PROCEDURAL HISTORY

In re PATSY M. TAXPAYER

ACCOUNT NUMBER 1-XXXXXXXX

APPEAL FROM TAX AUDIT HEARING

NOTICE DATED JULY 19, 2008

APPEAL DATED AUGUST 18, 2008

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PRELIMINARY STATEMENT

The matter on appeal before The State Board of Equalization involves one of three high-yield investment fraud schemes (hereinafter "schemes") perpetrated against the appellant, Patsy M. Taxpayer, (hereinafter "Taxpayer"). These schemes are commonly known to the public as "Ponzi schemes".

Central to the schemes at issue is the promoter, William A. Hooligan, (hereinafter "Hooligan"). According to a complaint filed by the United States Securities and Exchange Commission in the United States District Court for the District of Arizona, Hooligan is one of three men who controlled and operated Planet-Earth Wide Capital Markets, Ltd., (hereinafter

"Planet-Earth"), a limited liability company registered in both Nevada and Texas since 1994, with its principal office in Houston, Texas. See, Complaint dated April 3, 2002, attached hereto and incorporated by reference as Exhibit "1". [Omitted.] Panet-Earth appears as one of the actors in two of the three schemes, including the scheme which is part of this appeal.

In addition to Hooligan and Planet-Earth, two separate banks are involved in two of the schemes. The first bank, UBS, (hereinafter "the Swiss Bank"), is the bank used by Hooligan and Planet-Earth in the scheme which is part of this appeal by Taxpayer. There is no evidence of wrongdoing by the Swiss Bank as part of this scheme. To Taxpayer's knowledge, there is no on-going investigation or civil complaint by the government involving this scheme.

The other bank is United States Official Sounding Bank & Trust, (hereinafter "USOSBT"). USOSBT is a non-incorporated entity and was purportedly granted two business licenses, the first on May 12, 1992, by the Tiger Lilly Tribe in South Dakota, and the second on November 9, 2001, by the Pimienta River Habitantes-Nipomo Indian Community in Arizona. USOSBT does not have a banking license and, along with Hooligan and Planet-Earth, are to this day part of civil and criminal complaints initiated by the government. This bank is an actor in the third scheme perpetrated against Taxpayer, but is not part of this appeal.

The remaining scheme perpetrated against Taxpayer by Hooligan continued for the longest period of time. It does not involve a bank or Panet-Earth. The government has taken no action on this scheme and this scheme is not part of this appeal.

In sum, there were three schemes. All schemes involved Hooligan, two schemes involved Planet-Earth and banks. One of the schemes which involved Planet-Earth and a bank is part of this appeal. The other scheme which involves Planet-Earth and a bank is part of ongoing

litigation by the government.

STATEMENT OF FACTS

The history of the three schemes is as tortured as it is confusing. Nonetheless, even though only one of these schemes is the subject of this appeal, it is imperative to conduct a brief discussion of these schemes if for no other reason than the "Audit Issue Presentation Sheet" on this matter indicates that the casualty/theft loss deducted in the amount of $1,420,995 in the Taxable Year 2002 was part of the same scheme as the casualty/theft loss deducted in the Taxable Year 2003 in the amount of $4,000,000. See, Audit Issue Presentation Sheet dated April 19, 2007, attached hereto and incorporated by reference as Exhibit "2". [Omitted.] In the alternative, perhaps the Franchise Tax Board (hereinafter "FTB") took the view that a promissory note issued by Hooligan for the benefit of Taxpayer in 2002, and its nonpayment, was the actual casualty loss. It is not clear from the Audit Issue Presentation Sheet. Regardless, the facts are as follows:

1. Make-Believe Scheme

Between 1990 and 2002, Taxpayer sent funds in the amount of $2,862,482 via wire transfer to Make-Believe Holdings Ltd., (hereinafter "Make-Believe"). As with the other schemes, Make-Believe was bogus and, in fact, was a DBA of Hooligan. However, what distinguishes this scheme from the others is that it appears that Hooligan acted alone in that this scheme did not involve Planet-Earth or a bank.

Taxpayer believed that Make-Believe was legitimate and that the funds she "invested" were for the operating expenses since she received monthly reports from Make-Believe which consisted of business activities and projected monthly earnings. Nevertheless, because of the events of 2002, Taxpayer concluded, after consultation with legal counsel in December of that

year, that Make-Believe was a scheme and that Hooligan was judgment proof.

Taxpayer took a casualty/theft loss for this scheme for the Taxable Year 2002 in the amount of $1,420,955, the amount of a substantiated loss.

2. The Swiss Bank Scheme

The Swiss Bank Scheme is the subject matter of this appeal.

In 1998, Taxpayer sent funds in the amount of $4,000,000 via wire transfer from her Citibank account directly to the Swiss Bank, naming herself as the beneficiary on the transfer. At the time, Taxpayer believed that she was sending money to an account in her name.

As part of the scheme, Taxpayer received a "right to trade" in promissory notes issued by the Swiss Bank on its own credit and a form of investment agreement with Planet-Earth. In hindsight, these promissory notes and the agreement were a sham. Yet, by the end of 2002, it was not certain if the Swiss Bank was involved, albeit innocently, or if the funds were in Taxpayer's name.

Because of the uncertainty, Taxpayer hired The Snoop Group, a multinational private investigation firm. On December 13, 2002, The Snoop Group issued a report to Taxpayer. The report mentioned in the last paragraph that The Snoop Group was still determining whether funds would ever become available, and on December 19, 2002, Taxpayer's personal attorney sent Taxpayer a letter. The letter stated that Taxpayer probably would never receive funds from Hooligan, but failed to mention the Swiss Bank. Hence, whether Taxpayer could receive the return of her funds from the Swiss Bank was not known by the end of 2002.

3. The USOSBT Scheme

In 2001, Taxpayer directly transfered $10,000,000 to USOSBT in return for a certificate

of deposit from this entity. This scheme directly paralleled the Swiss Bank scheme, the only difference being a change of bank.

Sometime in early 2002, the Securities and Exchange Commission brought suit against USOSBT, Planet-Earth, Hooligan and others, to cease and desist the selling of securities connected with this scheme and to place any funds held by USOSBT in the hands of a trustee. Taxpayer does not deny that in 2002 she had knowledge of this suit. However, given the similarity between this scheme and the Swiss Bank scheme, there is a fair argument to be made that government intervention would enable Taxpayer to retrieve funds from the Swiss Bank.

To date, Taxpayer has not taken a casualty/theft loss on the USOSBT scheme as she has received some of the funds back and expects to receive more.

4. The Promissory Note

On July 31, 2002, Hooligan signed a promissory note to Taxpayer in the amount of $6,862,482. Purportedly this amount was arrived at as the $2,862,482 for the Make-Believe scheme and the $4,000,000 for the Swiss Bank scheme. One month later, on August 29, 2002, Taxpayer's personal attorney, Larry Lawyer, sent a demand letter to Hooligan stating that the principal sum should be paid by November 1, 2002. And, on December 19, 2002, Mr. Lawyer informed Taxpayer that the note was probably uncollectible. Presumably, the FTB takes the position that since the note was uncollectible from Hooligan, Taxpayer's ability for reimbursement of the Swiss Bank funds was knowingly utterly hopeless in 2002. Thus, the deduction should have been taken in the Taxable Year 2002.

LAW AND ANALYSIS

As stated in the FTB's Audit Issue Presentation Sheet, "California conforms to Internal

Revenue Code (IRC) § 165 under California Revenue and Taxation Code (CR&TC) § 17207 which states that: '(a) There shall be allowed a deduction any loss sustained during the taxable year and not compensated for by insurance or otherwise.'" Taxpayer does not disagree with the FTB's statement of law and further agrees that the Treasury Regulations provide further guidance that the amount of a theft loss is the adjusted basis of the property, subject to the ten percent "floor" of adjusted gross income, and that the theft loss is generally deductible in the year of discovery of the theft. See, Treas. Reg. §§ 1.165-7(b) and 1.165-8(a). Conversely, what is in disagreement is the timing of the deduction. Taxpayer contends that the Taxable Year 2003 was proper for the Swiss Bank scheme.

To be deductible under the Internal Revenue Code section 165(a), a "loss must be evidenced by closed and completed transactions, [and] fixed by identifiable events". Treas. Reg. § 1.165-1(b) and (d)(1). Hence, if in the year of discovery there exists a claim for reimbursement that has a reasonable prospect of recovery, then the loss is not treated as sustained "until the taxable year in which it can be ascertained with reasonable certainty whether or not such reimbursement [of the loss] will be received". Treas. Reg. § 1.165-1(d)(3), *Premji v. Comm'r*, 1998 U.S. App LEXIS 2737 (1998), *Jeppsen v. Comm'r*, 128 F.3d 1410 (10th Cir. 1997). A reasonable prospect of recovery generally exists when a taxpayer had reasonable claims for recoupment from *third parties or otherwise*, and when those claims have a substantial possibility of being decided in the taxpayer's favor. *Premji* at 9.

Here, the FTB believes that the loss occurred when it became apparent that the promissory note made by Hooligan became uncollectible in 2002. This belief is misplaced as the promissory note was obviously a tactic to pacify Taxpayer and delay further investigation into

his schemes. The promissory note does not obviate the Swiss Bank scheme, nor does it obviate the possibility that a third party may indeed provide recovery. To be sure, by the end of December 2002, Taxpayer's hired investigation firm, The Snoop Group, was uncertain whether funds would become available. Given this report, to expect Taxpayer, or her lawyers, to conclude that recovery of funds in the Swiss Bank scheme was irremediable as of 2002 is the antithesis of reasonableness.

Given that the government was able to place funds in the hands of a trustee in the USOSBT scheme, it was not unreasonable for Taxpayer to investigate further as to whether there was a reasonable possibility that she could receive her funds in the Swiss Bank scheme. After all, when she wired the funds from her Citibank account to the Swiss Bank she named herself as a beneficiary. Regardless of what the Audit Issue Presentation Sheet may state about the secrecy of the Swiss banking system,[1] there are circumstances where the Swiss banks will lift the secrecy.

A reading of the Swiss government's website informs that the secrecy of the Swiss banking system is similar to one of our common law privileges such as the attorney-client privilege or the spousal privilege which may be "lifted" under narrow circumstances. One of those circumstances is when a crime, as determined by the Swiss government, has been committed. This can be baffling to those practicing law only in the United States since the Swiss government does not recognize United States tax evasion, but does recognize, and very stringently, money laundering. It should be no less baffling to Taxpayer and her attorneys.

It would be impossible for Taxpayer and her attorneys to come to any conclusions regarding whether a crime, as determined by the Swiss government, had been committed

[1] Item 4(f) states that "[t]o date, Ms. Taxpayer has not received a penny from the Swiss Bank Investment transaction, although Hooligan repeatedly promised to return the money to her. Her $4 million was deposited in Switzerland where secrecy laws prevent us from tracing the funds.

between December 13, 2002, when they received The Snoop Group's report, and December 31, 2002, when the Taxable Year 2002 ended. As a result, no one could say with any certainty that Taxpayer's situation with the Swiss Bank scheme was "hopeless" since the secrecy provision may have been lifted which appears to be the aim of Taxpayer's daughter, Debra Daughter, in her discussions with the Federal Bureau of Investigations on March 6, 2003.

The Audit Issue Presentation Sheet makes much of Taxpayer's personal attorney's letter of December 2002, in that he states Hooligan is judgment proof. Taxpayer does not deny that she knew that Hooligan was judgment proof in 2002. That was the very reason she took the Make-Believe deduction in that year as Hooligan was the only participant in that scheme. However, as stated above, the Swiss Bank scheme and the USOSBT scheme were indistinguishable in their operation, and both schemes involved Planet-Earth and banks.

Finally, Taxpayer sympathizes with the FTB's confusion concerning the "bifurcation" of her losses between 2002 and 2003 since the FTB has chosen to utilize the worthless promissory note as the trigger for the casualty/theft loss.[2] Again, it is not the inability to collect on the promissory note that triggered the casualty/theft loss, it is loss created by two separate and distinct schemes, the Planet-Earth scheme and the Swiss Bank scheme.

CONCLUSION

Over the years, Appellant Patsy M. Taxpayer transfered funds to three separate investments which in retrospect were frauds. The first was with Make-Believe Holdings, Ltd. The promoter of the scheme, William A. Hooligan acted alone in the scheme and when the

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[2] On page 6, the FTB states that [f]or some unknown reason, the taxpayer bifurcated her losses between 2002 and 2003. In 2002, the taxpayer deducted $1,420,955 as theft loss and labeled it 'cash extortion from William A. Hooligan.' In 2003, the taxpayer took a .... loss of $4,000,000 for the Swiss Bank Investment. *Why*?" Emphasis added.

appellant discovered that Mr. Hooligan was judgment proof in 2002, appellant properly took a casualty/theft deduction for the Taxable Year 2002. The second scheme, known as the Swiss Bank scheme, involved Mr. Hooligan, Planet-Earth Capital Markets, Ltd. and UBS, a Swiss bank. It was not until the Taxable Year 2003 that Taxpayer knew with any reasonable certainty that her funds in this scheme would not be returned to her. Notably, one could argue that had she taken the deduction for this scheme in the Taxable Year 2002, the Franchise Tax Board could be arguing the opposite as to what it is arguing today as there was a reasonable possibility that by lifting the Swiss banking secrecy privilege those funds could have been traced as appellant sent those funds naming herself as beneficiary. And, the third scheme, known as the USOSBT scheme, also involved Mr. Hooligan and Planet-Earth Capital Markets, Ltd., substituting another bank as part of the scheme. This scheme is the mirror image of the Swiss Bank scheme, yet the appellant has not taken a deduction since she continues to receive a return of her funds from a government trustee in the scheme. Arguably, the same result could have reasonably occurred with the Swiss Bank scheme. It did not. Accordingly, the casualty/theft deduction for the Taxable Year 2003 was proper.

WHEREFORE Appellant Patsy M. Taxpayer respectfully requests that The State Board of Equalization allow her casualty/loss deduction for the "Swiss Bank" scheme for the Taxable Year 2003.

DATED this 17th day of February, 2009.

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