

Rev. Proc. 2009-20

IRS Guidance on Examination of Returns and Claims for Refund, Credit or Abatement Code IRC Section 165

Results This revenue procedure provides an optional safe harbor treatment for taxpayers that experienced losses in certain investment arrangements discovered to be criminally fraudulent. This revenue procedure also describes how the Internal Revenue Service will treat a return that claims a deduction for such a loss and does not use the safe harbor treatment described in this revenue procedure.

SECTION 1. PURPOSE

This revenue procedure provides an optional safe harbor treatment for taxpayers that experienced losses in certain investment arrangements discovered to be criminally fraudulent. This revenue procedure also describes how the Internal Revenue Service will treat a return that claims a deduction for such a loss and does not use the safe harbor treatment described in this revenue procedure.

SECTION 2. BACKGROUND

.01 The Service and Treasury Department are aware of investment arrangements that have been discovered to be fraudulent, resulting in significant losses to taxpayers. These arrangements often take the form of so-called “Ponzi” schemes, in which the party perpetrating the fraud receives cash or property from investors, purports to earn income for the investors, and reports to the investors income amounts that are wholly or partially fictitious. Payments, if any, of purported income or principal to investors are made from cash or property that other investors invested in the fraudulent arrangement. The party perpetrating the fraud criminally appropriates some or all of the investors' cash or property.

.02 Rev. Rul. 2009-9, 2009 I.R.B (April 6, 2009), describes the proper income tax treatment for losses resulting from these Ponzi schemes.

.03 The Service and Treasury Department recognize that whether and when investors meet the requirements for claiming a theft loss for an investment in a Ponzi scheme are highly factual determinations that often cannot be made by taxpayers with certainty in the year the loss is discovered.

.04 In view of the number of investment arrangements recently discovered to be fraudulent and the extent of the potential losses, this revenue procedure provides an optional safe harbor under which qualified investors (as defined in § 4.03 of this revenue procedure) may treat a loss as a theft loss deduction when certain conditions are met. This treatment provides qualified investors with a uniform manner for determining their theft losses. In addition, this treatment avoids potentially difficult problems of proof in

determining how much income reported in prior years was fictitious or a return of capital, and alleviates compliance and administrative burdens on both taxpayers and the Service.

SECTION 3. SCOPE

The safe harbor procedures of this revenue procedure apply to taxpayers that are qualified investors within the meaning of section 4.03 of this revenue procedure.

SECTION 4. DEFINITIONS

The following definitions apply solely for purposes of this revenue procedure.

.01 Specified fraudulent arrangement. A specified fraudulent arrangement is an arrangement in which a party (the lead figure) receives cash or property from investors; purports to earn income for the investors; reports income amounts to the investors that are partially or wholly fictitious; makes payments, if any, of purported income or principal to some investors from amounts that other investors invested in the fraudulent arrangement; and appropriates some or all of the investors' cash or property. For example, the fraudulent investment arrangement described in Rev. Rul. 2009-9 is a specified fraudulent arrangement.

.02 Qualified loss. A qualified loss is a loss resulting from a specified fraudulent arrangement in which, as a result of the conduct that caused the loss—

(1) The lead figure (or one of the lead figures, if more than one) was charged by indictment or information (not withdrawn or dismissed) under state or federal law with the commission of fraud, embezzlement or a similar crime that, if proven, would meet the definition of theft for purposes of § 165 of the Internal Revenue Code and § 1.165-8(d) of the Income Tax Regulations, under the law of the jurisdiction in which the theft occurred; or

(2) The lead figure was the subject of a state or federal criminal complaint (not withdrawn or dismissed) alleging the commission of a crime described in section 4.02(1) of this revenue procedure, and either –

(a) The complaint alleged an admission by the lead figure, or the execution of an affidavit by that person admitting the crime; or

(b) A receiver or trustee was appointed with respect to the arrangement or assets of the arrangement were frozen.

.03 Qualified investor. A qualified investor means a United States person, as defined in § 7701(a)(30) --

(1) That generally qualifies to deduct theft losses under § 165 and § 1.165-8;

(2) That did not have actual knowledge of the fraudulent nature of the investment arrangement prior to it becoming known to the general public;

(3) With respect to which the specified fraudulent arrangement is not a tax shelter, as defined in § 6662(d)(2)(C)(ii); and

(4) That transferred cash or property to a specified fraudulent arrangement. A qualified investor does not include a person that invested solely in a fund or other entity (separate from the investor for federal income tax purposes) that invested in the specified fraudulent arrangement. However, the fund or entity itself may be a qualified investor within the scope of this revenue procedure.

.04 Discovery year. A qualified investor's discovery year is the taxable year of the investor in which the indictment, information, or complaint described in section 4.02 of this revenue procedure is filed.

.05 Responsible group. Responsible group means, for any specified fraudulent arrangement, one or more of the following:

(1) The individual or individuals (including the lead figure) who conducted the specified fraudulent arrangement;

(2) Any investment vehicle or other entity that conducted the specified fraudulent arrangement, and employees, officers, or directors of that entity or entities;

(3) A liquidation, receivership, bankruptcy or similar estate established with respect to individuals or entities who conducted the specified fraudulent arrangement, in order to recover assets for the benefit of investors and creditors; or

(4) Parties that are subject to claims brought by a trustee, receiver, or other fiduciary on behalf of the liquidation, receivership, bankruptcy or similar estate described in section 4.05(3) of this revenue procedure.

.06 Qualified investment.

(1) Qualified investment means the excess, if any, of --

(a) The sum of --

(i) The total amount of cash, or the basis of property, that the qualified investor invested in the arrangement in all years; plus

(ii) The total amount of net income with respect to the specified fraudulent arrangement that, consistent with information received from the specified fraudulent arrangement, the qualified investor included in income for federal tax purposes for all taxable years prior to the discovery year, including taxable years for which a refund is barred by the statute of limitations; over

(b) The total amount of cash or property that the qualified investor withdrew in all years from the specified fraudulent arrangement (whether designated as income or principal).

(2) Qualified investment does not include any of the following—

(a) Amounts borrowed from the responsible group and invested in the specified fraudulent arrangement, to the extent the borrowed amounts were not repaid at the time the theft was discovered;

(b) Amounts such as fees that were paid to the responsible group and deducted for federal income tax purposes;

(c) Amounts reported to the qualified investor as taxable income that were not included in gross income on the investor's federal income tax returns; or

(d) Cash or property that the qualified investor invested in a fund or other entity (separate from the qualified investor for federal income tax purposes) that invested in a specified fraudulent arrangement.

.07 Actual recovery. Actual recovery means any amount a qualified investor actually receives in the discovery year from any source as reimbursement or recovery for the qualified loss.

.08 Potential insurance/SIPC recovery. Potential insurance/SIPC recovery means the sum of the amounts of all actual or potential claims for reimbursement for a qualified loss that, as of the last day of the discovery year, are attributable to--

(1) Insurance policies in the name of the qualified investor;

(2) Contractual arrangements other than insurance that guaranteed or otherwise protected against loss of the qualified investment; or

(3) Amounts payable from the Securities Investor Protection Corporation (SIPC), as advances for customer claims under 15 U.S.C. § 78fff-3(a) (the Securities Investor Protection Act of 1970), or by a similar entity under a similar provision.

.09 Potential direct recovery. Potential direct recovery means the amount of all actual or potential claims for recovery for a qualified loss, as of the last day of the discovery year, against the responsible group.

.10 Potential third-party recovery. Potential third-party recovery means the amount of all actual or potential claims for recovery for a qualified loss, as of the last day of the discovery year, that are not described in section 4.08 or 4.09 of this revenue procedure.

SECTION 5. APPLICATION

.01 In general. If a qualified investor follows the procedures described in section 6 of this revenue procedure, the Service will not challenge the following treatment by the qualified investor of a qualified loss—

(1) The loss is deducted as a theft loss;

(2) The taxable year in which the theft was discovered within the meaning of § 165(e) is the discovery year described in section 4.04 of this revenue procedure; and

(3) The amount of the deduction is the amount specified in section 5.02 of this revenue procedure.

.02 Amount to be deducted. The amount specified in this section 5.02 is calculated as follows—

(1) Multiply the amount of the qualified investment by—

(a) 95 percent, for a qualified investor that does not pursue any potential third-party recovery; or

(b) 75 percent, for a qualified investor that is pursuing or intends to pursue any potential third-party recovery; and

(2) Subtract from this product the sum of any actual recovery and any potential insurance/SIPC recovery.

The amount of the deduction calculated under this section 5.02 is not further reduced by potential direct recovery or potential third-party recovery.

.03 Future recoveries. The qualified investor may have income or an additional deduction in a year subsequent to the discovery year depending on the actual amount of the loss that is eventually recovered. See § 1.165-1(d); Rev. Rul. 2009-9.

SECTION 6. PROCEDURE

.01 A qualified investor that uses the safe harbor treatment described in section 5 of this revenue procedure must –

(1) Mark "Revenue Procedure 2009-20" at the top of the Form 4684, Casualties and Thefts, for the federal income tax return for the discovery year. The taxpayer must enter the "deductible theft loss" amount from line 10 in Part II of Appendix A of this revenue procedure on line 34, section B, Part I, of the Form 4684 and should not complete the remainder of section B, Part I, of the Form 4684;

(2) Complete and sign the statement provided in Appendix A of this revenue procedure; and

(3) Attach the executed statement provided in Appendix A of this revenue procedure to the qualified investor's timely filed (including extensions) federal income tax return for the discovery year. Notwithstanding the preceding sentence, if, before April 17, 2009, the taxpayer has filed a return for the discovery year or an amended return for a prior year that is inconsistent with the safe harbor treatment provided by this revenue procedure, the taxpayer must indicate this fact on the executed statement and must attach the statement to the return (or amended return) for the discovery year that is consistent with the safe harbor treatment provided by this revenue procedure and that is filed on or before May 15, 2009.

.02 By executing the statement provided in Appendix A of this revenue procedure, the taxpayer agrees—

(1) Not to deduct in the discovery year any amount of the theft loss in excess of the deduction permitted by section 5 of this revenue procedure;

(2) Not to file returns or amended returns to exclude or recharacterize income reported with respect to the investment arrangement in taxable years preceding the discovery year;

(3) Not to apply the alternative computation in § 1341 with respect to the theft loss deduction allowed by this revenue procedure; and

(4) Not to apply the doctrine of equitable recoupment or the mitigation provisions in §§ 1311-1314 with respect to income from the investment arrangement that was reported in taxable years that are otherwise barred by the period of limitations on filing a claim for refund under § 6511.

SECTION 7. EFFECTIVE DATE

This revenue procedure applies to losses for which the discovery year is a taxable year beginning after December 31, 2007.

SECTION 8. TAXPAYERS THAT DO NOT USE THE SAFE HARBOR TREATMENT PROVIDED BY THIS REVENUE PROCEDURE

.01 A taxpayer that chooses not to apply the safe harbor treatment provided by this revenue procedure to a claimed theft loss is subject to all of the generally applicable provisions governing the deductibility of losses under § 165. For example, a taxpayer seeking a theft loss deduction must establish that the loss was from theft and that the theft was discovered in the year the taxpayer claims the deduction. The taxpayer must also establish, through sufficient documentation, the amount of the claimed loss and must establish that no claim for reimbursement of any portion of the loss exists with respect to which there is a reasonable prospect of recovery in the taxable year in which the taxpayer claims the loss.

.02 A taxpayer that chooses not to apply the safe harbor treatment of this revenue procedure to a claimed theft loss and that files or amends federal income tax returns for years prior to the discovery year to exclude amounts reported as income to the taxpayer from the investment arrangement must establish that the amounts sought to be excluded in fact were not income that was actually or constructively received by the taxpayer (or accrued by the taxpayer, in the case of a taxpayer using an accrual method of accounting). However, provided a taxpayer can establish the amount of net income from the investment arrangement that was reported and included in the taxpayer's gross income consistent with information received from the specified fraudulent arrangement in taxable years for which the period of limitation on filing a claim for refund under § 6511 has expired, the Service will not challenge the taxpayer's inclusion of that amount in basis for determining the amount of any allowable theft loss, whether or not the income was genuine.

.03 Returns claiming theft loss deductions from fraudulent investment arrangements are subject to examination by the Service.

SECTION 9. PAPERWORK REDUCTION ACT

The collection of information contained in this revenue procedure has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545-0074. Please refer to the Paperwork Reduction Act statement accompanying Form 1040, U.S. Individual Income Tax Return, for further information.

DRAFTING INFORMATION

The principal author of this revenue procedure is Norma Rotunno of the Office of Associate Chief Counsel (Income Tax & Accounting). For further information regarding this revenue procedure, contact Ms. Rotunno at (202) 622-7900.

APPENDIX A

Statement by Taxpayer Using the Procedures in Rev. Proc. 2009-20 to Determine a Theft Loss Deduction Related to a Fraudulent Investment Arrangement

Part 1. Identification

1. Name of Taxpayer _____
2. Taxpayer Identification Number _____

Part II. Computation of deduction

(See Rev. Proc. 2009-20 for the definitions of the terms used in this worksheet.)

Computation of Deductible Theft Loss Pursuant to Rev. Proc. 2009-20

Line

- 1 Initial investment
- 2 Plus: Subsequent investments
- 3 Plus: Income reported in prior years
- 4 Less: Withdrawals ()
- 5 Total qualified investment (combine lines 1 through 4)

- 6 Percentage of qualified investment (95% of line 5 for investors with no potential third-party recovery; 75% of line 5 for investors with potential third-party recovery)
- 7 Actual recovery
- 8 Potential insurance/SIPC recovery
- 9 Total recoveries (add lines 7 and 8) ()
- 10 Deductible theft loss (line 6 minus line 9)

Part III. Required statements and declarations

1.. I am claiming a theft loss deduction pursuant to Rev. Proc. 2009-20 from a specified fraudulent arrangement conducted by the following individual or entity (provide the name, address, and taxpayer identification number (if known)).

2 I have written documentation to support the amounts reported in Part II of this document.

3. I am a qualified investor as defined in § 4.03 of Rev. Proc. 2009-20.

4. If I have determined the amount of my theft loss deduction under § 5.02(1)(a) of Rev. Proc. 2009-20, I declare that I have not pursued and do not intend to pursue any potential third-party recovery, as that term is defined in § 4.10 of Rev. Proc. 2009-20.

5. If I have already filed a return or amended return that does not satisfy the conditions in § 6.02 of Rev. Proc 2009-20, I agree to all adjustments or actions that are necessary to comply with those conditions. The tax year or years for which I filed the return(s) or amended return(s) and the date(s) on which they were filed are as follows:

Part IV. Signature

I make the following agreements and declarations:

1. I agree to comply with the conditions and agreements set forth in Rev. Proc. 2009-20 and this document.

2. Under penalties of perjury, I declare that the information provided in Parts I-III of this document is, to the best of my knowledge and belief, true, correct and complete.

Your signature here _____ Date signed: _____

Your spouse's signature here _____ Date signed: _____

Corporate Name _____

Corporate Officer's signature _____

Title _____

Date signed _____

Entity Name _____

S-corporation, Partnership, Limited Liability Company, Trust

Entity Officer's signature _____

Date signed _____

Signature of executor _____

Date signed _____