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7 **BOARD OF EQUALIZATION**  
8 **STATE OF CALIFORNIA**

10 In the Matter of the Appeal of: ) **HEARING SUMMARY**  
11 ) **PERSONAL INCOME TAX APPEAL**  
12 **ANNABELL M. PALMER**<sup>1</sup> ) Case No. 467214  
13 )

<u>Year</u>	<u>Proposed Assessment</u> <sup>2</sup>
2003	\$279,523

18 Representing the Parties:

19 For Appellant: William F. Swearinger, Esq.  
20 For Franchise Tax Board: Irina Iskander Krasavtseva, Tax Counsel

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24 <sup>1</sup> Appellant resides in Los Angeles County, California.

25 <sup>2</sup> This amount does not include interest. In its opening brief, respondent states that appellant submitted a check in the amount  
26 of \$310,000 at the time she filed her appeal, which respondent placed in a suspense account until the appeal is finalized.  
27 (Resp. Opening Br., p. 3, Exhibit Q.) Board records indicate that appellant filed her appeal on August 17, 2008. The Notice  
28 of Action dated July 17, 2008, states that the total additional tax and interest amounts to \$325,188.40 and respondent will  
begin charging interest on any outstanding balance 15 days after the date of the notice. (Appeal Letter, Attachment.)  
Respondent should be prepared to provide the accrued interest amount at the time of the oral hearing.

1 QUESTION: Whether the Franchise Tax Board (FTB or respondent) properly disallowed a  
2 claimed theft deduction on appellant's return for tax year 2003.

3 HEARING SUMMARY

4 Background

5 This appeal arises from appellant losing substantial amounts of money in fraudulent  
6 investment operations originated by William Herisko under the auspices of Global Link Capital  
7 Markets Ltd. ("Global Link"); Herisko acted as chairman and chief executive officer of Global Link.  
8 Specifically, appellant invested \$2,862,482 in Investus Holdings Ltd. ("Investus"),<sup>3</sup> which was a  
9 fictitious business name (i.e. "dba")<sup>4</sup> of Herisko, \$4 million in the Union Bank of Switzerland  
10 ("UBS"), and \$10 million in the United States Resolution Bank and Trust (USRBT), a Native  
11 American bank.<sup>5</sup> The sole issue in this appeal is whether appellant is entitled to claim a theft loss  
12 deduction for tax year 2003 based on the \$4 million she wired to an account at the UBS at the  
13 direction of Global Link and Herisko. According to appellant, all three of these fraudulent investment  
14 operations must be analyzed and discussed in order for her to establish her entitlement to claim the  
15 theft loss deduction at issue.

16 At sometime in 1983, appellant sued Herisko for eviction and back rent. (Resp.  
17 Opening Br., Exhibit A, p. 5.) On January 15, 1985, appellant sued Herisko and his wife for  
18 nonpayment of \$3,500 of monthly rent. (Id. p. 1, fn. 1.)

19 According to an FBI investigator's affidavit, Herisko was the subject of a public  
20 administrative proceeding initiated by the Securities and Exchange Commission (SEC) in 1995 in  
21 which the SEC alleged that Herisko, Kenneth S. Harrison, and Global Link violated the Securities Act  
22 of 1933 by offering investments in prime bank instruments and by making representations and  
23

24 <sup>3</sup> Staff notes that appellant has interchangeably used "Investus" and "Invectus" in its Appeal Letter, Statement of Facts,  
25 Opening Brief, Reply Brief, and Supplemental Brief. For clarity purposes, this hearing summary consistently refers to  
26 "Investus."

27 <sup>4</sup> California Business and Professions Code section 17900, subd. (a)(1) defines "fictitious business name" as follows: "in  
28 the case of an individual, a name that does not include the surname of the individual or a name that suggests the existence  
of additional owners."

<sup>5</sup> According to respondent, USRBT is a business entity but not a licensed bank. (Resp. Reply Br., p. 9.)

1 omissions of material facts to investors concerning these investments. As a result of this public  
2 administrative proceeding, Herisko and Harrison agreed to cease and desist from committing further  
3 such violations. (App. Reply Br., Exhibit 18, ¶ 33; Resp. Reply Br., p. 2.)

#### 4 UBS Scheme

5 In 1998, Mr. Herisko represented to appellant that Global Link had access to a high-  
6 yield exclusive participation trading account with UBS and appellant could purchase this account for  
7 \$4 million and make extraordinary profits. (Appeal Letter, Statement of Facts, p. 4; Resp. Opening  
8 Br., p. 1.) Appellant agreed to the purchase and sent Global Link a copy of her passport, a letter of  
9 intent, a letter stating she had legitimate funds to open the UBS account, and an account application  
10 for UBS. (Appeal Letter, Statement of Facts, p. 4; App. Reply Br., p. 3.) Appellant and Herisko also  
11 executed operating and asset purchase agreements. (Resp. Opening Br., p. 1, exhibit B.) On  
12 August 24, 1998, appellant wired \$4 million from her Citibank account to UBS and received a  
13 confirmation of the wire transfer from Citibank, which lists appellant as the beneficiary of the wire  
14 transfer. (Id. Exhibit C; Appeal Letter, Statement of Facts, p. 5; App. Suppl. Br., p. 1.) The UBS  
15 scheme is the subject of this appeal.

#### 16 Investus Scheme

17 From 1990 to 2002, Herisko induced appellant to fund Investus by sending to Investus  
18 money each month for its purported operating expenses for a total sum of \$2,862,482. (Appeal Letter,  
19 Statement of Facts, pp. 2-3.) As a result of Investus obtaining large deposits for banks and arranging  
20 loans, Herisko promised appellant that she would earn better-than-market interest returns. (*Ibid.*) The  
21 only evidence appellant had to show of her investment in Investus was wire transfer receipts and  
22 monthly written reports from Herisko that described the purported business activities of Herisko and  
23 his associates during the prior month and their expected activity for the future month. (*Id.* at p. 3.) In  
24 2002, appellant discovered that the Investus operation was a scheme and her lawyer informed her that  
25 Herisko was judgment-proof. (*Id.*) The Investus scheme is not the subject of the present appeal.

#### 26 USRBT Scheme

27 In 2001, Herisko induced appellant to invest \$10 million through Global Link with  
28 USRBT. (Appeal Letter, Statement of Facts, p. 3.) Herisko provided appellant with an investment

1 agreement with Global Link. (*Id.* at p. 4.) According to appellant, Herisko made the following  
2 representations to her: 1) appellant would receive a Certificate of Deposit (CD) from USRBT;  
3 2) Global Link was soliciting depositors who would be introduced to USRBT; 3) these depositors  
4 would deposit their funds into USRBT; 4) USRBT would pay a fee to Global Link; 5) Global Link  
5 would introduce clients to the trading of standby letters of credit; and 6) appellant would receive  
6 better-than-market interest on her investment. (*Id.* at pp. 3-4.). Appellant transferred \$10 million  
7 directly to USRBT and received a CD from USRBT. (*Id.* at p. 4.) Appellant received interest  
8 payments from USRBT in 2001. (App. Reply Brief, p. 2.)

9           In 2002, the SEC investigated and filed a complaint against USRBT, Global-Link, and  
10 other defendants, alleging that there was a scheme to defraud investors through the issuance of bank  
11 CDs that had impaired value. (Appeal Letter, Statement of Facts, p. 5; App. Reply Brief, Exhibit 15;  
12 Resp. Reply Br., p. 2.) The SEC appointed a receiver and seized funds from USRBT. (Appeal Letter,  
13 Statement of Facts, p. 5.) Through the receiver, appellant subsequently received more than five  
14 million dollars associated with the \$10 million she deposited with USRBT, and the receiver informed  
15 appellant that additional amounts of money will be distributed. (*Id.*) According to appellant, she  
16 learned of the SEC complaint and recovered USRBT funds in late 2002. (*Id.* App. Opening Br., p. 5.)  
17 Appellant has not yet claimed a theft loss deduction with respect to the USRBT scheme, because she  
18 still expects to recover more funds from the receiver. (Appeal Letter, Statement of Facts, p. 11; App.  
19 Opening Br., p. 5.) The USRBT scheme is not the subject of the present appeal. (Appeal Letter,  
20 Statement of Facts, p. 4.)

21           At appellant's insistence, Herisko personally signed a promissory note dated June 28,  
22 2002, promising to repay appellant \$6,862,482, which consists of the \$4 million appellant wired to  
23 UBS and the \$2,862,482 appellant wired to Investus.<sup>6</sup> (Resp. Opening Br., p. 2, Exhibit E.) On  
24 August 29, 2002, appellant's attorney sent a demand letter to Herisko making a formal demand for the  
25

26 \_\_\_\_\_  
27 <sup>6</sup> In her opening brief, appellant asserts that Herisko signed the promissory note on July 31, 2002. In her Appeal Letter,  
28 Statement of Facts, however, appellant states that in December 2002 she obtained a promissory note from Herisko for the  
UBS and Investus monies. Staff notes that, although the promissory note is dated June 28, 2002, the notary jurat is dated  
July 31, 2002. It therefore appears that Herisko may have signed the promissory note on July 31, 2002.

1 promissory note's principal sum of \$6,862,482 to be paid on November 1, 2002. (Resp. Opening Br.,  
2 p. 2, Exhibit F; App. Opening Br., p. 5.) Appellant and her daughter retained the Arkin Group LLC,  
3 an investigation company, to investigate Herisko.<sup>7</sup> In a memorandum to appellant and her daughter  
4 dated December 13, 2002, The Arkin Group reported its findings regarding Herisko's personal and  
5 professional background and stated that its inquiries regarding the UBS account were still ongoing.  
6 (App. Opening Br., Attachment.) Appellant asked her lawyer to ascertain whether she would recover  
7 any of her money from Herisko. (Appeal Letter, Statement of Facts, p. 6.) In a letter dated  
8 December 19, 2002, appellant's attorney informed appellant that it was not likely that appellant would  
9 ever receive funds from Herisko; he did not specifically mention UBS in his letter.<sup>8</sup> (Appeal Letter,  
10 Statement of Facts, p. 6.; App. Opening Br., p. 4.)

11 On appellant's 2002 return, she claimed a theft loss deduction for \$1,420,955 of the  
12 \$2,862,482 she invested in Investus. (Appeal Letter, Statement of Facts, p. 3; Resp. Opening Br.,  
13 p. 2.) She did not claim a theft loss deduction for the remainder of the amount she invested in Investus  
14 on her 2002 return on the advice of her tax preparer due to proof problems (i.e., lack of substantiation).  
15 (*Id.*)

16 In 2003, Herisko pled guilty in a federal court in Greenville, South Carolina to wire  
17 fraud for participating in a prime bank investment fraud scheme promising potential investors that the  
18 promoter had access to a secret overseas bank trading program sponsored by the Federal Reserve Bank  
19 and overseen by institutions, such as the World Bank and the International Monetary Fund, that  
20 yielded an extremely high rate of return with no risk to the principal. (Appeal Letter, Statement of  
21 Facts, pp. 6-7.) According to appellant, she learned of Herisko's wire fraud conviction in early 2003.  
22 (*Id.* p. 7.)

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24 <sup>7</sup> The Arkin Group's Memorandum dated December 13, 2002, which is addressed to appellant and her daughter, states that  
25 this memorandum is issued pursuant to the parties' retainer agreement of October 14. (App. Opening Br., Attachment.)

26 <sup>8</sup> In a letter dated May 2, 2008, appellant's attorney informed appellant's representative that his December 19, 2002, letter to  
27 appellant was not based on any detailed investigation but rather on his conversation with Herisko in which Herisko stated that  
28 he was willing to sign a promissory note to please appellant but he could not possibly repay the money. (Appeal Letter,  
Statement of Facts, Attachment.)

1 In 2003, appellant retained counsel and on November 5, 2003, she filed a lawsuit  
2 against Herisko in the Los Angeles Superior Court for fraud to recover \$6,862,482, the amount  
3 appellant invested in the Investus and UBS schemes, plus interest. (Resp. Opening Br., p. 2, exhibit  
4 G; Appeal Letter, Statement of Facts, p. 7.) In 2003, after engaging in settlement discussions with  
5 Herisko's attorney, appellant's attorney became convinced that the UBS funds were not likely to be  
6 recovered because Herisko "would not or could not provide information that would lead to the bank  
7 account, or a method to obtain the funds from it." (Appeal Letter, Statement of Facts, p. 7.)

8 On August 11, 2004, appellant filed her 2003 return. (Resp. Opening Br., p. 2, Exhibit  
9 I.) On her federal Schedule D, she claimed a long-term capital loss of \$4 million for worthless notes  
10 of Global Link reportedly purchased on August 24, 1998 and sold on December 31, 2003. (*Id.*) On  
11 line 13a of her federal Form 1040, appellant reported a total net capital loss of \$-3,000 resulting in  
12 federal adjusted gross income (AGI) of \$-26,038. (*Id.*) On her California Form 3805V, appellant  
13 offset \$3,122,177 in nonbusiness capital gains with reported nonbusiness capital losses of \$-4,039,091  
14 resulting in California AGI of \$-56,783 and \$0 tax due. (*Id.*)

15 On October 14, 2004, appellant's attorney deposed Herisko. (Resp. Opening Br.,  
16 Exhibit R.) On May 19, 2005, the court filed a stipulated judgment against Herisko for the total  
17 amount of the lawsuit, plus an annual interest of eight percent. (Appeal Letter, Statement of Facts, p.  
18 7; Resp. Opening Br., p. 2, exhibits D, G.)<sup>9</sup> According to appellant, the judgment remains entirely  
19 unsatisfied. (Appeal Letter, Statement of Facts, p. 7; App. Supp. Brief, p. 2.)

20 In a letter dated October 16, 2006, respondent informed appellant that it was examining  
21 her returns for tax years 2003, 2004, and 2005, and that it would also examine the \$4 million of  
22 worthless notes capital loss she reported on Schedule D of her 2003 return. (Resp. Opening Br., p. 3.)  
23 Respondent's Audit Division subsequently sent appellant several requests for information. (*Id.*)  
24 Appellant provided some information requested in the first request, but did not respond to subsequent  
25 requests. (*Id.* Exhibits K, L.). On April 19, 2007, respondent mailed an Audit Issue Presentation  
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27 <sup>9</sup> In the Appeal Letter, appellant contends that Herisko stipulated to the judgment in 2004. (Appeal Letter, Statement of  
28 Facts, p. 7.)

1 Sheet (AIS) to appellant, in which respondent concluded that the UBS loss of \$4 million should be  
2 reclassified from a worthless notes long-term capital loss to a theft loss deduction and that it should  
3 have been reported on appellant's 2002 return because there was no reasonable prospect of a recovery  
4 of the UBS funds at the end of 2002. (*Id.* p. 3, Exhibit N.)

5 On August 20, 2007, respondent issued an NPA based on the audit. The NPA states  
6 that appellant improperly claimed a capital loss of \$4 million for tax year 2003 and respondent shifted  
7 the loss to 2002 and characterized the deduction as a theft loss under IRC section 165. The NPA  
8 disallows the capital loss deduction of \$3,086,086 and \$3,287 of itemized deductions and increases  
9 appellant's taxable income by \$3,089,373 (\$3,086,086 + \$3,287) from \$-63,140 to \$3,026,233. The  
10 NPA proposes additional tax of \$279,523, plus interest accrued from April 15, 2004, to February 11,  
11 2006. (Appeal Letter, Attachment.)

12 On October 19, 2007, appellant protested the NPA. (Resp. Opening Br., p. 3.) On  
13 May 7, 2008, there was an oral protest hearing. In a letter dated May 28, 2008, the hearing officer  
14 described appellant's position at the protest stage as follows:

15 The loss reported in tax year 2003 should remain as a capital loss in tax  
16 year 2003 since the loss resulted from an uncollectible promissory note  
17 and not a theft. The note had value at the beginning of tax year 2003.  
18 However, the note no longer had any value in March 2003 when the  
Federal Bureau of Investigation indicated the case against the party who  
received the investment would be turned over for criminal investigation.

19 (App. Opening Br., Attachment.) In the May 28, 2008, letter, the hearing officer concluded that the \$4  
20 million loss should be reclassified as a theft loss, which should be changed from a capital loss to an  
21 itemized deduction and shifted to tax year 2002. The hearing officer determined that the facts indicate  
22 no reasonable prospect for recovery of the \$4 million existed after tax year 2002. The hearing officer  
23 noted, however, that such net operating losses were suspended for tax years 2002 and 2003 and then  
24 reinstated in tax year 2004. The hearing officer further noted that none of the theft loss could be used  
25 in tax year 2004, and therefore the loss must be carried over to tax year 2005, and a portion of the loss  
26 could be used in tax year 2005 with the balance carried over to tax year 2006. (*Ibid.*)

27 Respondent issued an NOA dated July 17, 2008, affirming the NPA and imposing  
28 additional interest of \$21,647.49 accrued from September 4, 2007, to July 17, 2008. The NOA states

1 that the facts indicate no reasonable prospect for recovery of the \$4 million loss existed after  
2 December 2002. (Appeal Letter, Attachment.) This timely appeal followed.

### 3 Appellant's Contentions

4 As discussed in greater detail below, appellant argues on appeal that the \$4 million loss  
5 she suffered from the UBS scheme is properly characterized as a theft loss, which she is entitled to  
6 claim as a theft loss deduction for tax year 2003. First, appellant asserts that at the end of 2002 she  
7 still had a reasonable prospect of recovering some or all of the \$4 million she wired to UBS, because  
8 the UBS scheme is similar to the USRBT scheme, and an appointed receiver recovered a portion of  
9 appellant's USRBT funds and indicated that more money would likely be recovered. Furthermore,  
10 appellant argues that tax year 2002 was not the proper tax year for claiming a theft loss deduction for  
11 the UBS scheme because that scheme is fundamentally different from the Investus scheme. Appellant  
12 argues that the Investus scheme only involved Herisko who was deemed to be judgment-proof at the  
13 end of 2002, whereas the UBS scheme involved a Swiss bank and she possessed a wire transfer  
14 confirmation from Citibank showing she wired \$4 million to UBS with herself listed as the sole  
15 beneficiary. Moreover, appellant claims that she simply lacked enough information at the end of 2002  
16 to ascertain whether she might still recover some or all of the UBS investment. Second, appellant  
17 asserts that by the end of 2003 she had no reasonable prospect of recovering some or all of the UBS  
18 funds because in 2003 she discovered that Herisko was convicted in federal court for wire fraud for  
19 participating in a prime bank investment fraud scheme similar to the UBS scheme. Appellant also  
20 argues that the fact that the lawsuit was pending at the end of 2003 is not determinative of the issue on  
21 appeal. According to appellant, she only filed the lawsuit against Herisko in November 2003 as an  
22 "insurance policy" in case he should experience a financial windfall in the future, such as an  
23 inheritance or a successful investment operation. Lastly, appellant argues that the doctrine of judicial  
24 estoppel precludes respondent from arguing the theft loss deduction should not be claimed until after  
25 the lawsuit against Herisko was terminated in 2005, because it argued at the audit stage that the theft  
26 loss deduction should have been claimed in tax year 2002.

### 27 Theft Loss Deduction

28 Appellant contends that she is entitled to claim a \$4 million theft deduction on her 2003

1 return. Appellant contends that at the time she wired \$4 million to UBS in 1998 she believed she was  
2 sending money to an account that would be held in her own name, which would be similar in nature to  
3 the money she later sent for a CD issued by USRBT. (Appeal Letter, Statement of Facts, p. 5.)  
4 Appellant asserts that, in late 2002, she discovered that there was a problem with her investments with  
5 Global Link because the SEC filed suit that year against USRBT, Global Link, Herisko, and others on  
6 charges that there was a scheme to defraud investors with uninsured certificates of deposits from  
7 USRBT. (*Id.* pp. 5-6.)

8 Appellant contends that she deducted the Investus loss on her 2002 tax return because  
9 she learned in 2002 that the funds she placed with Investus were not recoverable, because Herisko,  
10 who was the only individual known to be liable for the Investus loss, was not solvent at that time.  
11 (Appeal Letter, Statement of Facts, p 11; App. Reply Br., p. 2.) She also contends that she has not  
12 taken a deduction on the USRBT loss because the receiver indicated that more money may be  
13 forthcoming to appellant and therefore the amount of loss has not yet been determined. (Appeal  
14 Letter, Statement of Facts, pp. 11-12.) Appellant argues that it was not the inability to collect on the  
15 “worthless promissory note” that triggered her decision to claim a theft loss deduction of \$1,420,955  
16 from the Investus scheme but not claim a theft loss deduction of \$4 million from the UBS scheme on  
17 her 2002 return. Rather, she asserts that she “bifurcated” the Investus loss from the UBS loss because  
18 these losses were “created by two separate and distinct schemes[.]” (App. Opening Br., p. 8.)  
19 Appellant therefore contends that respondent is confused concerning the “bifurcation” of the theft  
20 losses for tax purposes because respondent “has chosen to utilize the worthless promissory note as the  
21 trigger for the casualty/theft loss.” (*Ibid.*) Appellant asserts that she would not have hired The Arkin  
22 Group to investigate Herisko if she already knew she could collect on a judgment against him. (App.  
23 Supp. Br., p. 2.)

24 Appellant contends that she believed at the end of 2002 there was a reasonable prospect  
25 of recovering the \$4 million from the UBS scheme. According to appellant, she initiated her own  
26 investigation with The Arkin Group, because the SEC was not investigating or acting with respect to  
27 the \$4 million UBS account and The Arkin Group’s December 13, 2002 memorandum stated in the  
28 last paragraph that it was still working on the UBS account to determine whether there would be funds

1 available for her from this account.<sup>10</sup> (Appeal Letter, Statement of Facts, p. 6.) With respect to her  
2 attorney's December 19, 2002, letter, appellant contends that her lawyer was only addressing Herisko  
3 personally and the funds appellant paid to Investus, and did not mention the UBS funds, as clarified by  
4 her attorney in his May 2, 2008, letter. (*Ibid.*)

5           Furthermore, appellant argues that the USRBT transaction is a focus of this appeal.  
6 Appellant contends that at the end of 2002 she had a reasonable prospect of recovering the UBS  
7 money because the UBS scheme and the USRBT scheme were factually very similar and there had  
8 been positive developments with respect to the USRBT scheme: 1) she received interest payments  
9 from USRBT in 2001; 2) the federal government recovered some of the embezzled USRBT funds; and  
10 3) she was notified in 2002 that she would likely receive some of her USRBT funds, which at the time  
11 were in the possession of a receiver. (App. Reply Br., p. 2.) Appellant also contends that, at the end  
12 of 2002, she knew that the UBS scheme was similar in character to the USRBT scheme for the  
13 following reasons: 1) she wired money directly to a bank account she believed was established in her  
14 name; and 2) she signed similar documents and received similar correspondence for both schemes.  
15 (*Id.* pp. 2-3.) In her supplemental brief, appellant states, "Although the respondent minimizes the  
16 similarities in the transactions, the fact is that, in a similar transaction, with the same people, appellant  
17 knew, at the end of 2002, that she was getting money back from that scheme." (App. Supp. Br., p. 1.)

18           Appellant contends that, at the end of 2002, she did not have any information regarding  
19 the chance of recovery from UBS and therefore was not in a position to write off the UBS loss. (App.  
20 Reply Br., p. 2.) In addition, appellant contends that at the end of 2002, she had a reasonable prospect  
21 of recovering the UBS money because it is possible for the Swiss banking system to lift the secrecy of  
22 the UBS account information if the Swiss Government were to determine that a crime, such as money  
23 laundering, had been committed. (App. Opening Br., pp. 7-8.) Appellant also contends that at the end  
24 of 2002 she had a reasonable belief that there was some chance she would recover money from the  
25 UBS scheme because she received a wire transfer confirmation from Citibank showing that it wired \$4  
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27 <sup>10</sup> The copy of The Arkin Group's December 13, 2002 memorandum attached to appellant's opening brief consists of five  
28 pages and only the *first* paragraph discussed the UBS account: "Inquiries regarding the Union de Banque Suisse (UBS)  
account into which \$4 million was transferred in 1998 are still ongoing." (App. Opening Br., Attachment.)

1 million from her Citibank account to UBS with herself designated as the beneficiary. (App. Supp. Br.,  
2 p. 1.) Appellant compares the wire transaction in the UBS scheme to the wire transaction in the  
3 USRBT scheme. (*Ibid.*) She further contends that appellant's daughter, Kathleen Johnson, "learned  
4 that appellant would not likely recover any funds from the UBS scheme" as a result of a conversation  
5 she had with an FBI agent on March 6, 2003. (App. Reply Br., p. 2.)

6 Appellant also argues that the Investus transaction is a focus of this appeal. She  
7 contends that she deducted \$1,376,015 of losses she incurred from the Investus scheme on her 2002  
8 return, because she knew at the end of 2002 that she could not recover any funds from Herisko. (App.  
9 Supp. Br., p. 1.) In contrast, because the UBS scheme involved her having wired \$4 million to a  
10 leading bank in Switzerland naming herself as the beneficiary on the wire transfer, appellant asserts  
11 that she knew at the end of 2002 that there was reason to believe the money was on deposit at UBS in  
12 her name. (*Ibid.*)

13 Also, appellant contends that at the end of 2002 she did not have a complete report  
14 from The Arkin Group concerning the UBS bank account and The Arkin Group was not sure whether  
15 funds would become available. (App. Opening Br., p. 7; App. Reply Br., p. 2.) Appellant contends  
16 that at the end of 2002 she reasonably believed that the funds she wired to UBS were deposited into an  
17 account in her own name and her direction to Citibank to note herself as the beneficiary of the wire  
18 transfer order was based on a reasonable, subjective belief that she owned the account. (App. Reply  
19 Br., p. 3.) Appellant asserts that she would have listed Mr. Herisko or Global-Link as beneficiaries if  
20 she believed they were the account holders. (*Id.*) Appellant contends that she first learned of the  
21 criminal indictment and conviction against Herisko in 2003. (*Id.* p. 2.)

22 Appellant asserts that she claimed the theft loss deduction for the UBS loss on her 2003  
23 return because it was in 2003 that she learned with reasonable certainty that the UBS funds were not  
24 recoverable. (Appeal Letter, Statement of Facts, p. 12.) According to appellant, the first time she had  
25 specific objective information that she would not be able to recover her \$4 million from the UBS  
26 scheme was in early 2003 when she learned of Herisko's criminal indictment and conviction in federal  
27 court in South Carolina in a criminal proceeding with allegations very similar to the UBS scheme. (*Id.*  
28 p. 7.) She argues that respondent disallowed the theft deduction because it incorrectly assumes the

1 UBS transaction was a Ponzi scheme and fails to understand that appellant was led to believe she was  
2 wiring money to her own UBS account. (App. Reply Br., pp. 3-4.) She further argues that she is  
3 entitled to claim the theft deduction on her 2003 return because the USRBT and UBS schemes are  
4 similar. (App. Reply Br., p.2.) Appellant states that she did not contest respondent's reclassification  
5 of the UBS money from capital loss deduction to theft loss deduction because she "did not receive  
6 indicia of the investment such as stock or other instrument." (Appeal Letter, Statement of Facts, p. 2.)

7 Appellant asserts the fact that she filed a lawsuit against Herisko has no bearing on the  
8 issues, and there is no merit to respondent's argument that the theft loss deduction should not have  
9 been taken until after the lawsuit against Herisko was terminated with a judgment. Appellant states:

10 This is a novel argument, but it is precluded from consideration here  
11 because the respondent has taken the hard position, via the result of the  
12 audit, that the deduction should have been taken in 2002, and also because  
13 the facts known by the appellant when the lawsuit was filed are more  
inferential that the lawsuit was filed as a back-up measure, in case Herisko  
became solvent in the future, than that she expected to see any money  
from it.

14 (App. Reply Br., p. 5.) Appellant contends that she filed the lawsuit against Herisko in 2003 merely as  
15 a back-up position with the hope that a judgment against Herisko might become collectible in the  
16 future, but at the time she filed the lawsuit she did not have an expectation that it would bring a  
17 recovery of the lost funds. (App. Supp. Br., p. 3.) Appellant states:

18 With such a large sum of money at risk, and the relatively small expense  
19 to obtain a judgment, the lawsuit is more reasonably seen as an insurance  
20 policy in case one of Herisko's schemes did, in the future, bear fruit,  
21 which, sometimes they do, or, at his age, in case he inherited or otherwise  
came into family money, and the judgment was collectible, or, in the  
event he had hidden assets, which he might, given the amount of money  
that appellant had thrown his way over the years.

22 (App. Reply Br., p. 6.) Appellant relies on *Parmelee Transportation Co. v. United States*, (1965 Ct.  
23 Cl.) 351 F.2d 619, for the proposition that the mere existence of a "possible" claim or pending  
24 litigation will not alone postpone loss recognition, because there are many reasons for initiating a  
25 lawsuit and a lawsuit may be completely justified even though there is little chance of recovery. (App.  
26 Suppl. Br., p. 3.)

27 Appellant argues that the *Johnson v. United States* (2006) 74 Fed. Cl. 360 (Johnson) case  
28 relied upon by respondent is factually distinguishable from the facts in this appeal. According to

1 appellant, the taxpayer in *Johnson* filed suit and when making an amended return to claim the theft loss  
2 deduction specifically stated that they expected to recoup \$20 million of the \$78 million stolen from  
3 them. Appellant contends that this indicates the taxpayer identified some fund they could recover. In  
4 contrast, appellant contends that she had no information indicating she could recover any amount of the  
5 UBS money at the time she filed either the tax return or the lawsuit. (App. Supp. Br., p. 2.)

#### 6 Judicial Estoppel

7 In her supplemental brief, appellant argues that the doctrine of judicial estoppel is  
8 appropriate under these circumstances to prevent an abuse of the judicial process resulting from  
9 respondent taking the position in this appeal that the theft loss deduction should not have been taken  
10 until 2005 at the earliest, which is purportedly inconsistent with respondent's position taken at the  
11 protest stage that the theft loss deduction should have been taken in 2002. (App. Suppl.Br., pp. 4-5.)  
12 In support of this argument, appellant relies on *Jogani v. Jogani* (2006) 141 Cal.App.4th 158 and *M.*  
13 *Perez Co., Inc. v. Base Camp Condominiums Assn. No. One* (2003) 111 Cal.App.4th 456 (*M. Perez*  
14 *Co., Inc.*).

#### 15 Respondent's Contentions

16 Respondent contends that appellant filed a lawsuit against Herisko in 2003 with the  
17 hope of recovering all or some of the promissory note amount for the moneys she lost in the Investus  
18 and UBS schemes. (Resp. Opening Br., p. 5; Resp. Reply Br., p. 9.) According to respondent,  
19 because filing of a lawsuit "supplies a strong indication Appellant had a reasonable prospect of  
20 recovering the amount, Appellant is precluded from claiming the deduction until sometime after  
21 termination of the lawsuit." (Resp. Opening Br., p. 5.) Citing *Premji v. Commissioner* (1996) T.C.  
22 Memo 1996-304, respondent asserts, "Where the taxpayer deems the chance of recovery sufficiently  
23 probable to warrant bringing a lawsuit and pursuing it with reasonable diligence to a conclusion, unless  
24 litigation is speculative or without merit, the taxpayer should postpone the loss until the litigation is  
25 terminated." (Resp. Opening Br., p. 4.) Respondent contends, "[H]ad Appellant not filed the lawsuit  
26 in November of 2003 against Herisko in hopes of recovering all or part of the \$4,000,000 from  
27 Herisko sometime in the future and/or had she produced objectively verifiable evidence that, in 2003,  
28 she ascertained with reasonable certainty that no reimbursement would in fact be received, Appellant

1 would be entitled to take the \$4,000,000 theft deduction.” (Resp. Reply Brief, p. 9.)

2 In its reply brief, respondent argues that the United States Claims Court’s decision in  
3 *Johnson, supra*, 74 Fed. Cl. 360, is controlling in this appeal. According to respondent, the court  
4 found that, because the taxpayers did not resolve their lawsuit against the perpetrators by a settlement,  
5 an adjudication, or abandonment until 2005, at which time the parties settled, the court denied the theft  
6 loss deduction for tax year 1998, the year following the discovery of the theft and during which the  
7 taxpayers filed the lawsuit against the perpetrators. (Resp. Reply Br., p. 5.) Respondent contends that  
8 the *Johnson* court clarified that there are two distinct tests with different standards to be applied:  
9 1) “the reasonable prospect of recovery” test, which is used when a taxpayer claims a theft loss  
10 deduction during the year of discovery; and 2) “the ascertain with reasonable certainty” inquiry, which  
11 is used when a taxpayer files a lawsuit for recoupment of the lost money. (*Id.* pp. 5-6 (citing *Johnson*,  
12 74 Fed. Cl. at 365.)) Respondent also contends, “In the absence of facts and circumstances showing  
13 such litigation to be ‘specious, speculative, or wholly without merit and that the taxpayer hence was  
14 not reasonable in waiting to claim the loss as a deduction,’ a taxpayer who feels a chance of recovery  
15 is sufficiently probable to warrant bringing a suit and prosecuting it with reasonable diligence to a  
16 conclusion is normally reasonable in waiting until the termination of the lawsuit prior to claiming the  
17 deduction.” (*Id.* at p. 6 (quoting *Johnson*, 74 Fed. Cl. at 365.))

18 Respondent asserts that appellant, who was advised by an attorney, would not have  
19 filed a lawsuit against Herisko, rather than claim a theft loss deduction, if she thought the amount of  
20 money was not collectable. (Resp. Reply Br., p. 6.) Respondent argues that during 2003 a recovery  
21 from Herisko was a “not-far-fetched possibility;” respondent points to appellant’s statement in her  
22 reply brief that Herisko’s future solvency was not presumptuous because one of his schemes could  
23 become profitable, he could inherent or otherwise obtain family money, or he may have hidden assets.  
24 (*Id.* at p. 7.) Respondent contends that appellant chose to litigate only against Herisko to the exclusion  
25 of his associates or the UBS based on her estimate of Herisko’s financial abilities as a result of her  
26 long-term relationship with him. (*Id.* at 7.) Respondent points out that at no time during 2003 did  
27 appellant settle, adjudicate or abandon the lawsuit. (*Ibid.*) Respondent contends that it is insufficient  
28 for appellant to assert that throughout 2003 she deemed the chance of recovery from Herisko to be

1 speculative. (*Ibid.*) For this reason, respondent argues that appellant has failed to establish during the  
2 2003 tax year she ascertained with reasonable certainty she would receive no reimbursement. (*Ibid.*)  
3 Accordingly, respondent contends that at the end of 2003 appellant had a reasonable prospect of  
4 recovering her UBS investment and therefore should not be allowed a theft loss deduction for 2003.  
5 (*Ibid.*)

6 Because appellant did not claim a theft loss deduction for the UBS money on her 2002  
7 return, respondent contends that the information appellant received in 2002 from The Arkin Group and  
8 her attorney apparently did not influence her into concluding she could not recover the UBS money.  
9 (Resp. Reply Br., p. 7.) Respondent also contends that appellant “remained somewhat confident” that  
10 she would recover the \$4 million, as evident from the fact that in January 2003 appellant transferred  
11 her interest in the UBS account to her trust. (*Id.* p. 7.) Respondent further contends that there is no  
12 evidence appellant ever contacted UBS to ascertain if the bank could trace the funds or whether the  
13 funds were recoverable by any means, or took any affirmative action directed at attempting to the  
14 collect the funds from UBS or to support her belief that she could recover the funds from UBS at any  
15 time.

16 Respondent argues there is no merit in appellant’s argument that she is entitled to claim  
17 a theft loss deduction for the UBS money because the UBS scheme is very similar to the USRBT  
18 scheme, and the USRBT transaction should not be relied upon in determining whether appellant is  
19 entitled to claim a \$4 million theft deduction in 2003 for the UBS money. (Resp. Reply Br., p. 8.) (*Id.*  
20 p. 8.) Respondent contends that the USRBT transaction is not a focus of the present appeal and its  
21 “determination is not conditioned on the similarity or difference of the UBS transaction with either the  
22 USRBT or any other transaction.” (*Ibid.*) According to respondent, appellant did not treat the UBS  
23 transaction and the USRBT transactions similarly in tax years 2002 and 2003, as evident from the  
24 following: 1) appellant did not include the USRBT amount in the promissory note she secured from  
25 Herisko in June 2002; 2) she never attempted to collect from or secure a judgment against Herisko for  
26 any portion of the money she invested in USRBT; 3) appellant originally claimed a long-term capital  
27 loss of \$4 million on her 2003 return, effectively offsetting \$3,083,086 in realized capital gains, rather  
28 than claim a theft loss deduction for any portion of the UBS money. (*Id.* p. 9.) Furthermore,

1 respondent argues that there are significant differences between the UBS transaction and the USRTB  
2 transaction, which suggest that appellant herself did not view the two transactions “so similar as to  
3 afford them a similar treatment,” including the following: 1) UBS is a Swiss bank subject to Swiss  
4 laws that protects financial privacy of depositors, whereas USRBT, which is not licensed as a bank,  
5 was a business entity subject to the laws of the United States; 2) appellant received a CD after  
6 transferring \$10 million to USRBT, whereas appellant has no evidence after wiring \$4 million to UBS  
7 that she or a third party opened an account in her name at UBS; 3) the SEC brought an action against  
8 USRBT and its affiliates and a receiver was appointed to track and distribute any remaining funds to  
9 the victims, whereas no agency has investigated or brought an action against UBS with respect to the  
10 \$4 million appellant wired to UBS; and 4) appellant filed a lawsuit against Herisko to recover the UBS  
11 money without including any part of the funds she deposited with USRBT and did not attempt to  
12 secure a promissory note from Herisko for any amount of the USRBT amount. (*Id.* at pp. 9-10.)

13           Respondent argues there is no reasonable basis for appellant’s argument that in 2002  
14 she thought that she had a claim for reimbursement of the \$4 million from UBS, because there is no  
15 evidence appellant ever had any proprietary or legal rights in the UBS account in which she wired \$4  
16 million. (Resp. Opening Br., p. 5.) Respondent asserts there is no evidence showing appellant had a  
17 UBS account in her name, she wired the money to her own UBS account, or she instructed UBS to  
18 transfer the amount from her own UBS account to a third-party account. (*Ibid.*) Respondent further  
19 argues that appellant has failed to explain the legal significance of her belief that she was the  
20 beneficiary of the \$4 million she wired to UBS. (*Id.*, pp. 5-6.) Moreover, respondent contends that  
21 appellant has failed to submit any evidence showing she ever contacted UBS to inquire about whether  
22 UBS could trace the \$4 million or whether the \$4 million could be recovered by any means. (*Id.* p. 6.)  
23 Similarly, respondent contends that appellant has not provided any evidence of affirmative action on  
24 her part directed at attempting to collect the \$4 million from UBS or evidence that supported her belief  
25 she could at any time recover the \$4 million from UBS. (*Ibid.*) Without establishing she has any legal  
26 rights to a UBS account, respondent argues that any argument regarding appellant’s prospect of a  
27 recovery from UBS is irrelevant. (*Ibid.*) Respondent contends that, assuming this Board concludes  
28 the UBS transaction and the USRBT transactions are similar or that appellant’s subjective belief she

1 had a claim against UBS at any time was reasonable, such a conclusion would not “counterbalance”  
2 respondent’s determination that appellant has not provided any objectively verifiable evidence that in  
3 2003 she ascertained with reasonable certainty that she would not receive the \$4 million she wired to  
4 UBS. (Resp. Reply Br., p. 10.)

5 Respondent does not discuss the doctrine of judicial estoppel in its opening brief or  
6 reply brief. Appellant raised this argument for the first time in her supplemental brief.

#### 7 Applicable Law

8 Income tax deductions are a matter of legislative grace, and the burden is on the  
9 taxpayer to show by competent evidence that she is entitled to any deductions claimed. (*New Colonial*  
10 *Ice Co. v. Helvering* (1934) 292 U.S. 435; *Appeal of James C. and Monablanch A. Walshe*, 75-SBE-  
11 073, Oct. 20, 1975.) In order to carry that burden, appellant must point to an applicable statute and  
12 show by credible evidence that she comes within its terms. (*Appeal of Robert R. Telles*, 86-SBE-061,  
13 Mar. 4, 1986.) Unsubstantiated assertions are insufficient to satisfy the burden of proof. (*Id.*) The  
14 fact that it may be difficult, if not impossible, for the taxpayer to substantiate any claimed deduction  
15 does not relieve her of this burden. (*Burnet v. Houston* (1931) 283 U.S. 223; *Appeal of Wing Edwin*  
16 *and Faye Lew*, 73-SBE-053, Sept. 17, 1973.) Further, there is a presumption of correctness as to  
17 respondent’s denial of deductions. (*Appeal of Gilbert W. Janke*, 80-SBE-059, May 21, 1980; *Todd v.*  
18 *McColgan* (1949) 89 Cal.App.2d 509.)

19 R&TC section 17201 incorporates by reference Internal Revenue Code (IRC) section  
20 165, except as otherwise provided. IRC section 165(a) allows individuals to claim as a deduction “any  
21 loss sustained during the taxable year and not compensated for by insurance or otherwise.” Under IRC  
22 section 165(c), such a loss includes “losses of property not connected with a trade or business or a  
23 transaction entered into for profit, if such losses arise from . . . theft.”<sup>11</sup> (Int.Rev. Code, § 165(c)(3).)

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26 <sup>11</sup> Whether acts constitute “theft” for purposes of the theft loss deduction must be determined under the law of the  
27 jurisdiction where the loss was sustained. (*Edwards v. Bromberg* (5th Cir. 1956) 232 F.2d 107; *Riet v. Commissioner*, T.C.  
28 Memo. 1989-494.) California Penal Code section 484, subdivision (a), defines theft to include obtaining money by false  
pretenses and section 503 defines embezzlement as “the fraudulent appropriation of property by a person to whom it has  
been entrusted.” (See also Treas. Reg. § 1.165-8(d) (defining theft broadly to include, but not necessarily be limited to,  
larceny, embezzlement, and robbery).)

1 Theft losses are "treated as sustained during the taxable year in which the taxpayer discovers such  
2 loss." (Int.Rev. Code, § 165(e).) However, in order for a theft loss deduction to be allowed, the loss  
3 must be evidenced by a closed and completed transaction. (Treas. Reg. § 1.165-1(b).) Under the  
4 "closed transaction" doctrine, an essential inquiry is whether the taxpayer had a claim for  
5 reimbursement with respect to which there was a reasonable prospect of recovery. (*Dawn v.*  
6 *Commissioner* (9<sup>th</sup> Cir. 1982) 675 F.2d 1077, 1078 (citing *Ramsay Scarlett & Co. v. Commissioner*,  
7 (1974) 61 T.C. 795, 807, aff'd (4th Cir. 1975) 521 F.2d 786.) "When such a claim exists, no portion  
8 of the loss with respect to which reimbursement might be received is sustained until it becomes  
9 reasonably certain that reimbursement will not be received." (*Ibid.* citing Treas. Reg. § 1.165-  
10 1(d)(2)(i).) The treasury regulations explain:

11 Any loss arising from theft shall be treated as sustained during the taxable  
12 year in which the taxpayer discovers the loss . . . . However, if in the year  
13 of discovery there exists a claim for reimbursement with respect to which  
14 there is a reasonable prospect of recovery, no portion of the loss with  
15 respect to which reimbursement may be received is sustained, for purposes  
16 of [the theft loss deduction] . . . , until the taxable year in which it can be  
17 ascertained with reasonable certainty whether or not such reimbursement  
18 will be received.

19 (Treas. Reg. § 1.165-1(d)(3); see also Treas. Reg., § 1.165-8.) Additionally, the treasury regulations  
20 provide:

21 Whether a reasonable prospect of recovery exists with respect to a claim  
22 for reimbursement of a loss is a question of fact to be determined upon an  
23 examination of all facts and circumstances. Whether or not such  
24 reimbursement will be received may be ascertained with reasonable  
25 certainty, for example, by a settlement of the claim, by an adjudication of  
26 the claim, or by an abandonment of the claim. When a taxpayer claims  
27 that the taxable year in which a loss is sustained is fixed by his  
28 abandonment of the claim for reimbursement, he must be able to produce  
objective evidence of his having abandoned the claim, such as the  
execution of a release.

(Treas. Reg., § 1.165-1(d)(2)(i).)

"Determining whether taxpayers had a claim for reimbursement that provided a  
reasonable prospect for recovery is an objective inquiry requiring an examination of the facts and  
circumstances surrounding the deduction." (*Dawn v. Commissioner, supra*, 675 F.2d at 1078 (citation  
omitted).) Although a taxpayer's subjective belief as to whether there was a reasonable prospect of  
recovery is a factor to consider, the standard to be applied is an objective one. (*Jeppsen v.*

1 *Commissioner* (10th Cir. 1997) 128 F.3d 1410, 1418.) See also *Boehm v. Commissioner* (1945) 326  
2 U.S. 287, 292-293 (the standard to be applied is primarily objective, but the taxpayer's subjective  
3 attitude and conduct are not to be ignored.) Where a taxpayer files a lawsuit to recover the deducted  
4 loss there is an inference that the taxpayer had a claim for reimbursement that provided a reasonable  
5 prospect of recovery. (*Dawn v. Commissioner, supra*, 675 F.2d at 1078. The determination of  
6 whether a reasonable prospect of recovery exists as of the end of the tax year is a question of foresight,  
7 not hindsight. (*Jeppsen v. Commissioner, supra*, 128 F.3d at 1416.) Hence, "a taxpayer's ultimate  
8 recovery does not *control* whether, at the end of a taxable year, that taxpayer enjoyed a reasonable  
9 prospect of recovering property stolen during that taxable year." (*Id.* at 1415.) Lawsuits filed after the  
10 close of a tax year for which the theft loss deduction was claimed may be considered in determining  
11 whether the taxpayer had a reasonable prospect of recovery so long as the taxpayer contemplated filing  
12 the lawsuit during the tax year. (*Id.* at 1418.) Furthermore, if a taxpayer's prospect of recovery was  
13 simply unknowable at the end of the tax year at issue, then the taxpayer will not be entitled to take the  
14 theft loss deduction that year. (*Ibid.*)

15 Treasury Regulation section 1.165-1(d)(3) further explains that "if in the year of  
16 discovery there exists a claim for reimbursement with respect to which there is a reasonable prospect  
17 of recovery, no portion of the loss with respect to which reimbursement may be received is sustained,  
18 for purposes of section 165, until the taxable year in which it can be ascertained with reasonable  
19 certainty whether or not such reimbursement will be received." (See also Treas. Reg., § 1.165-8.)

#### 20 Judicial Estoppel

21 The doctrine of judicial estoppel "prevents a party from asserting inconsistent positions  
22 in separate judicial proceedings. (*Jackson v. County of Los Angeles* (1997) 60 Cal.App.4th 171, 181  
23 (hereafter *Jackson*)). The doctrine of judicial estoppel is an equitable doctrine whose purpose to  
24 prevent fraud on the courts. (*M. Perez Co., Inc.*, 111 Cal.App.4th at p. 469. (Citations omitted).) "It  
25 'is an extraordinary remedy that should be applied with caution.'" (*Ibid.*) Unlike collateral estoppel or  
26 equitable estoppel, judicial estoppel focuses on the relationship between the litigant and the judicial  
27 system and not on the relationship of the parties. (*Jackson*, 60 Cal.App.4th at 183.) Unlike the  
28 doctrine of equitable estoppel, judicial estoppel does not require privity, reliance, and prejudice.

1 (*Ibid.*) “The gravamen of judicial estoppel . . . is the intentional assertion of an inconsistent position  
2 that perverts the judicial machinery.” (*Ibid.*) Judicial estoppel applies generally “to statements made  
3 under oath in judicial proceedings, and does not apply where the prior statement is merely an  
4 expression of opinion or legal conclusion.” (*United States v. Siegel* (N.D. Ill. 1979) 472 F.Supp. 440,  
5 442, fn. 4 (citing *United States v. Certain Land and Interests in Property*, 225 F. Supp. 338, 341  
6 (M.D.Tenn., 1964). See also Comment, *The Judiciary Says, You Can’t Have It Both Ways: Judicial*  
7 *Estoppel - A Doctrine Precluding Inconsistent Positions* (1996) 30 Loy. L.A. L. Rev. 323,327  
8 (Judicial estoppel only applies when a party is asserting a matter of fact, not law); Comment,  
9 *Precluding Inconsistent Statements: The Doctrine of Judicial Estoppel* (1986) 80 Nw. U.L. Rev 1244,  
10 1244 fn.1 (hereafter *Precluding Inconsistent Statements*) (The term "position" is used in this Comment  
11 to refer to sworn testimonial representations, sworn testimony, and positions asserted that, although  
12 not technically under oath, nevertheless were intended to be accepted by a court as true.)) “Reliance is  
13 not a factor because *any* inconsistent statement violates *the sanctity of the oath* and injures the  
14 integrity of the judicial process, whether or not some party relied on the first statement.” (*Precluding*  
15 *Inconsistent Statements*, p. 1249 (emphasis added).) In *Allen v. Zurich Insurance Co.* (4th Cir. 1982)  
16 667 F.2d 1162, 1167, the court explained the doctrine of judicial estoppel as follows:

17 Its essential function and justification is to prevent the use of "intentional  
18 self-contradiction . . . as a means of obtaining unfair advantage in a forum  
19 provided for suitors seeking justice." [citation] This obviously  
20 contemplates something other than the permissible practice, now freely  
21 allowed, of simultaneously advancing in the same action inconsistent  
22 claims or defenses which can then, under appropriate judicial control, be  
23 evaluated as such by the same tribunal, thus allowing an internally  
24 consistent final decision to be reached. See Fed.R.Civ.P. 8(e)(2).

25 Judicial estoppel is applicable when: (1) the same party has taken two positions;  
26 (2) those positions were taken in judicial or quasi-judicial administrative proceedings; (3) the party  
27 was successful in asserting the first position, *i.e.* the tribunal adopted the position or accepted it as  
28 true; (4) the two positions are totally inconsistent; and (5) the first position was not taken as a result of  
ignorance, fraud or mistake. (*Jackson*, 60 Cal.App.4th at 183. See also *The Swahn Group, Inc. v.*  
*Malcolm S. Segal* (April 7, 2010, C056970) \_\_ Cal.App.4<sup>th</sup> \_\_ [2010 Cal.App. Lexis 480, pp. 16-17].)  
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1 STAFF COMMENTS

2 Theft Loss Deduction

3 Appellant bears the burden of proving she is entitled to claim a theft loss deduction for  
4 her loss of \$4 million from the UBS scheme on her 2003 return. On appeal, there is no dispute that the  
5 reported long-term capital loss of worthless notes in the amount of \$3,086,086 constitutes a "theft,"  
6 and that appellant's loss therefore qualifies as a "theft loss" within the meaning of IRC section 165.  
7 (Resp. Opening Br., p. 3; Resp. Reply Br., p. 4.) The issue before the Board is whether appellant's  
8 theft loss was "sustained" during tax year 2003. Even though the theft occurred prior to 2003 and  
9 appellant discovered the theft prior to 2003, appellant has the burden of establishing that as of the end  
10 of 2003 there was no reasonable prospect of recovery of the \$4 million she transferred to UBS at the  
11 behest of Herisko. (Treas. Reg., §§ 1.165-1(d)(2)(i), 1.165-1(d)(3); accord Treas. Reg. § 1.165-  
12 8(a)(2).) Staff notes that Treasury Regulation section 1.165-1(d)(2)(i) requires appellant to produce  
13 objective evidence of having abandoned the claim for reimbursement of the \$4 million, such as the  
14 execution of a release. In the event that appellant has such objective evidence relative to tax year  
15 2003, she should submit it to the Board and respondent at least 14 days prior to the hearing date.<sup>12</sup>

16 The parties should also be prepared to discuss whether based on all of the facts and  
17 circumstances appellant has established that she had no reasonable prospect of recovering the \$4  
18 million *as of December 31, 2003*, notwithstanding the fact that she filed her lawsuit against Mr.  
19 Herisko in November 2003, it was still pending at the end of 2003, appellant's attorney deposed  
20 Herisko on October 14, 2004, and the judgment was not filed until 2005. It appears to staff that the  
21 courts have held that pending litigation is a strong factor to consider, but is not dispositive of the issue  
22 of whether the taxpayer had a reasonable prospect of recovering the amount in the year at issue.  
23 Respondent, however, appears to argue that appellant is not entitled to claim the theft loss of the \$4  
24 million arising from the UBS scheme in 2003 for the simple reason that at the end of 2003 appellant  
25 had pending litigation against Herisko involving the UBS scheme. In its reply brief, respondent states  
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28 <sup>12</sup> Exhibits should be submitted to: Claudia Madrigal, Board Proceedings Division, Board of Equalization. P. O. Box 942879 MIC: 80,  
Sacramento, CA 94279-0080.

1 that filing of a lawsuit “supplies a strong indication appellant had a reasonable prospect of recovering  
2 the amount, Appellant is precluded from claiming the deduction until sometime after termination of  
3 the lawsuit.” (Resp. Opening Br., p. 5.)

4           The parties should also be prepared to discuss whether the analysis in *Johnson, supra*, 74  
5 Fed. Cl. 360, is controlling in this appeal. The court in *Johnson* held that when a taxpayer discovers a  
6 theft in one year for which she elects to pursue in a subsequent year a claim for reimbursement for  
7 which there was a reasonable prospect of recovery, the issue for purposes of the theft loss deduction is  
8 whether the taxpayer ascertained with reasonable certainty in that subsequent year whether or not  
9 reimbursement would be received. The *Johnson* court held that under Treasury Regulation section  
10 1.165-1(d), the requirement that a taxpayer “ascertain with reasonable certainty” means that a taxpayer  
11 must obtain a verifiable determination of the amount she will receive based on a resolution of the  
12 reimbursement claim before taking a theft loss deduction. (74 Fed. Cl. at p. 365.) By distinguishing  
13 situations where the taxpayer claims the deduction in the year of discovery from situations where the  
14 taxpayer claims the deduction in subsequent years, it appears the *Johnson* court is simply reiterating the  
15 language of Treasury Regulation 1.165-1(d)(3), which states, “[I]f in the year of discovery there exists a  
16 claim for reimbursement with respect to which there is a reasonable prospect of recovery, no portion of  
17 the loss with respect to which reimbursement may be received is sustained, for purposes of section 165,  
18 until the taxable year in which it can be ascertained with reasonable certainty whether or not such  
19 reimbursement will be received.” Staff notes that appellant argues that *Johnson* does not apply because  
20 it is factually distinguishable.

21           It is unclear to staff why the NPA disallows the capital loss deduction of \$3,086,086  
22 and itemized deductions in the amount of \$3,287 while stating that appellant improperly claimed a  
23 capital loss of \$4 million for tax year 2003. (Appeal Letter, Attachment.) Staff notes that the two  
24 items do not amount to \$4 million. Respondent should be prepared to discuss at the hearing how it  
25 arrived at the disallowed amounts set forth in the NPA. Appellant should also be prepared to discuss  
26 whether it is seeking to claim a theft loss deduction for exactly \$4 million on her 2003 return.

#### 27           Judicial Estoppel

28           With respect to appellant’s judicial estoppel argument, the parties should be prepared to

1 discuss at the hearing whether the facts here satisfy all the elements of the doctrine of judicial  
2 estoppel. The parties should also be prepared to discuss whether respondent could even be deemed to  
3 be *an advocate* that successfully asserted *before itself* in the oral protest hearing a position that is  
4 inconsistent with the position it has taken on appeal before this Board, which is an independent  
5 agency. (See *State Water Resources Central Board Cases* (2006) 136 Cal.App.4th 674, 827 (“[E]ven  
6 if the Board could be deemed to be an advocate that asserted in the proceedings before itself [a  
7 purported position], the Board *as advocate* plainly was not successful in asserting that position  
8 because the Board *as tribunal* did not adopt that position or accept it as true.”) (Emphasis added).)

9 Appellant is requesting the Board to apply the doctrine of judicial estoppel to prevent  
10 respondent from arguing on appeal that appellant was not entitled to claim a theft loss deduction of \$4  
11 million until tax year 2005 at the earliest, because respondent argued at the protest stage that the theft  
12 loss deduction should have been claimed for tax year 2002. It appears to staff that the doctrine of  
13 judicial estoppel does not apply to inconsistent legal arguments, such as respondent purportedly  
14 changing its reasons for disallowing a theft loss deduction of \$4 million in tax year 2003. Appellant  
15 argues that there was no indication at the audit phase that respondent would take this position and no  
16 evidence responsive to this position were requested by or provided to the auditor. Appellant further  
17 argues, “It is unfair, at this late date after the facts have been submitted to the auditor, for the  
18 respondent to now assert a factual scenario that appellant has not had the opportunity to properly  
19 address at the fact-finding stage.” It appears to staff that appellant’s detrimental reliance argument is  
20 misplaced, because there is no reliance element in the doctrine of judicial estoppel, unlike the doctrine  
21 of equitable estoppel. Instead, judicial estoppel focuses on the relationship between the litigant (i.e.,  
22 respondent) and the judicial system. Accordingly, appellant must show that respondent has made “an  
23 intentional assertion of an inconsistent position that perverts the judicial machinery.” (*Jackson, supra*,  
24 60 Cal.App. 4th at 183.)

25 While appellant argues that respondent should be precluded by the doctrine of judicial  
26 estoppel from assuming a position on appeal different than that at the oral protest hearing, staff notes  
27 that appellant apparently changed her position on appeal from that which she argued at the oral protest  
28 hearing. According to the hearing officer’s May 28, 2008 letter, appellant argued at the oral protest

1 hearing that the loss she reported on her 2003 return should remain as a capital loss in tax year 2003  
2 because the loss resulted from an uncollectible promissory note and not a theft. On appeal, appellant  
3 argues that she is entitled to claim a theft loss in 2003 and the loss did not occur in 2002 when it  
4 became apparent to appellant that the promissory note was uncollectible. It would thus appear that  
5 both parties have taken on new positions on appeal.

6 Appellant was on notice after respondent filed its opening brief that it was arguing the  
7 theft loss could not be taken until after the termination of the lawsuit in 2005. Appellant had the  
8 opportunity to submit any additional documentation or arguments to refute respondent's position on  
9 appeal when she filed her reply and supplemental briefs. If appellant still wishes to submit any  
10 supporting documentation, she may provide copies to respondent and the Board no less than 14 days  
11 prior to the hearing. Appellant should be prepared to discuss how respondent perpetrated a  
12 miscarriage of justice on the Board by purportedly changing its legal argument from the audit stage to  
13 the appeal stage, which would justify such an extraordinary equitable remedy as judicial estoppel.

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