

STATE OF WISCONSIN
TAX APPEALS COMMISSION

JANICE J. KUHN
N5055 County Road J
Tigerton, WI 54486,

DOCKET NO. 01-I-70

Petitioner,

vs.

DECISION AND ORDER

WISCONSIN DEPARTMENT OF REVENUE
P.O. Box 8907
Madison, WI 53708,

Respondent.

DON M. MILLIS, COMMISSION CHAIRPERSON:

This matter came before the Commission for trial on January 13, 2004, in Wausau. Petitioner has filed a post-hearing submission. Respondent's closing argument on the record constituted its post-hearing submission. Petitioner appears *pro se*. Respondent appears by Attorney Michael J. Buchanan.

Based upon the evidence received at trial, the submissions of the parties, and the entire record in this matter, the Commission hereby makes the following findings of fact, conclusions of law, and order.

FINDINGS OF FACT

1. Petitioner has been president of Milwaukee Auction Galleries, Ltd. ("MAG"), since its incorporation in 1977.

2. At some point prior to 1988, petitioner became the sole shareholder of MAG as the result of one or more gifts of MAG stock.

3. MAG was in the business of selling property on consignment.

4. In 1988 and 1989, there were instances when MAG sold items but lacked sufficient funds to remit proceeds to the owners of the property sold. Some of the owners complained to the authorities.¹

5. On February 5, 1990, petitioner was charged in Milwaukee County Circuit Court with seven felony counts of theft by bailee contrary to section 943.20(1)(b) of the Statutes.

6. Following a trial to the court, petitioner was found guilty on four felony counts on May 20, 1991.

7. On July 26, 1991, the Circuit Court imposed, but stayed, a series of two-year sentences on each count running concurrently. In addition, the court imposed seven years of probation and directed petitioner to pay \$182,004.27 in restitution.

8. On her Wisconsin income tax returns for 1995 through 1998, petitioner subtracted from her income the following amounts as losses:

- A. 1995: \$180,658.64
- B. 1996: \$ 508,112.00
- C. 1997: \$ 491,427.20
- D. 1998: \$ 491,427.20

¹ Petitioner asserts that she and MAG are the victims of embezzlement by MAG's accountants. The Commission makes no finding on this point because it is not relevant to the outcome of the issues raised.

9. The amount claimed in 1995 represents petitioner's calculation of the amount of restitution imposed by the Milwaukee County Circuit Court, less amounts already paid. The amounts claimed by petitioner in the remaining years are based upon petitioner's calculation of MAG's losses due to embezzlement in 1988 and 1989 as carried forward.²

10. Neither MAG nor petitioner actually suffered any losses during the years at issue.

11. Petitioner has instituted a number of lawsuits in recent years trying to recover losses on her behalf and on behalf of MAG. Petitioner believes that there is a possibility that she will recover some or all of these losses.

12. On December 27, 1999, respondent issued an income tax assessment against petitioner in the principal amount of \$2,349, plus \$733.50 in interest, for years 1995 through 1998. Respondent denied petitioner's claimed deductions from income.³

13. Petitioner filed a timely petition for redetermination. On February 23, 2001, respondent denied the petition for redetermination.

CONCLUSIONS OF LAW

1. The loss claimed for 1995 is not allowable, because a restitution order is not eligible as a loss and it did not occur in 1995.

² The amount claimed for 1997 is within \$50 of the amount claimed in 1996, less petitioner's income for 1996. Petitioner apparently made no similar adjustment for 1998.

³ Respondent's Office Audit Worksheet showed the denial of these losses by adding back the amount of the claimed loss as "embezzlement/theft income." In fact, the assessment did not seek to impose Wisconsin income tax on embezzlement or theft income. The effect of the assessment was to impose the income tax on the income petitioner reported in each year without deduction for the claimed losses.

2. The losses claimed for 1996 through 1998 are not allowable, because (1) petitioner is not entitled to deduct losses suffered by MAG, a separate corporate entity, (2) petitioner asserts there is a possibility she will recover funds from others who are responsible for MAG's losses, and (3) because such losses are deductible in the year in which they are discovered.

OPINION

Deductions are matters of legislative grace, and petitioner must demonstrate to the Commission that she has brought herself clearly within the terms of the deduction. *Department of Revenue v. Greiling*, 112 Wis. 2d 602, 605 (1983); *Ramrod, Inc. v. Dep't of Revenue*, 64 Wis. 2d 499, 504 (1974). For the reasons explained below, we conclude that petitioner has not shown that she is entitled to deductions for the losses at issue.

Tax Year 1995

With respect to 1995, petitioner sought to deduct as a loss the amount of the restitution order she claimed was due and owing as of that year. Section 165(a) of the Internal Revenue Code allows a loss as a deduction only if it was sustained during the year in which it is claimed. The restitution order was imposed in 1991.

More importantly, there is no provision that considers the mere imposition of a restitution order as a loss. It is true that an embezzler may be able to deduct as a loss amounts of restitution actually paid, but only if the amount initially embezzled was actually included in the embezzler's income. *See, generally, Morrison v. Commissioner*, 42 TCM 1514 (1981); *Norman v. Commissioner*, 407 F. 2d 1337, 69-1 USTC ¶9245 (3rd Cir. 1969). Not only were the amounts at issue in petitioner's criminal proceeding not included in her

income, the record does not indicate how much, if any, of the restitution was paid in 1995. Therefore, petitioner has not shown that she is entitled to a deduction for loss in 1995.

Tax Years 1996 through 1998

The losses claimed for the remaining years at issue are based on the losses experienced by MAG. Losses of a corporation are not deductible by a shareholder. *Evans v. Commissioner*, 557 F. 2d 1095, 77-2 USTC ¶ 9596 (5th Cir. 1977). This rule applies to losses by a corporation due to theft. *Malik v. Commissioner*, 69 TCM 2566 (1995). Thus, MAG—not petitioner—is the only taxpayer who may claim a loss.

No portion of a theft loss may be claimed as a loss as long as there exists a reasonable prospect of recovery. Treas. Regs. §§ 1.165-1(d)(2); 1.165-8(a)(2). Petitioner maintains hope that MAG will obtain recovery of these theft losses. Therefore, even if petitioner were able to claim these losses on behalf of MAG, they are not properly deductible as long as there exists a reasonable prospect of recovery.

Section 165(e) of the Internal Revenue Code provides that theft losses are deductible in the year in which they are discovered. MAG's theft losses were discovered no later than 1990.⁴

For these reasons, there is no basis to allow the losses claimed for 1996 through 1998.

⁴ While it is true that MAG's theft losses might be carried forward, the record contains no information on how these losses were treated in the years between the year in which they were discovered and the years at issue. Moreover, as stated above, these losses are MAG's losses, not petitioner's losses.

ORDER

Respondent's action on the petition for redetermination is affirmed.

Dated at Madison, Wisconsin, this 23rd day of June, 2004.

WISCONSIN TAX APPEALS COMMISSION

Don M. Millis, Commission Chairperson

Jennifer E. Nashold, Commissioner

ATTACHMENT: "NOTICE OF APPEAL INFORMATION"