LEXSEE

Rev. Rul. 70-333

Section 165. - Losses

26 CFR 1.165-8: Theft losses.

(Also Section 163; 1.163-1.)

1970-1 C.B. 38; 1970 IRB LEXIS 496; REV. RUL. 70-333

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The Revenue Service will not follow the Tax Court decision in *Perry A. Nichols* which held that the taxpayer was defrauded and sustained a deductible theft loss to the extent of out-of-pocket expenses in a sham transaction arranged to reduce his income taxes.

The Internal Revenue Service will not follow the decision of the Tax Court of the United States in *Perry A. Nichols v. Commissioner, 43 T.C. 842 (1965),* nonacquiescence, page xvii.

The point at issue in the *Nichols* case was whether a loss suffered by the taxpayer in the amount of his out-of-pocket expenses in connection with a tax avoidance scheme he entered into in reliance upon misrepresentations that he would realize a tax "bonanza" therefrom is a deductible loss for purposes of the Federal income tax. The court held that the taxpayer was defrauded (in that he bargained for a "substance" transaction from which a tax benefit might have been realized, and received, instead, a "sham" transaction from which no tax benefit could be realized). The court allowed the taxpayer a theft loss deduction for his related out-of-pocket expenses.

It has been subsequently held that no deduction is allowable for interest paid in a transaction entered into, not in anticipation of genuine economic benefits, but merely to secure a tax benefit in the form of an interest deduction. *Kapel Goldstein v. Commissioner, 364 F.2d 734 (1966),* certiorari denied, *385 U.S. 1005 (1967); Carola W. Rothschild v. United States, 407 F.2d 402 (1969).*

Under the facts of the *Nichols* case, therefore, no tax benefit could have been realized by the taxpayer even if he had received the exact transaction for which he bargained. Even though there was a misrepresentation and a loss, there was no direct relationship between the two, since the loss would have been sustained by one entering into the transaction regardless of whether he did so in reliance on fraudulent misrepresentation. Since the taxpayer bargained for a transaction with zero value and received a transaction with zero value, even though in a different form than anticipated, he did not sustain a deductible loss for Federal income tax purposes.

Therefore, the *Nichols* decision will not be followed as a precedent in the disposition of similar cases.