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Reliance by a Foolish Victim of an Absurd Fraud is Still Theft

Cross References

- *Leslie,* T.C. Memo. 2016-171, September 14, 2016

The taxpayer met Eugene McCullough at a local swap meet. McCullough sold golf clubs and accessories. They became friends and he told her about an old friend of his named Lawyer Stanley who he knew from his days in the Navy. He explained that Stanley had a troubled past, but had since gotten into the diamond business and seemed to be doing very well for himself. The taxpayer decided she would like a small pair of earrings. McCullough reached out to Stanley on behalf of the taxpayer to purchase the earrings, but Stanley only did wholesale.

A few weeks later, Stanley contacted McCullough and said he had an offer the taxpayer might be interested in. For the right initial investment, Stanley would give the taxpayer $1 million once the diamonds were in hand and then resold.

The taxpayer took the bait. No contract was signed because she trusted McCullough, and it was only supposed to take 10 to 30 days for her to see a return on her investment. She wired a first payment of $320,000 to an entity named Africa World Trade, LLC. A few days later, Stanley began emailing McCullough exclaiming that the taxpayer could make millions and that if she would keep providing capital, she could own her own bank. Giving into the sense of urgency projected by Stanley's emails, the taxpayer wired him an additional $60,000.

Stanley's excuses for delay began. First, it was some bank's standing in the way of Stanley's payment to the taxpayer, then it was delays because of the Christmas holidays, and finally Stanley wrote McCullough another email explaining that the inland revenue taxes was the last obstacle. They raised it 1.0025% and that he needed additional funds. So the taxpayer wired another $25,000 to Stanley.

The court said in its ruling that this was all of course just a scam of the same kind anyone with an email address has encountered since the opening of the internet. And it played out just as one would expect. More delays followed by more excuses followed by more delays.

The taxpayer finally became leery of her newfound business partner 74 days after her initial investment. She emailed McCullough and Stanley to complain about Stanley's over the top delays but received one last excuse. Stanley needed to get a probate document for some reason or another before he could make the deal go through. The scales cascaded from the taxpayer's eyes and she threatened to call the police. There was still no progress, only more stalling. Stanley upped his game from deceit to outright forgery by creating and sending to her documents from something called the Foreign Credit Commission (FCC), but the number shown on the documents was false. Stanley then blamed the taxpayer for causing more delay by contacting this FCC.

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The taxpayer finally realized she had been duped. Stanley wasn't answering emails or telephone calls. McCullough spoke with several authorities on the taxpayer's behalf. He contacted the FBI and the district attorney and even reached out to Congress, all to no avail. The taxpayer personally called the local police in Florida near an address Stanley had given, and asked them to do a welfare visit to Stanley's home, but he'd already skipped town. She spoke with two lawyers but they laughed her out of the room and advised that she shouldn't spend any more good money chasing bad. All that was left was a collection of emails between Stanley and her detailing the course of the transactions from the past year. She never filed suit or made any other claim against Stanley because she simply couldn't even find him. Seeing no other way to benefit from this debacle, she deducted the $405,000 on her tax return as a theft loss.

The IRS disallowed the loss claiming that the taxpayer made no headway with police enforcement on the matter, nor did she sue or file an administrative claim against Stanley. The court said that while neither a criminal case nor a civil suit is required to prove a theft loss, the burden is on the taxpayer to prove by a preponderance of the evidence that a theft occurred under state law.

The court noted that state law defines the crime of theft by false pretense to consist of three elements:

- The making of false pretense or representation by the defendant,
- The intent to defraud the owner of his property, and
- Actual reliance by the owner upon the false pretense in parting with his property.

The taxpayer must first establish that failure to keep the promise was not merely a result of a commercial default. The failure to keep a promise is the result of a commercial default in cases where the taxpayer entered into a contract with a legitimate business. For example, in one court case, there was no theft loss from stock purchased in a legitimate business that later went bankrupt. And in another court case, there was no theft loss from a bad business deal.

The court noted that Stanley's business was not legitimate. The taxpayer received little documentation from Stanley, and the suspicious FCC document was phony. The taxpayer expected to double her investment in only 10 to 30 days. She received no written contract before wiring her money to Africa World Trade, LLC. The court said Stanley's representations to the taxpayer were fraudulent and the whole deal was a scam.

The second element that must be established is that the offense must have the intent to defraud the owner of his property. The court said "we can think of no plausible intent on Stanley's part other than to defraud her of her money and never perform the deal he promised."

The third element that must be established is that the taxpayer actually relied upon the false pretense. The court agreed that she did in fact rely on the false pretense. State courts have held that "even reliance by a foolish victim of an absurd fraud is nonetheless reliance." There is nothing in the facts to indicate that the taxpayer initially believed that Stanley was not a legitimate businessman. Even if the taxpayer had been suspicious of Stanley's promises, which she wasn't, she came across no evidence to suggest that the transaction was a scam.

Based upon these facts, the court ruled that the taxpayer was entitled to a $405,000 theft loss deduction.

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