis of whether there was a reasonable prospect of recovery. It could not be ascertained with reasonable certainty at the end of Year 11 that TP could not recover some amount of his losses from the sale of Corporation X stock. The distinction between the two cases resides in the Jeppsen taxpayer's fortitude to pursue a legal remedy against the offending stockbroker, whereas TP here only pursued Corporation D. Nonetheless, the fact remains that at the end of Year 11, other avenues of recovery were still available to him, and it would be inequitable to reward his abandonment of potential legal remedies against Corporation P, Individual A, other Corporation X executives, and any other Wall Street firms by allowing him to take a theft loss deduction before the reasonable prospect of reimbursement was foreclosed.

Based on the foregoing, TP did not meet his burden of proving that his loss in connection with Corporation X was a loss resulting from theft. The shortage of evidence in the documents and information leaves open the question as to whether the date of discovery is accurate or a date of convenience. A theft loss is treated as sustained during the taxable year in which the taxpayer discovers the loss. I.R.C. § 165(e). It is the discovery of the theft loss, not a mere claim of loss that is determinative. Until knowledge of both theft and loss coexist, there cannot be a valid theft loss deduction. Treas. Reg. § 1.165-8(a)(2).

TP has not proved the elements of a theft loss. The information and documents provided make it highly improbable that any specific amount can be determined to be a theft loss in Year 11. Finally, the year of discovery remains imprecise. Should it be determined that the claimed losses were losses from the sales or exchanges of capital assets, the losses would only be allowed subject to the limitations of I.R.C. §§ 1211 and 1212. I.R.C. § 165(f).

CASE DEVELOPMENT, HAZARDS, AND OTHER CONSIDERATIONS

TP's claims are blanket references to acts or omissions of Corporation X, Individual A, Corporation X executives, Corporation P, Corporation D, and Individual C, but fail to specifically identify independent facts constituting the alleged fraudulent conduct. TP's

information and documents do not address the allegations and defenses set forth in the Answer Corporation D filed with the Arbitration Division of the NASD. Instead, he relies in conclusory fashion on newspaper articles and the criminal convictions of Individual A and Corporation X executives to support his claims of a criminal scheme or conspiracy to inflate Corporation X's stock prices. See

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(citations and punctuation omitted (emphasis in the original). Such allegations alone do not prove securities fraud or common law fraud, thus, TP's reliance on §§

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cannot be sustained.

Not only has the TP failed to show that any of the stock was either purchased or granted in connection with any wrongdoing by Corporation X executives, but also failed to show that any “theft” occurred under the cited statutes. A person commits the offense of when he

. TP has not shown that he was deprived of any property through any deceit by Corporation X officers, Corporation D, Individual C, or Corporation P, or that any of these parties possessed the requisite intent to deprive TP of his property under common law. TP's arguments with respect to the are deficient. No persuasive evidence of a exists to support an indictment for securities fraud. Similarly, TP failed to establish that Individual C or Corporation D appropriated his property in violation of law. In fact, TP's shares remained in his account in electronic form until they were sold. As noted above, TP bought all of the Corporation X stock well before any wrongdoing occurred. He has neither provided evidence that he was promised the options would be worth a certain amount when they vested nor has he shown that he was misled in any way by accepting the ISO option “in lieu of compensation.”[23] Thus, there is no evidence that a theft occurred under law.

Because the TP has not presented any evidence to show that he is entitled to take a theft loss deduction, we recommend denying the claim for theft loss.

DISCLOSURE STATEMENT

This writing may contain privileged information. Any unauthorized disclosure of this writing may undermine our ability to protect the privileged information. If disclosure is

[23] The RA noted that TP still received his extremely sizable compensation in addition to the ISO.

determined to be necessary, please contact this office for our views. Please call (404) 338-8536 if you have any further questions.

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