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BOARD OF EQUALIZATION

STATE OF CALIFORNIA

In the Matter of the Appeal of:	**HEARING SUMMARY**
	PERSONAL INCOME TAX APPEAL
DAVID JONES AND JAMIE JONES[1]	Case No. 525089

Year	Proposed Assessment Tax
2005[2]	$486

Representing the Parties:

For Appellant: Mark Shaltes, Tax Appeals Assistance Program (TAAP)[3]

For Franchise Tax Board: Joanne A. Garcia, Senior Legal Analyst

QUESTION: Whether appellants have shown error in the Franchise Tax Board's (respondent) determination that appellants are only entitled to a claimed theft loss deduction in the

[1] Appellants reside in Sacramento County.

[2] In its opening brief, respondent inadvertently refers to tax year 2006 as the tax year at issue but it is clear from respondent's exhibits and the other evidence and briefing in the record that the tax year at issue is 2005. (Resp. Opening Br., p. 1.)

[3] Appellants submitted the Appeal Letter and Mr. Shaltes of TAAP submitted appellants' reply and supplemental briefs.

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amount of $6,078 under Internal Revenue Code (IRC) section 165.[4]

HEARING SUMMARY

Background

Appellants filed a timely 2005 California income tax return on which they reported federal adjusted gross income (AGI) of $81,189, California adjustments (additions) of $2,236, itemized deductions of $31,625, taxable income of $51,800, and a tax liability of $1,437. After applying exemption credits of $718, California income tax withholdings of $688, and child and dependent care expenses credit of $408, they claimed a refund of $377. On the 2005 Schedule CA (540), line 41, appellants listed a casualty and theft loss adjustment (i.e., deduction) of $14,196. (Resp. Opening Br., p. 1, exhibit A.) Respondent accepted appellants' 2005 return as filed and issued a refund. (*Id*., p. 1.)

Respondent subsequently audited appellants' 2005 return and determined that they did not provide sufficient substantiation to support the itemized deductions adjustment of $14,196 claimed on appellants' Schedule CA (540). (Resp. Opening Br., p. 1.) Respondent issued an NPA dated May 23, 2008, disallowing the claimed casualty loss deduction of $14,196.[5] The NPA increased appellants' taxable income by $14,196 from $51,800 to $65,996 and assessed additional tax of $859 plus interest. The NPA reflects that respondent suspended interest beginning 18 months from the original due date of the return, April 15, 2006 until October 15, 2007. (Appeal Letter, Attachment.)

In a protest letter dated June 27, 2008, appellants protested the NPA, stating their casualty loss was valid because on May 5, 2005, their house was robbed and their truck was stolen, the only item recovered was the truck, and they incurred costs to repair the truck. In the protest letter, appellants state that appellant-wife came home on May 5, 2005, to discover the truck was stolen and the house was ransacked. Appellants asserted that their personal estimate of the loss is over $30,000, but

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[4] As discussed below, appellants claimed a casualty and theft loss adjustment of $14,196 on their 2005 return, which respondent disallowed entirely in the Notice of Proposed Assessment (NPA). (Appeal Letter, Attachment.) In response to appellants' protest, however, respondent allowed the full amount of claimed losses of $14,196 but reduced that amount by 10 percent of appellants' 2005 federal AGI of $81,189 ($8,118) and thus allowed on the Notice of Action (NOA) the casualty and theft loss adjustment in the amount of $6,078 ($14,196 - $8,118). (Resp. Opening Br., Exhibit C, Appeal Letter, Attachment.)

[5] As discussed below, IRC section 165 provides a deduction for losses sustained by, among other things, casualty or from theft. The parties in this appeal interchangeably use the terms casualty and theft, casualty, and theft when in fact appellants are only claiming a theft loss deduction.

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they could not find all of the receipts and their computer with tax information was stolen. Appellants attached to their protest letter copies of police reports for burglary and auto theft, and documents related to the truck repairs and costs, plus additional receipts related to the claimed loss. (Resp. Opening Br., exhibit B.)

In a letter dated April 6, 2009, respondent acknowledged receiving appellants' protest letter and stated that it would revise the proposed assessment to allow a casualty and theft loss deduction of $6,078 because the claimed casualty and theft loss adjustment of $14,196 reported on appellants' return must be reduced by 10 percent of appellants' federal AGI of $8,118 ($81,189 x .10). In the April 6, 2009 letter, respondent stated that it would revise the additional tax to $486 plus interest. (*Id.*, exhibit C.)

In a letter dated June 20, 2009, appellant-husband stated the police report did not contain appellants' entire loss because after the police left appellants discovered more items missing. The letter also stated that he was attaching receipts from his claim and some of the receipts appellants did not previously report because they are hard to read. Appellant-husband also stated in this letter that the receipts he provided total $24,993.96, plus he has several boxes of collectables that were stolen, including $5,000.00 in comic books and $400.00 in coins; he asserted that he does not have receipts for these items because they were given to him as gifts. In addition, appellant-husband stated that the house suffered structural damage from the robbery, a lot of which appellants repaired between 2006 and 2008, and he would be willing to send copies of these receipts. Attached to the June 20, 2009 letter are copies of various receipts. (Resp. Opening Br., exhibit D.)

In a letter dated August 12, 2009, respondent acknowledged receiving appellant-husband's letter dated June 20, 2009, and requested additional information. (Resp. Opening Br., exhibit E.) Appellants subsequently responded by writing a note on respondent's August 12, 2009 letter as follows: 1) they did not file a police report to report the additional loss and the police did not say that they needed a separate report ; 2) they did not file a claim with the insurance company for the additional loss; and 3) although appellants faxed all receipts to the agent in 2005, the insurance company only reimbursed appellants for approximately $1,500; appellants requested a "full refund" from the insurance company, but "gave up" after the adjuster stopped returning their calls. (*Ibid.*)

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Respondent apparently prepared a spreadsheet concerning the receipts appellants submitted with their June 20, 2009 letter in support of their claimed loss of $24,993.96. (Resp. Opening Br., exhibit F.) Respondent issued an NOA dated February 10, 2010, which revises the NPA by reducing the disallowed casualty loss adjustment from $14,196 to $8,118 and reducing the additional tax from $859 to $486 plus interest. In other words, the NOA allowed a casualty and theft loss adjustment of $6,078 ($14,196 - $8,118). The NOA provides that interest was suspended for the time period reflected in Revenue and Taxation Code (R&TC) section 19116 and interest accrual would resume 15 days after the date of the NPA. (App. Opening Br., Attachment.)

Contentions

Appellants' Contentions

In the Appeal Letter, appellants contend that they only claimed a loss of $14,096 on their 2005 return resulting from the break-in of their home in 2005 because they could not locate all of the receipts. (Appeal Letter, p. 1.) Appellants contend that they subsequently were able to find $24,993.96 in receipts and submitted them to respondent. (*Ibid*.) Appellants contend that they are not able to produce receipts for the many items because they were gifts. (*Ibid*.) Appellants assert that they filed a claim with their homeowner's insurance company but they were not able to get anyone at the insurance company to return their phone calls or respond to their letters. (*Ibid*.) They also assert that they ultimately received a check from the insurance company. (*Ibid*.) Appellants further assert that they cannot recall the amount of the insurance company check, but "it was close to 1,200" but "less than $1,500 so this is the number [they] will report on form 4684." (*Ibid*.) According to appellants, they contacted the insurance company to ask why the insurance company did not reimburse them in full but received no reply. (*Ibid*.) Appellants contend that it "was a horrible experience to be violated by robbers & [their] insurance company," they subsequently cancelled the insurance policy, and currently have a policy with a new insurance company. (*Ibid*.)

Appellants further contend that they have submitted adequate documentation to establish their entitlement to a casualty and theft deduction of $15,275.96, as asserted at protest, rather than the casualty and theft loss deduction of $14,096 claimed on their return. (Appeal Letter, pp. 1-2.) Appellants contend that respondent failed to revise the deduction amount to the higher amount asserted

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at protest because they did not previously submit a federal Form 4684. (*Ibid*.) In the Appeal letter, appellants provide their calculation of the casualty and theft deduction of $15,275.96 as follows: a loss claim of $24,993.96 less $100.00 (as required by instructions for federal Form 4684) less $8,118.00 (10% of federal AGI of $81,189.00) less insurance payment of $1,500. (*Ibid*.) According to appellants, the "new amounts should show that [they] do not owe any penalty." (*Id*., p. 2.) In the Appeal Letter, appellants state they are also submitting copies of their return, respondent's notices, and a completed federal Form 4684. (*Ibid*.) They also state that they are sending a copy of the Appeal Letter to the Taxpayers' Advocate Office for their records and review. (*Ibid*.) Appellants attached a copy of a completed federal Form 4684 to their Appeal Letter showing the above-described calculations and claimed deduction of $15,275.96. (*Id*., Attachment.)

In their reply brief, appellants contend that they are now appealing "the NPA [sic] amount of $486," which they believe they do not owe. (Apps. Reply Br., p. 1.) They assert that they were only able to provide respondent with "merely a portion of the theft loss they are able to show by way of receipts, as well as the major items that were stolen." (*Ibid*.) According to appellants, the actual loss sustained from the burglary is "in the high $30,000 range, but [they] only claimed $24,993.96 because that was what [they were] best able to prove. (*Id*.. p. 2.) Citing *Cohan v. Commissioner* (2d Cir. 1930) 39 F.2d 540, 544 (*Cohan)*, appellants argue that they are not required to "show an exactness of the amount of theft loss suffered" and "the Board should make as close an approximation as it can, bearing heavily if it chooses upon the Appellant[s] whose inexactitude is of [their] own making[,] [b]ut to allow nothing at all appears to us inconsistent with saying that something was spent." (*Id*., pp. 1-2.)

Appellants also argue that the Board is responsible for determining whether appellants are credible. (Apps. Reply Br., p. 2.) Appellants assert that in the *Appeal of David and Goldie Krechman* (86-SBE-078), decided on April 9, 1986, the Board stated:

> Despite the weakness of appellants' evidence as to the value of the jewelry, this board finds appellants to be credible witnesses and is convinced that appellants owned and lost more jewelry than the items listed on the two appraisals. In cases where the taxpayer has established that a theft loss occurred but has not established the amount of the loss, courts have frequently applied the Cohan rule and estimated the amount of the loss.

(*Ibid*.)

Appellants argue that the theft loss deduction's purpose "is to mitigate damages done to

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those who have been harmed and to provide equity in an otherwise inequitable world." (Apps. Reply Br., p. 3.) Appellants assert that they were harmed by the burglar, the insurance company, and respondent. (*Ibid*.) They state, "The theft loss deduction allows a small piece of comfort to know that they will regain a small amount of what was taken; however, the FTB has destroyed that comfort and has made the process of being burglarized even worse for Appellant[s]." (*Ibid*.) Appellants contend that it would not be equitable to penalize appellants for not submitting documentation regarding how the insurance company determined they were entitled to receive $1,500 because the insurance company provided them no explanation of how it determined that amount. (*Id*., p. 2.) Appellants further contend that, although respondent asserts that they are required to file an insurance claim on the additional $10,797.96, they did not believe it was feasible to recover any money from their unresponsive insurance company and thus they ceased contacting the insurance company after it stopped returning their calls. (*Ibid*.) They state, "Appellant[s] would have preferred receiving the insurance claim instead of the meager $486 that is in question in this case." (*Ibid*.) According to appellants, respondent is "guessing as to the amount that Appellant[s] should be allowed to claim as theft loss" and it "reduced the original claimed amount of $14,196 to $8,118," which "is the exact amount that Appellant[s] cannot claim, because allowable theft loss must be reduced by 10 percent of one's federal AGI and Appellants [sic] federal AGI was $8,118." (*Id*., p. 3.) Appellants further assert, "FTB is estimating just as the Appellant[s] [are] doing, however, in this appeal, it is not up to the FTB to determine what is allowable and only the Board can determine how much theft loss should be allowed to be claimed by Appellant[s]." (*Ibid*.)

In their supplemental brief, appellants contend that they provided respondent with receipts, which are attached to respondent's opening brief, and "[t]hese receipts should be adequate to show that there was something spent." (Apps. Supp. Br.) Referring to an attachment to their supplemental brief, which they describe as a breakdown of submitted receipts and items listed on the police report, appellants concede, "There was a slight amount of overlap and those items have been highlighted, the matching colors show which items were duplicated. (*Ibid*., Attachment.)

Respondent's Contentions

Respondent asserts that, although the NPA disallowed the entire claimed casualty and

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theft loss of $14,196 listed on appellants' return, it issued an NOA that allowed a casualty and theft loss deduction (after reductions required by law) in the amount of $8,118, as discussed above. (Resp. Opening Br., p. 3.)[6] Respondent contends that on appeal appellants have failed to establish their entitlement to a casualty and theft loss deduction (after reductions) of $15,275.96, which includes the original amount of $14,196.00 plus a list of additional receipts for $10,797.96. (*Ibid*. See also Appeal Letter, p. 2.) Respondent asserts that the original amount of $14,196 includes $10,619 for stolen personal property, such as office equipment, power tools, and computer accessories, truck repairs of $3,099, towing of $285, plus various receipts. (*Ibid*.) Respondent contends that it is unclear how appellants calculated their claimed casualty and theft loss deduction of $14,196 on the return because they did not provide a breakdown of all claimed lost items. (*Ibid*.) In addition, respondent contends that appellants failed to show they are entitled to a deduction for the list of additional receipts for $10,797.96.

Respondent also asserts that it lacks sufficient information to determine how the insurance company reportedly decided to pay appellants $1,500 as reimbursement. (Resp. Opening Br., p. 3.) Respondent contends that appellants failed to provide adequate details concerning the $1,500 reimbursement from the insurance company, such as documents showing reimbursement and/or a denial letter from the insurance company, the name of the insurance company, or a copy of the check from the insurance company. (*Ibid*.) Furthermore, because appellants reportedly did not submit a claim to the insurance company for the additional items amounting to $10,797.96, respondent contends that it is unknown whether the insurance company would have covered more claimed lost items. (*Ibid*.) Respondent argues that it cannot allow the additional claimed casualty and theft loss deduction of $10,797.96 because appellants failed to submit a claim to their insurance company for reimbursement of the additional expenses, as required by law, and they failed to prove their insurance company would not have covered those items. (*Ibid*.)

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[6] Respondent inadvertently states that "at protest a NOA was issued to allow a casualty and theft loss deduction (after reduction as required by law) of $8,118.00." (Resp. Opening Br., p. 3.) As set forth in respondent's letter dated April 6, 2009, as well as in the NOA, respondent allowed appellants' entire claimed theft losses of $14,196 *reduced by* $8,118, which is 10 percent of their 2005 federal AGI, for a total theft loss deduction amount of $6,078. (Resp. Opening Br., exhibit C, Appeal Letter, Attachment.)

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Respondent argues that under Treasury Regulation 1.165-7(a)(2) and 1.165-8(c), appellants must adjust the basis of the lost property when determining the loss and "[t]he amount deductible as a casualty or theft loss is the lesser of the actual value of the property just before the casualty less its value immediately after the casualty, or the adjusted basis of the property for determining the loss on a sale." (Resp. Opening Br., p. 4.) Citing *Barney C. Ruben and Estate of Eleanor Ruben*, 88-SBE-013, May 3, 1988, respondent contends that appellants improperly claimed the cost of restoring the additional items amounting to $10,797.96 to their original condition to determine the amount of deductible property casualty losses, as evident by the submitted original purchase receipts dating back to 1998, personal estimations, and replacement purchases subsequent to the theft. (*Ibid.*) Respondent further contends that the items listed in the police report are not supported with purchase receipts and appellants may have duplicated items in the police report and the listing of additional receipts amounting to $10,797.96, such as computers, computer accessories, CDs and cassettes. (*Ibid.*) In addition, respondent asserts that appellants included the purchase of a motion light detector for future protection against theft, which is not allowable because it is not a claimed reimbursement for a stolen item, and an estimate of $1,500 for fence repair based on the purchase value of wood in 2002, which is not allowable because they have not proven the cost of repairing the fence. (*Ibid.*)

In its reply brief, respondent addressed appellant's argument that the *Cohan* rule should apply to allow the additional items amounting to $10,797.96. Citing *Appeal of Albert Hakim*, 90-SBE-005, Aug. 1, 1990; *Appeal of Zorik and Artimis Soulkanian*, 87-SBE-077, Dec. 3, 1987; and *Appeal of Richard W. Cassady*, 86-SBE-111, June 10, 1986, respondent asserts that the Board has determined that the *Cohan* rule should be applied to approximate deductions, rather than entirely disallow them, in instances "when it is apparent by credible evidence that 'something was spent' but the taxpayer's records are inadequate to the extent that it is impossible to make an accurate determination of the amount spent for deductible business purposes." (Resp. Reply Br., p. 2.) According to respondent, the present appeal is distinguishable because the court in *Cohan, supra*, determined that it was obvious the taxpayer incurred some expenditures and thus allowed a deduction of a reasonable portion of unsubstantiated expenses. (*Ibid*.) Citing *Appeal of Henrietta Swimmer, Executrix, et al*., 63-SBE-138, Dec. 10, 1963, respondent states, "When applicable, the *Cohan* rule permits the deduction of a

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reasonable portion of unsubstantiated expenses." (*Ibid*.) Respondent argues that it is not necessary to apply the *Cohan* rule in this appeal because "appellants were allowed a deduction to the extent they were able to substantiate entitlement to the losses claimed. (*Ibid.*) Citing *Appeal of California Steel Industries, Inc.*, 03-SBE-001-A, July 9, 2003, respondent contends that the Board has "expressed its reluctance 'to disturb respondent's determinations involving unsubstantiated amounts without independent facts on which to base a different finding.'" (*Ibid*.) Respondent does not discuss the *Appeal of David and Goldie Krechman, supra*, in any of its briefs.

Citing *Appeal of Frederick and Jean Giesea*, 86-SBE-016, Feb. 4, 1986, respondent asserts that taxpayers' burden of proof is not relieved merely because it may be difficult or impossible for them to substantiate any of the claimed losses. (*Ibid*.) Respondent argues that its determination must be sustained because appellants failed to submit credible evidence substantiating their entitlement to the disallowed claimed theft losses and "it appears that the *Cohan* rule should not apply." (*Ibid*.)

Applicable Law

Casualty and Theft Deduction

IRC section 165, as incorporated by R&TC section 17201, allows a deduction for losses sustained during the taxable year and not compensated for by insurance or otherwise. In the case of a taxpayer who is an individual, IRC section 165(c) permits losses to be deducted by such a taxpayer only if they are incurred in a trade or business, a transaction entered into for profit, or are caused by fire, storm, shipwreck, other casualty, or from theft. (Int. Rev. Code, § 165(c)(1)-(3).) For tax year 2005, IRC section 165(h)(1) provided that if property not connected with a trade or business or a transaction entered into for profit is damaged or destroyed by casualty or from theft, the amount of the loss thus sustained is deductible only to the extent it exceeds $100.[7] The amount deductible as a result of a theft loss is the lesser of the fair market value of the property stolen immediately before the theft or the taxpayer's adjusted basis in the property. (Treas. Regs., §§ 1.165-7(b), 1.165-8.(c).) Furthermore, IRC section 165(h)(2) provides that if property not connected with a trade or business or a transaction entered into for profit is damaged or destroyed by casualty or from theft, the net amount of the loss is deductible

[7] In 2008, IRC section 165(h)(1) was amended by P.L. 110-343, section 706(c)DivC, which substituted "$500 ($100 for taxable years beginning after December 31, 2009)" for "$100," effective for tax years beginning after December 31, 2008.

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only to the extent it exceeds 10 percent of the taxpayer's federal adjusted gross income. (Int. Rev. Code, § 165(h)(2)-(3)(B).)[8] IRC section 165(e) provides that "any loss arising from theft shall be treated as sustained during the taxable year in which the taxpayer discovers such loss."

Burden of Proof

It is well-established that deductions are a matter of legislative grace and a taxpayer has the burden of proving that he/she is entitled to the claimed deductions. (*New Colonial Ice Co. v. Helvering* (1934) 292 U.S. 435, 440; *Welch v. Helvering* (1933) 290 U.S. 111; *Appeal of James C. and Monablanche A. Walshe*, 75-SBE-073, Oct. 20, 1975.) Deductions are narrowly construed against the taxpayer (*Miller v. McColgan* (1941) 17 Cal.2d 432, 441-442) and respondent's determination to disallow deductions is presumed to be correct. (*Welch v. Helvering, supra*; *Appeal of Ambrose L. and Alice M. Gordos*, 82-SBE-062, Mar. 31, 1982.)

Moreover, a presumption of correctness attends respondent's determinations as to issues of fact and appellant has the burden of proving such determinations erroneous. (*Appeal of Oscar D. and Agatha E. Seltzer*, 80-SBE-154, Nov.18, 1980.) This presumption is a rebuttable one and will support a finding only in the absence of sufficient evidence to the contrary. (*Ibid*.) Respondent's determination cannot, however, be successfully rebutted when the taxpayer fails to present uncontradicted, credible, competent and relevant evidence to the contrary. (*Ibid*.) When the taxpayer fails to support his assertions with such evidence, respondent's determinations must be upheld. (*Ibid.*) It is also well-established that a taxpayer's failure to introduce evidence that is within his/her control gives rise to the presumption that the evidence, if provided, would be unfavorable to his/her position. (*Appeal of Don A. Cookston*, 83-SBE-048, Jan. 3, 1983.)

The *Cohan* Rule

As a general rule, if there is sufficient evidence indicating the taxpayer incurred a deductible expense, but the precise amount of the deduction to which he is otherwise entitled cannot be determined, a court or other finder of fact may make an approximation of the amount of the deduction,

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[8] In 2005, IRC section 165(h)(2) only referred to "personal casualty losses" and made no reference to personal theft losses, but IRC section 165(h)(3)(B) provided, "The term 'personal casualty loss' means any loss described in subsection (c)(3)." In 2005, IRC section 165(c)(3) included both casualty and theft losses.

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bearing heavily against the taxpayer whose inexactitude is of his own making. (See *Cohan v. Commissioner, supra, 39* F.2d at pp. 543-544; *Vanicek v. Commissioner* (1985) 85 T.C. 731, 742-743*; WB Acquisition v. Commissioner* (T.C. 2011) T.C. Memo 2011-36.) This is known as the *Cohan* rule. The *Cohan* Rule has been superseded by statute with respect to some business expense deductions, including those for travel, meals and entertainment, and automobile expenses. (26 U.S.C. § 274(d); Treas. Reg. § 1.274-5(A).) In order to estimate the amount of an expense, however, the courts have held that there must be some basis upon which an estimate may be made. (*Vanicek v. Commissioner, supra,* 85 T.C. at 742-743; *WB Acquisition v. Commissioner, supra; Cherry v. Commissioner* (T.C. 1983) T.C. Memo. 1983-470.) Without such a basis, any allowance would amount to unguided largesse. (*Williams v. United States* (5th Cir. 1957) 245 F.2d 559, 560-561; *Whitaker v. Commissioner,* T.C. Memo 2010-209; *Green v. Commissioner*, T.C. Memo 2010-109. The Ninth Circuit summarized its position on the *Cohan* rule as follows:

> This circuit's precedents adopting the *Cohan* rule, however, are clear that the rule does not obviate the need for some proof of entitlement to a deduction in the first place. The finding of the Tax Court that Sparkman failed to establish such an entitlement eliminates the requirement that the Tax Court estimate what those losses were. (citing *Edelson v. Comm'r*, 829 F.2d 828, 831 (9th Cir. 1987) (summarizing *Cohan* as standing for the proposition that "a court should allow the taxpayer some deductions if the taxpayer proves he is entitled to the deduction but cannot establish the full amount claimed" (emphasis added)); *Norgaard v. Comm'r*, 939 F.2d 874, 879 (9th Cir. 1991) (noting that, under the *Cohan* rule, the trial court "may not be compelled to guess or estimate . . . even though such an estimate, if made, might have been affirmed").

(Sparkman v. Commissioner (9th Cir. 2007) 509 F.3d 1149, 1160.)

In the *Appeal of Henrietta Swimmer, Executrix, et. al*., *supra*, which was decided on December 10, 1963, the Board discussed the *Cohan* rule as follows:

> [T]he *Cohan* rule merely permitted the deduction of a reasonable portion of substantiated expenses. Here only a portion of appellant's deductions have been disallowed. Generally speaking, respondent permitted appellant to deduct 50 percent of the amounts he was unable to substantiate. Where the respondent has allowed part of a deduction, we will not alter its determination unless facts appear from which a different approximation can be made. (citations omitted.) We perceive no such facts in the record before us.

In the *Appeal of California Steel Industries, Inc*., *supra*, the taxpayer argued that under the *Cohan* rule, "substantiating 92 percent of its claimed costs is sufficient for respondent to proceed as if adequate documentation has been provided for the remaining costs." There, the Board quoted the

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language set forth above from the *Appeal of Henrietta Swimmer, Executrix, et al, supra*. The Board further stated,

> Our prior discussion of the *Cohan* Rule indicates our reluctance to disturb respondent's determinations involving unsubstantiated amounts without independent facts on which to base a different finding. Given no independent facts have been provided to us, we refuse to alter respondent's determination regarding unsubstantiated costs.

See also *Appeal of Albert Hakim, supra* ("The rule of Cohan . . . does not require us to allow a loss based on mere speculation, unsupported allegations or mere inference.")

In the present appeal, appellants argue that under the *Cohan* rule, they are not required to "show an exactness of the amount of theft loss suffered." (Apps. Reply Br., p. 1.) Appellants cite *David and Goldie Krechman, supra*, to support their contention. This appeal concerned whether the taxpayers adequately substantiated the amounts of their claimed theft loss deduction based on an incident on April 16, 1980, in which two knife wielding assailants entered and ransacked the taxpayers' residence and fled with their money and uninsured jewelry. Respondent did not dispute the theft of the jewelry occurred. According to the taxpayers, they inherited some of the jewelry and, during his extensive business trips throughout his career, the taxpayer-husband purchased a great deal of the jewelry but did not maintain purchase records. The taxpayers submitted to respondent two written appraisals, which were obtained for insurance purposes. The first appraisal dated 1963 appraised 13 pieces of jewelry at $16,350, and the second appraisal dated 1971 appraised one piece of jewelry at $2,600. Respondent allowed a deduction based on these 14 pieces of appraised jewelry but did not allow a deduction for any other items. On appeal, the taxpayers provided the Board with a list and description of various pieces of stolen jewelry and testified that the cost of these items (to the best of their recollection) was in excess of $101,000. They also testified that they did not get appraisals or insurance for all of the jewelry because the cost was prohibitive. The Board acknowledged that the taxpayers' evidence concerning the value of the jewelry was weak, but determined that appellants were credible witnesses and they owned and lost more jewelry than the amount listed on the two appraisals. Applying the *Cohan* rule, the Board thus modified respondent's action by allowing the taxpayers an additional theft loss deduction in the amount of $20,000. The Board stated:

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> In cases where the taxpayer has established that a theft loss occurred but has not established the amount of the loss, courts have frequently applied the Cohan rule and estimated the amount of the loss. (citations omitted) We believe that application of the Cohan rule is appropriate in this case. However, in the absence of supporting records, we will "bear heavily" against appellants "whose inexactitude is of [their] own making." (Cohan v. Commissioner, 39 F.2d 540, 544 (2d Cir. 1930).) . . .

STAFF COMMENTS

Staff notes that appellants claimed a lower amount of loss on their 2005 return, which they signed under penalty of perjury, than they claimed during the protest stage and on appeal. Staff further notes that in the NOA respondent allowed the theft loss deduction of $6,078 based on the entire amount of theft loss appellants claimed on their 2005 return ($14,196) less reductions of 10 percent of appellants' federal AGI ($8,118). There is no indication that appellants reduced the claimed loss amount by $100, as required by IRC section 165(h)(1), prior to listing the claimed loss amount of $14,196 on their 2005 return. Although respondent reduced the claimed theft loss by 10 percent of appellant' federal AGI, it appears that respondent failed to reduce the claimed theft loss by $100, as required by IRC section 165(h)(1). (See Resp. Opening Br., exhibit C, Appeal Letter, Attachment.)

At the hearing, appellants should be prepared to present evidence showing that the Internal Revenue Service accepted the disputed amount of loss for purposes of an IRC section 165 deduction for federal income tax purposes. They should also be prepared to substantiate the full amount of the theft loss they are claiming on appeal for purposes of the theft loss deduction, especially in light of their concession in their supplemental brief that "there was a slight amount of overlap" in the claimed theft loss items. Furthermore, appellants should clarify whether they are claiming they are entitled to a deductible amount based on the purchase price, or the lesser of the fair market value of the property stolen immediately before the theft or the taxpayer's adjusted basis in the property. (Treas. Regs., §§ 1.165-7(b), 1.165-8.(c).)

With respect to the *Cohan* rule, the parties should be prepared to discuss whether there is a basis on which the Board can make an approximation for the amount of theft loss included in appellants' additional list. (*Vanicek v. Commissioner, supra*.) The parties should also be prepared to discuss whether the present appeal is factually similar to the *Appeal of David and Goldie Krechman, supra* , and whether the Board's decision in that appeal or the Board's decision in *Appeal of California*

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NOT TO BE CITED AS PRECEDENT - Document prepared for Board review. It does not represent the Board's decision or opinion.

Steel Industries, Inc., supra, is controlling in this appeal.

Pursuant to California Code of Regulations, title 18, section 5523.6, if appellants are able to locate any additional evidence supporting their appeal, it should be submitted if possible to the Board and respondent at least 14 days prior to the hearing date. [9]

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[9] Exhibits should be submitted to: Claudia Madrigal, Board Proceedings Division, Board of Equalization. P. O. Box 942879 MIC: 80, Sacramento, CA 94279-0080

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