BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO

In the Matter of the Protest of	)	
	)	DOCKET NO. 22472
[Redacted]	)	
	)	DECISION
Petitioners.	)	
	)	

On December 23, 2009, the Idaho State Tax Commission's (Commission) Revenue Operations Division (RO) issued a Notice of Deficiency Determination (NODD) to [Redacted] (petitioners) denying the petitioners' claim for refund for taxable year 2006 in the total amount of $7,416. The petitioners filed a timely protest and petition for redetermination. The Commission, having reviewed the file, hereby issues its decision.

I. ISSUE

The petitioners filed an amended return for taxable year 2006 in which the petitioners claimed an Idaho net operating loss carryback deduction from taxable year 2008. In 2008, the petitioners suffered several "Ponzi" type losses that the petitioners included in the calculation of their 2008 Idaho net operating loss. The question before the Commission is whether or not the petitioners' theft losses, claimed as an itemized deduction in 2008, are includible in the calculation of the Idaho Code section 63-3021 net operating loss for that taxable year?

II. FINDING

The Commission finds that the petitioners' theft losses incurred in taxable year 2008 are governed by IRC section 162(c)(2) not IRC section 162(c)(3); therefore, the theft losses are excluded from the calculation of the Idaho Code section 63-3021 net operating loss for taxable year 2008. Since the losses are excluded from the calculation of the Idaho net operating loss for taxable year 2008, the RO correctly denied the petitioners' refund claim for taxable year 2006.

III. History

In October 2009, the petitioners filed their Idaho resident individual income tax return for taxable year 2008 claiming a refund of overpaid tax in the amount of $5,944. The Commission approved the petitioners' refund claim of tax for taxable year 2008.

For taxable year 2008, the petitioners reported on their [Redacted] an "other miscellaneous deduction" in the amount of $662,082. Attached to their 2008 income tax return, was a statement containing the following explanation, in part:

[Redacted]

In the statement attached to their income tax return, the petitioners calculated their theft losses as follows:

[Redacted]	[Redacted]	[Redacted]
	[Redacted]	[Redacted]
[Redacted]	[Redacted]	[Redacted]
[Redacted]	[Redacted]	[Redacted]
[Redacted]	[Redacted]	[Redacted]
[Redacted]	[Redacted]	[Redacted]
[Redacted]	[Redacted]	[Redacted]
[Redacted]	[Redacted]	[Redacted]

Since the petitioners' [Redacted] for taxable year 2008 exceeded the petitioners' federal adjusted gross income for taxable year 2008, the petitioners did not receive a tax benefit for the full theft loss. As such, the petitioners calculated an Idaho net operating loss for taxable year 2008 as follows:

Table 2 - Idaho Net Operating Loss

Idaho adjusted income	$131,199
Adjustments:	
Net capital loss	3,000
Casualty loss on Idaho property	-662,098
Idaho net operating loss	-$527,899

The petitioners filed a refund claim for taxable year 2006 as a result of having carried $100,000 of the Idaho net operating loss from taxable year 2008 back to taxable year 2006. The petitioners were seeking a refund of tax in the amount of $7,416. The remaining $427,899 was treated by the petitioners as available for carryforward to taxable year 2009 and beyond.

The RO issued its NODD denying the petitioners' refund claim for taxable year 2006, and the petitioners filed a timely petition for redetermination.

In the petitioners' e-mail dated December 18, 2009, the petitioners argued that they had followed the intent of the federal and state laws regarding the treatment of their theft losses. More specifically, the petitioners stated, in part:

1. [Redacted]

After the file was transferred into the appeals process, the possibility existed that the Idaho legislature, during the 2010 legislative session, might clarify this issue regarding the inclusion of a "Ponzi" type loss in the calculation of an Idaho Code section 63-3021 Idaho net operating loss. This file was placed on hold pending possible legislation in this area. The legislature adjourned without addressing this issue, and on April 27, 2010, the petitioners were sent a letter requesting that the petitioners advise the Commission if they wished to proceed with an informal hearing or the issuance of a decision. The petitioners did not respond to the April 27, 2010, letter, and as such, the Commission issues it decision based upon the information contained within the file.

IV. Law and Analysis

Idaho Code section 63-3021 states in pertinent part:

> **63-3021. Net operating loss.** (a) The term "net operating loss" means the amount by which Idaho taxable income, after making the modifications specified in subsection (b) of this section, is less than zero.
> (b) Add the following amounts:
> (1) The amount of any net operating loss deduction included in Idaho taxable income.
> (2) In the case of a taxpayer other than a corporation:
> (i) Any amount deducted due to losses in excess of gains from sales or exchanges of capital assets; and
> (ii) Any deduction for long-term capital gains provided by this chapter.
> (3) Any deduction allowed under section 151 of the Internal Revenue Code (relating to personal exemption) or any deduction in lieu of any such deduction.
> (4) Any deduction for the standard or itemized deductions provided for in section 63 of the Internal Revenue Code, or section 63-3022(j), Idaho Code, <u>except for any deduction allowable under section 165(c)(3) of the Internal Revenue Code (relating to casualty losses) pertaining to property physically located inside Idaho at the time of the casualty</u>.

[Emphasis added.]

Unless the theft loss qualifies as a casualty loss under IRC section 165(c)(3) on property physically located inside Idaho at the time of the casualty, the theft loss, just like the other federal IRC section 63 "itemized deductions," is excluded from the calculation of an Idaho net operating loss.

In Rev. Rul. 2009-09, the Internal Revenue Service provides the following clarification of theft loss treatment under the IRC, in pertinent part:

> Section 165(a) allows a deduction for losses sustained during the taxable year and not compensated by insurance or otherwise. For individuals, § 165(c)(2) allows a deduction for losses incurred in a transaction entered into for profit, and § 165(c)(3) allows a deduction for certain losses not connected to a transaction entered into for profit, including theft losses. Under § 165(e), a theft loss is sustained in the taxable year the taxpayer discovers the loss. Section 165(f) permits a deduction for capital losses only to the extent allowed in §§ 1211 and 1212. In certain circumstances, a theft loss may be taken into account in determining gains or losses for a taxable year under § 1231.
>
> For federal income tax purposes, "theft" is a word of general and broad connotation, covering any criminal appropriation of another's property to the use of the taker, including theft by swindling, false pretenses and any other form of guile. Edwards v. Bromberg, 232 F.2d 107 (5th Cir. 1956); see also § 1.165-8(d) of the Income Tax Regulations ("theft" includes larceny and embezzlement). A taxpayer claiming a theft loss must prove that the loss resulted from a taking of property that was illegal under the law of the jurisdiction in which it occurred and was done with criminal intent. Rev. Rul. 72-112, 1972-1 C.B. 60. However, a taxpayer need not show a conviction for theft. Vietzke v. Commissioner, 37 T.C. 504, 510 (1961), acq., 1962-2 C.B. 6.
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> The character of an investor's loss related to fraudulent activity depends, in part, on the nature of the investment. For example, a loss that is sustained on the worthlessness or disposition of stock acquired on the open market for investment is a capital loss, even if the decline in the value of the stock is attributable to fraudulent activities of the corporation's officers or directors, because the officers or directors did not have the specific intent to deprive the shareholder of money or property. See Rev. Rul. 77-17, 1977-1 C.B. 44.
>
> In the present situation, unlike the situation in Rev. Rul. 77-17, B specifically intended to, and did, deprive A of money by criminal acts. B's actions constituted

> a theft from A, as theft is defined for § 165 purposes. Accordingly, A's loss is a theft loss, not a capital loss.
>
> . . .
>
> Rev. Rul. 71-381, 1971-2 C.B. 126, concludes that a taxpayer who loans money to a corporation in exchange for a note, relying on financial reports that are later discovered to be fraudulent, is entitled to a theft loss deduction under § 165(c)(3). **However, § 165(c)(3) subsequently was amended to clarify that the limitations applicable** to personal casualty and **theft losses under § 165(c)(3) apply only to those losses that are not connected with** a trade or business or **a transaction entered into for profit. Tax Reform Act of 1984, Pub. L. No. 98-369, § 711 (1984).** As a result, Rev. Rul. 71-381 is obsolete to the extent that it holds that theft losses incurred in a transaction entered into for profit are deductible under § 165(c)(3), rather than under § 165(c)(2).
>
> **In opening an investment account with B, A entered into a transaction for profit. A's theft loss therefore is deductible under § 165(c)(2) and is not subject to the § 165(h) limitations.**

[Emphasis added.] The Internal Revenue Service concluded that following the 1984 law change, a theft loss involving a transaction entered into for profit is a loss under IRC section 165(c)(2) not IRC section 165(c)(3). At least one court has agreed that IRC section 165(c)(2) controls the reporting of theft losses relating to transactions entered into for profit. Premji v. Commissioner, T.C. Memo. 1996-304, affd. without published opinion 139 F.3d 912 (10th Cir.1998).

The Commission has previously found that a theft loss relating to investment transactions entered into for profit are governed by IRC section 165(c)(2). See Commission's published decisions in Docket No. 19797 at http://tax.idaho.gov/decisions/0719797.pdf and Docket No. 22423 at http://tax.idaho.gov/decisions/1022423.pdf.

In their e-mail dated December 18, 2009, the petitioners acknowledged that they treated the various theft losses for federal purposes as a deduction under IRC section 165(c)(2) as losses related to investments entered into for profit. It is that federal code section that allowed the

petitioners to include the entire amount of their various theft losses as fully includible in their calculation of their federal net operating loss. As a deduction under IRC section 165(c)(2), the theft loss is excluded from the calculation of the Idaho Code section 63-3021 net operating loss for taxable year 2008.

V. Conclusion

As of the date of this decision, the petitioners have not provided any information that would resolve this case in the petitioners favor for taxable year 2006. It is the petitioners' burden of proving error on the part of the deficiency determination. Albertson's, Inc. v. State Dept. of Revenue, 106 Idaho 810, 814, (1984); Parsons v. Idaho State Tax Comm'n, 110 Idaho 572, 574 (Ct. App. 1986). Since the petitioners have not met this burden of proof showing that the NODD for taxable year 2006 is incorrect, the Commission upholds the RO's determination for taxable year 2006.

WHEREFORE, the Notice of Deficiency Determination dated December 23, 2009, denying the petitioners a refund for 2006, is hereby APPROVED, AFFIRMED, and MADE FINAL.

An explanation of the petitioners' rights to appeal this decision is enclosed.

DATED this ____ day of _____ 2010.

IDAHO STATE TAX COMMISSION

_____
COMMISSIONER

CERTIFICATE OF SERVICE

I hereby certify that on this _____ day of _____ 2010, a copy of the within and foregoing DECISION was served by sending the same by United States mail, postage prepaid, in an envelope addressed to:

[Redacted] Receipt No.

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