Farcasanu v. Commissioner, 50 T. C. 881 (1968)

Confiscation of property by a foreign government, even if arbitrary and despotic, does not constitute a theft loss deductible under Section 165(c)(3) of the Internal Revenue Code.

Summary

Louisa B. Gunther Farcasanu sought a tax deduction for a 'theft' loss after her property in Romania was confiscated by the Communist regime between 1947 and 1951. The U. S. Tax Court ruled that such confiscation, despite being under color of law, did not qualify as a theft under IRC Section 165(c)(3). However, the court recognized her basis in the confiscated property as at least equal to the amount she recovered from the Foreign Claims Settlement Commission, thus allowing her to offset any capital gains from this recovery.

Facts

Louisa B. Gunther Farcasanu's husband, Franklin M. Gunther, an American diplomat, died in Romania in 1941. After his death, Farcasanu left most of their valuable personal property in Romania when she evacuated in 1942 due to Romania's declaration of war on the U. S. She returned to Romania in 1945 and again in 1947, leaving her property with friends, but was unable to retrieve it due to the political instability. Between 1947 and 1951, her property was confiscated by the Communist regime under various decrees. In 1959, Farcasanu filed a claim with the Foreign Claims Settlement Commission and was awarded $103,445, receiving a net payment of $23,386. 45. She sought to deduct the difference between her claim and the award as a theft loss on her 1959 tax return.

Procedural History

Farcasanu filed her 1959 tax return claiming a theft loss deduction of $192,271. 50. The IRS disallowed the deduction and determined that the net recovery from the Foreign Claims Settlement Commission should be taxed as capital gain. Farcasanu petitioned the U. S. Tax Court, which upheld the IRS's disallowance of the theft loss deduction but allowed her to offset the capital gain by recognizing her basis in the property as at least equal to her net recovery.

Issue(s)

1. Whether the confiscation of Farcasanu's property by the Communist regime in Romania constituted a theft loss deductible under IRC Section 165(c)(3).

2. Whether Farcasanu's net recovery from the Foreign Claims Settlement Commission should be taxed as capital gain and, if so, what her basis in the confiscated property was.

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Holding

1. No, because the confiscation was under color of law by a recognized foreign government, it did not constitute a theft as defined by IRC Section 165(c)(3).

2. Yes, the net recovery was taxable as capital gain, but Farcasanu's basis in the property was at least equal to her net recovery, allowing her to offset the gain.

Court's Reasoning

The court relied on the precedent set in *William J. Powers*, which held that confiscation by a foreign government, even if despotic, does not qualify as a theft under IRC Section 165(c)(3). The court emphasized the 'Act of State' doctrine, which precludes judicial determination that acts of a recognized foreign government constitute theft. The court noted that Congress's subsequent enactment of IRC Section 165(i) to allow deductions for specific Cuban expropriations further supported their interpretation that confiscation by a foreign government is not generally deductible as theft. Regarding the basis in the property, the court found that Farcasanu's basis was at least equal to her net recovery, allowing her to offset any capital gain from the award.

Practical Implications

This decision clarifies that property confiscation by a foreign government, even if under despotic regimes, is not deductible as a theft loss under IRC Section 165(c)(3). Taxpayers facing similar situations must look to specific legislation, such as IRC Section 165(i) for Cuban expropriations, for potential deductions. The ruling also underscores the importance of establishing a basis in confiscated property to offset any capital gains from recovery awards. Subsequent cases involving property seized by foreign governments will likely reference this decision to determine the deductibility of losses and the taxation of recoveries.

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