

STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition :
of :
Estate of Kenneth H. Leeds : AFFIDAVIT OF MAILING
for Redetermination of a Deficiency or Revision :
of a Determination or Refund of Personal Income :
Tax under Article 22 of the Tax Law for the Year :
1976.

State of New York }
County of Albany } ss.:

David Parchuck, being duly sworn, deposes and says that he is an employee of the State Tax Commission, that he is over 18 years of age, and that on the 14th day of March, 1984, he served the within notice of Decision by certified mail upon Estate of Kenneth H. Leeds, the petitioner in the within proceeding, by enclosing a true copy thereof in a securely sealed postpaid wrapper addressed as follows:

Estate of Kenneth H. Leeds
Ivin Mann, Executor
630 Fifth Avenue
New York, NY 10111

and by depositing same enclosed in a postpaid properly addressed wrapper in a post office under the exclusive care and custody of the United States Postal Service within the State of New York.

That deponent further says that the said addressee is the petitioner herein and that the address set forth on said wrapper is the last known address of the petitioner.

Sworn to before me this
14th day of March, 1984.

David Parchuck

James J. [Signature]
Authorized to administer oaths
pursuant to Tax Law section 174

STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition :
of :
Estate of Kenneth H. Leeds : AFFIDAVIT OF MAILING
for Redetermination of a Deficiency or Revision :
of a Determination or Refund of Personal Income :
Tax under Article 22 of the Tax Law for the Year :
1976.

State of New York }
ss.:
County of Albany }

David Parchuck, being duly sworn, deposes and says that he is an employee of the State Tax Commission, that he is over 18 years of age, and that on the 14th day of March, 1984, he served the within notice of Decision by certified mail upon Mark W. Brown, the representative of the petitioner in the within proceeding, by enclosing a true copy thereof in a securely sealed postpaid wrapper addressed as follows:

Mark W. Brown
Ryan, Brown & Ryan
224 Old Loudon Rd.
Latham, NY 12110

and by depositing same enclosed in a postpaid properly addressed wrapper in a post office under the exclusive care and custody of the United States Postal Service within the State of New York.

That deponent further says that the said addressee is the representative of the petitioner herein and that the address set forth on said wrapper is the last known address of the representative of the petitioner.

Sworn to before me this
14th day of March, 1984.

David Parchuck

Bruce Acknowledged
Authorized to administer oaths
pursuant to Tax Law section 174

STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition :
of :
Estate of Kenneth H. Leeds : AFFIDAVIT OF MAILING
for Redetermination of a Deficiency or Revision :
of a Determination or Refund of Personal Income :
Tax under Article 22 of the Tax Law for the Year :
1976.

State of New York }
ss.:
County of Albany }

David Parchuck, being duly sworn, deposes and says that he is an employee of the State Tax Commission, that he is over 18 years of age, and that on the 14th day of March, 1984, he served the within notice of Decision by certified mail upon Edgar Hills, the representative of the petitioner in the within proceeding, by enclosing a true copy thereof in a securely sealed postpaid wrapper addressed as follows:

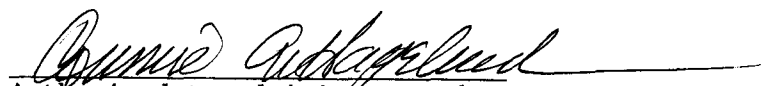
Edgar Hills
Cruser, Hills, Hills & Besuder
206 Roanoke Ave.
Riverhead, NY 11901

and by depositing same enclosed in a postpaid properly addressed wrapper in a post office under the exclusive care and custody of the United States Postal Service within the State of New York.

That deponent further says that the said addressee is the representative of the petitioner herein and that the address set forth on said wrapper is the last known address of the representative of the petitioner.

Sworn to before me this
14th day of March, 1984.




Authorized to administer oaths
pursuant to Tax Law section 174

STATE OF NEW YORK
STATE TAX COMMISSION
ALBANY, NEW YORK 12227

March 14, 1984

Estate of Kenneth H. Leeds
Ivin Mann, Executor
630 Fifth Avenue
New York, NY 10111

To the Executor:

Please take notice of the Decision of the State Tax Commission enclosed herewith.

You have now exhausted your right of review at the administrative level. Pursuant to section(s) 690 of the Tax Law, a proceeding in court to review an adverse decision by the State Tax Commission may be instituted only under Article 78 of the Civil Practice Law and Rules, and must be commenced in the Supreme Court of the State of New York, Albany County, within 4 months from the date of this notice.

Inquiries concerning the computation of tax due or refund allowed in accordance with this decision may be addressed to:

NYS Dept. Taxation and Finance
Law Bureau - Litigation Unit
Building #9, State Campus
Albany, New York 12227
Phone # (518) 457-2070

Very truly yours,

STATE TAX COMMISSION

cc: Petitioner's Representative
Mark W. Brown
Ryan, Brown & Ryan
224 Old Loudon Rd.
Latham, NY 12110
AND
Edgar Hills
Cruser, Hills, Hills & Besuder
206 Roanoke Ave.
Riverhead, NY 11901

Taxing Bureau's Representative

STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition	:	
	:	
of	:	
	:	
THE ESTATE OF KENNETH H. LEEDS	:	DECISION
	:	
for Redetermination of a Deficiency or for	:	
Refund of Personal Income Tax under Article 22	:	
of the Tax Law for the Year 1976.	:	

Petitioner, The Estate of Kenneth H. Leeds, c/o Ivin Mann, Executor, 630 Fifth Avenue, New York, New York 10111, filed a petition for redetermination of a deficiency or for refund of personal income tax under Article 22 of the Tax Law for the year 1976 (File No. 30162).

A formal hearing was held before Dennis M. Galliher, Hearing Officer, at the offices of the State Tax Commission, Building 9, State Office Campus, Albany, New York, on May 13, 1983 at 11:00 A.M., with all briefs to be submitted by August 5, 1983. Petitioner appeared by Ryan, Brown & Ryan, Esqs. (Mark W. Brown, Esq., of counsel), and by Cruser, Hills, Hills, & Besunder, Esqs. (Edgar Hills, Esq., of counsel). The Audit Division appeared by John P. Dugan, Esq. (Harry Kadish, Esq., of counsel).

ISSUE

Whether the Audit Division's disallowance of a theft loss deduction in the amount of \$504,287.00, claimed by Kenneth H. Leeds in 1976, was proper.

FINDINGS OF FACT

1. Kenneth H. Leeds, who died on April 30, 1980, had timely filed a New York State Income Tax Resident Return (Form IT-201/208) for the year 1976, whereon he claimed, at Line "5" of Schedule "B" ("casualty or theft losses"),

a deduction in the amount of \$504,287.00. This deduction was also taken on Mr. Leeds' U.S. Individual Income Tax Return (Form 1040) filed for 1976.

2. On February 6, 1980, the Audit Division issued to Mr. Leeds a Notice of Deficiency asserting additional tax due for 1976 in the amount of \$70,762.01, plus interest. A Statement of Audit Changes previously issued to Mr. Leeds on September 7, 1979, explained the basis for the asserted deficiency as follows:

"[t]he embezzlement loss claimed is disallowed. No deduction may be taken in the year of the loss for any portion of that loss for which there is a reasonable prospect of recovery in a later year. Since a claim was filed for the full amount and since the amount of recovery is still undetermined, the loss is disallowed in full."

3. Prior to July 30, 1976, Mr. Leeds was the owner of a non-negotiable certificate of deposit in the principal amount of \$504,386.98, which had been purchased on June 21, 1976 from the American Bank and Trust Company ("American Bank"), then an existing and viable banking institution with offices in New York City. This certificate was due to mature on December 20, 1976.

4. On July 30, 1976, the funds on deposit with American Bank, represented by the aforementioned certificate of deposit, were transferred without the knowledge, authority or consent of Mr. Leeds to Banque Pour L'Amerique du Sud ("BAS"), a bank located in Brussels, Belgium, and controlled by the transferor, American Bank. Immediately after July 30, 1976, both banks were declared to be insolvent. It was this unauthorized transfer of Mr. Leeds' funds, together with the subsequent collapse of the banks involved, upon which Mr. Leeds based his assertion that he had suffered a theft loss for which, as of the end of 1976, he foresaw no reasonable prospect of recovery and thus claimed a deduction under section 165(e) of the Internal Revenue Code in the amount of \$504,287.00.¹

¹ The \$504,287.00 amount of the deduction claimed represents the face value of the certificate of deposit (\$504,386.98; as rounded to \$504,387.00), less the \$100.00 exclusion specified in section 165(c)(3) of the Internal Revenue Code.

5. By a registered letter dated August 18, 1976, Mr. Leeds, through his accountants (Mann, Brown & Bauman, P.C.), advised American Bank as follows:

"..., Kenneth H. Leeds, has received notification today that the American Bank & Trust Co. transferred \$504,386.98 to the Banque Pour L'Amerique Du Sud as of July 30, 1976. This transaction was done without authority and we must demand immediate recession (sic) of this transaction or we will be forced to seek every available remedy."

A July 30, 1976 debit memo from American Bank to Mr. Leeds, together with an attached cover letter, indicated the bank's transfer of the funds at issue as an "investment to Banque Pour L'Amerique Du Sud, Brussels, Belgium, until 12/20/76".

6. By an October 13, 1976 letter from the New York State Banking Department, Mr. Leeds, through his attorneys (Lippe, Ruskin & Schlissel, P.C., later known as Ruskin, Schlissel, Moscou & Evans, P.C.), was advised (in response to a letter he had previously written) of the address and names of the receivers appointed for BAS, and also that any claim against BAS had to be presented to these receivers by October 20, 1976.

7. A letter dated October 12, 1976, from the law firm of Cleary, Gottlieb, Steen & Hamilton to Mr. Leeds' attorneys, apparently in response to their inquiries as to the prospects of recovering, in Belgium, the funds at issue, provided, in part, as follows:

"...our Brussels office is of the view that there is no chance that any Belgian government agency will assume any obligations of BAS denominated in currencies other than Belgian francs. They are also of the opinion that any distribution of a bankruptcy dividend in the BAS bankruptcy in Belgium is highly unlikely. They suggest that Leeds investigate his ability to sue American Bank and Trust Company and/or Bank Leumi or the officials at ABTCO who 'invested' Leeds' money in BAS.

* * *

We strongly urge that Mr. Leeds and his counsel investigate the possibility of a suit to rescind the alleged transfer of funds from Mr. Leeds' account of ABTCO to a dollar account at BAS on the grounds

of fraud and to seek to have Mr. Leeds restored as a depositor at ABTCO in such a manner that Bank Leumi would be required to make good the full amount of his deposit. Since rescission is an equitable remedy as to which the defenses of laches and waiver are applicable, any suit should be commenced promptly."

A subsequent letter from Cleary, Gottlieb, Steen & Hamilton, dated October 28, 1976, advised Mr. Leeds' attorneys that the claim against BAS had been filed, as required (see Finding of Fact "7"), in Belgium, and further noted that the receivers of BAS had advised that "...a distribution among the creditors is unlikely."

8. No further efforts to recover against BAS were made by Mr. Leeds, nor was there any distribution by or recovery from BAS or from the Belgian government.

9. Mr. Leeds, through his attorneys, also attempted to determine possible avenues of recourse against American Bank and other parties involved, as follows:

a) On or about September 15, 1976, the Superintendent of Banks of the State of New York took possession of the business and property of American Bank, and the Supreme Court of the State of New York appointed the Federal Deposit Insurance Corporation (the "F.D.I.C.") as Receiver to liquidate the assets of American Bank and apply the proceeds to satisfy the claims of creditors on behalf of the Superintendent of Banks;

b) Mr. Leeds' attorneys met with officials of the New York State Banking Department and of the F.D.I.C., and obtained a copy of a Purchase and Assumption Agreement between the F.D.I.C., as receiver, and Bank Leumi Trust Company of New York ("Bank Leumi"), which had acquired American Bank's assets. After reviewing this agreement, which revealed that American Bank depositor liabilities assumed by Bank Leumi were specifically limited to those deposits listed on the books of American Bank as of its

September 15, 1976 liquidation date, Mr. Leeds' attorneys concluded there was no likelihood of recovery against Bank Leumi;

c) On or about March 31, 1977, Mr. Leeds filed a Proof of Claim for the funds at issue with the F.D.I.C.;

d) On June 23, 1977, the F.D.I.C. issued a provisional rejection of Mr. Leeds' proof of claim, but reserved the right to accept or reject the claim on or before September 30, 1977. On September 30, 1977, the F.D.I.C. notified Mr. Leeds that his claim was rejected on the basis that the F.D.I.C. had "...insufficient evidence upon which to base an acceptance...". The F.D.I.C. rejection letter further provided, in part, as follows:

"...in view of the complexities involved and the expenses which would result from protracted litigation, we are prepared to submit the matter to the court for a final determination upon a stipulation of fact agreed upon between the Federal Deposit Insurance Corporation and you or your attorney.

In the interim, the Federal Deposit Insurance Corporation Board of Directors is prepared to reconsider its decision as to any specific claim if additional facts upon which to base an acceptance are presented to it. The Federal Deposit Insurance Corporation Legal staff will make any such presentation to the Board during this interim period, and if your claim is among those which is accepted, you will be promptly notified."

10. On or about November 16, 1977, after the F.D.I.C.'s rejection of his claim, Mr. Leeds (through his attorneys) commenced an action by filing a complaint in the Supreme Court, New York County, within the time limits specified by section 625 of the Banking Law, seeking recovery on his claim (and also asserting priority of payment thereon against certain assets formerly held by American Bank). Named as defendants by Mr. Leeds were American Bank, the F.D.I.C., and Muriel Siebert (as Superintendent of Banks of the State of New

York). On or about January 30, 1978, the F.D.I.C. filed its answer to Mr. Leeds' complaint, asserting therein seven affirmative defenses against his complaint.

11. On or about October 2, 1978, an agreement was reached whereby expedited court proceedings (Supreme Court, New York County) would be held to adjudicate the assertions of 129 claimants, including Mr. Leeds, who claimed depositor status with American Bank as of September 15, 1976 (the date of takeover by the Superintendent of Banks), but whose claims had been rejected by the F.D.I.C. Of the 129 claimants involved, 120 claims were adjudicated by the court, 5 claims were withdrawn with prejudice, 2 claims were adjourned or withdrawn without prejudice and 2 claims, one of which was Mr. Leeds' claim, were settled by agreement and stipulation of counsel with approval but no decision rendered on the matter by the court. The terms of Mr. Leeds' agreement of settlement, which was formalized on or about January 15, 1979, provided essentially that Mr. Leeds was to be paid the full amount of his claim (\$504,386.98), without interest, in exchange for the assignment of his entire claim for this amount to the F.D.I.C.²

12. On or about February 2, 1979, Mr. Leeds received from his attorneys a check in the amount of \$414,110.48, representing his recovery upon settlement with the F.D.I.C. (\$504,386.98) less approximately \$101,000.00 in legal fees charged by his attorneys in connection with this matter. Mr. Leeds included his recovery, less legal fees incurred, in income on his 1979 Federal and New York State income tax returns. It was noted that Mr. Leeds had paid his attorneys, prior to February 2, 1979, approximately \$11,000.00 to pursue his

² The settlement did reserve to Mr. Leeds the right to pursue claims for interest, costs and disbursements, attorney's fees and exemplary damages against anyone except the Receiver, the F.D.I.C., American Bank and Bank Leumi, and to pursue a claim for interest against the Receiver and the F.D.I.C. upon appeal of any order of the court.

claim, but that legal fees ultimately charged were asserted to have been based on a contingent fee arrangement. The terms of such asserted arrangement were not specified, but the approximately \$11,000.00 paid by Mr. Leeds prior to February 2, 1979 was credited and returned to him by his attorneys as part of the payment of the net amount of his recovery.

13. Petitioner asserts that Mr. Leeds' deduction, taken in 1976, was proper inasmuch as at the end of 1976 there was no reasonable prospect of recovery of his loss. In this regard, petitioner notes Mr. Leeds' efforts to determine his possible avenues of recourse both in Belgium and in the United States. Mr. Leeds' accountant, one Ivin Mann, who prepared Mr. Leeds' tax returns, testified that the deduction was taken in 1976 upon his belief and upon the opinion of counsel that, based upon all the facts and circumstances at that time, there was no reasonable prospect of recovery by Mr. Leeds. Mr. Mann noted that not only was there no prospect of recovery in Belgium, but that both banks involved were insolvent, that it was unclear as to whether Mr. Leeds was considered a depositor of American Bank after the unauthorized transfer (and at the time of the banks' collapse), and further if the form of the funds at issue, denominated both as a non-negotiable certificate of deposit and as an investment, were of the type which were in fact F.D.I.C. insured (see Finding of Fact "6"). Furthermore, petitioner asserts that the recovery was factually, legally and procedurally complex, as evidenced by events occurring after 1976, and that it is the reasonableness of the prospect of recovery as of the end of 1976, irrespective of subsequent events including the ultimate recovery of the funds, which determines the propriety of claiming the instant deduction in 1976.

14. The Audit Division asserts, by contrast, that a claim was filed by Mr. Leeds, that there existed a reasonable prospect of recovery of the funds as of the end of 1976 and thus the deduction was improperly taken in 1976.

CONCLUSIONS OF LAW

A. That subsection (a) of section 165 of the Internal Revenue Code ("I.R.C.") allows a deduction for "...any loss sustained during the taxable year and not compensated for by insurance or otherwise.". Subsection (e) of said section further provides that "[f]or purposes of subsection (a), any loss arising from theft shall be treated as sustained during the taxable year in which the taxpayer discovers such loss."³ The Audit Division does not challenge the characterization of the instant loss as a theft loss, nor is it questioned that the loss was discovered in 1976.

B. That Treasury Regulation section 1.165-1(d)(2)(i) provides as follows:

"[i]f a casualty or other event occurs which may result in a loss and, in the year of such casualty or event, there exists a claim for reimbursement with respect to which there is a reasonable prospect of recovery, no portion of the loss with respect to which reimbursement may be received is sustained, for purposes of section 165, until it can be ascertained with reasonable certainty whether or not such reimbursement will be received. Whether a reasonable prospect of recovery exists with respect to a claim for reimbursement of a loss is a question of fact to be determined upon an examination of all facts and circumstances. Whether or not such reimbursement will be received may be ascertained with reasonable certainty, for example, by a settlement of the claim, or by an abandonment of the claim."

C. That whether there existed a reasonable prospect of recovery is to be determined in view of all the facts and circumstances as of the close of the taxable year for which the deduction was claimed [see Ramsay, Scarlett & Co., 61 T.C. 795, aff'd, 521 F.2d 786 (4th Cir., 1975); see also James Petroleum Corp.,

³ The dollar amount of such a loss is equal to that portion of the loss which exceeds \$100.00 [I.R.C. section 165(c)(3)].

40 T.C. 166, rem'd on other issue, 331 F.2d 344 (10th Cir., 1964)]. However, in making a determination as to the prospect of a future recovery,

"...it is apparent that claims for reimbursement and other actions taken toward recoupment by the taxpayer after the close of the taxable year may be examined in order to determine if a substantial possibility of recoupment existed as of the close of the taxable year if at that time it was reasonably foreseeable that such claims and actions would occur." (National Home Products, Inc., 71 T.C. 501).

Thus, the likelihood of recovery on post-1976 claims filed on behalf of Mr. Leeds is not barred from being considered in determining the reasonableness of his overall prospects for recovery of the loss as of the end of 1976.

D. That as of the end of 1976, it was apparent that there was no likelihood of recovery by Mr. Leeds on the claim filed in Belgium (see Findings of Fact "7" and "8"). His prospects for recovery in the United States were, as of the end of 1976, only marginally better. Mr. Leeds' attorneys had met, in the latter part of 1976, with representatives of the Banking Department and the F.D.I.C., but no resolution was reached regarding recovery on the loss nor did recovery appear likely to be granted by these bodies. His attorneys had reviewed the Purchase and Assumption Agreement and determined there was no likelihood of recovery against Bank Leumi (see Finding of Fact "10-b"). Furthermore, with regard to his other possible avenues of recourse, as suggested by his attorneys and later undertaken against American Bank, the F.D.I.C., etc., the potential for recovery must be viewed in light of the insolvency of American Bank, the question of whether the funds at issue were insured by the F.D.I.C., and the question of whether Mr. Leeds was even a depositor as of the date of receivership. Finally, notwithstanding Mr. Leeds' ultimate recovery, the nature and uncertainty of the questions involved and the complexity of the pending litigation, as described by the aforementioned circumstances, as of the close of 1976 cast very substantial doubt upon his prospects of recovery on the


loss. Accordingly, as of December 31, 1976, there was no reasonable prospect of recovery and the theft loss deduction was properly taken by Mr. Leeds in 1976.

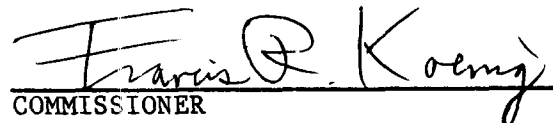
E. That the petition of The Estate of Kenneth H. Leeds is hereby granted and the Notice of Deficiency dated February 6, 1980 is cancelled.

DATED: Albany, New York

STATE TAX COMMISSION

MAR 14 1984


PRESIDENT


COMMISSIONER


COMMISSIONER