

Appeal of Richard and Kathleen Moe

The issue is whether appellants are entitled to a theft loss deduction for a loss arising from their purchase of a "Family Equity Trust".

In 1977, appellants paid \$3,000 to the Institute of Individual Religious Studies (the "Institute") in exchange for instructions concerning the establishment of a Family Equity Trust and the use of that trust to obtain substantial income tax savings. In addition, the Institute was to provide appellants with legal representation at no extra charge if the validity of the trust was challenged.

Appellants established the trust and used it to attempt to reduce their 1977 income tax obligation. In 1979, the Internal Revenue Service notified appellants that the use of the trust was invalid for income tax purposes and assessed additional income tax., Appellants attempted to obtain legal assistance from the Institute, but were unable to contact the Institute since it had ceased operations in January or February 1979. Appellants contend that since they were without free legal assistance, they abandoned the use of the trust.

On their 1979 joint personal income tax return, appellants claimed a theft loss deduction for the amount paid to the Institute. They contend that a major portion of the amount paid to the Institute was in exchange for the promised legal services and that since these services were not received, the Institute has committed theft by false pretenses. Respondent determined that appellants did not establish any theft and issued a proposed assessment denying the claimed deduction. Respondent reaffirmed that assessment after appellants' protest and this appeal followed.

A deduction is allowed for a loss by theft not compensated for by insurance to the extent the loss exceeds \$100. (Rev. & Tax. Code, § 17206.) In order to be entitled to a theft loss, the taxpayer must prove that the loss resulted from a taking which was illegal under the laws of the jurisdiction where the loss was sustained. (Appeal of Donald D. Harwood, Cal. St. Rd. of Equal., July 26, 1978.)

Under California law, the definition of theft includes the obtaining of money or property by false pretenses. (Pen. Code, § 484.) A person is guilty of this offense only if he made a false representation of

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fact with knowledge of its falsity and with an intent to deprive the owner of property and if the owner of the property was defrauded and gave the property in reliance upon the misrepresentation. (People v. Brady, 275 Cal.App.2d 984 [80 Cal.Rptr. 418] (1969).) In order to be entitled to the claimed deduction, appellants must prove the existence of each of these elements.

Appellants claim that the misrepresentation made by the Institute was its promise to provide future legal assistance. A promise made without the intention to perform is a misrepresentation of a state of mind and thus, a misrepresentation of fact. (People v. Ashley, 42 Cal.2d 246 [267 P.2d 271] cert. den., 348 U.S. 900 [99 L.Ed. 7071 (1954).) However, mere nonperformance of a promise is not enough to prove false pretenses. (People v. Otterman, 154 Cal.App.2d 193 [316 P.2d 85] (1957).) It must also be shown that when the promise was made, the promisor did not intend to perform. (People v. Otterman, supra.)

Appellants have produced no evidence to prove that, at the time the Institute promised to provide legal services, it intended to mislead them. They rely completely upon the fact that the Institute did not perform as promised. This is insufficient to prove false pretenses. Based on the facts presented, it is possible that when the Institute promised to provide legal services, it intended to do so. Apparently in 1977, the Institute was able to perform in that it had a legal division, staffed by attorneys. The Institute's nonperformance can be explained by the fact that it ceased all business operations in the beginning of 1979.

Since appellants have failed to prove that their loss resulted from an illegal taking, they are not entitled to the claimed deduction.

For the foregoing reasons, the action of respondent must be sustained.

