DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

OFFICE OF
CHIEF COUNSEL

July 29, 2009

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Release Date: 9/25/2009

CONEX-131780-09

UIL: 165.11-00

The Honorable Mike Coffman
U.S. House of Representatives
Washington, DC 20515

Dear Mr. Coffman:

This letter responds to your inquiry dated June 18, 2009. You asked for clarification of certain definitions in Revenue Ruling 2009-9, 2009-14 Internal Revenue Bulletin 735, and Revenue Procedure 2009-20, 2009-14 I.R.B. 749. You also asked that we expand the definition of a "qualified investor" to include indirect investors and recognize the economic loss to holders of IRAs and other tax deferred accounts.

Rev. Rul. 2009-9 explains the income tax law that applies to investors who lost money in a fraudulent investment arrangement and are entitled to a theft loss deduction. Rev. Proc. 2009-20 provides an optional safe harbor treatment for qualified investors who lost money in certain fraudulent investment arrangements. Qualified investors under the revenue procedure include only investors that transferred cash or property to the perpetrators of the fraudulent scheme. These direct investors include individuals, partnerships, limited liability corporations, and other "persons" as defined in section 7701(a)(30) of the Internal Revenue Code (the Code). The primary reason for the restriction to direct investors in Rev. Proc. 2009-20 is because they are the party from which the perpetrator of the fraudulent arrangement stole money or property, and thus the proper party to compute and claim a theft-loss deduction under section 165 of the Code.

However, this restriction does not prevent indirect investors from benefitting from the safe harbor treatment or from deducting their share of a theft loss sustained by a passthrough entity. Partnerships (or entities that may elect to be taxed as partnerships, such as limited liability companies) that qualify as direct investors may use the safe harbor treatment and pass the loss through to the indirect investor (partner). Most hedge funds are organized as partnerships. Under subchapter K of the Code, a partnership must determine and report its taxable income or loss. However, the partnership is not taxed on its income. Instead, the partnership's income or loss is

passed through to its partners, who report their share of the income or loss on their own returns. Like other losses, theft losses a partnership incurred are determined at the partnership level, and partners deduct their ratable share of such losses as reflected on Schedule K-1. In this way, each indirect investor can benefit from the safe harbor in Rev. Proc. 2009-20 and claim the theft-loss deduction to which the investor is entitled.

You also wrote about investors whose stolen investments were in individual retirement accounts (IRAs) or similar tax-deferred investment vehicles. You asked that we allow these investors to deduct the loss, less the amount of federal income tax on the pre-tax investment. You also proposed the elimination of IRA and other required minimum distributions for all years until investors fully use the Ponzi scheme losses.

The Code limits a loss or other deduction to the taxpayer's cost or other "basis" to prevent multiple deductions or exclusions for the same amount. If taxpayers have basis in a tax-favored retirement plan or IRA (for example, because they made after-tax contributions to an IRA), they can take a miscellaneous itemized deduction to the extent they have unrecovered basis after their entire interest in the plan or IRA is distributed. For an IRA, the aggregate amount in all of the taxpayer's IRAs must have been distributed. If taxpayers have no basis in the retirement plan or IRA (for example, because they claimed a deduction for IRA contributions), they cannot take a deduction for the economic loss in the plan or IRA. Allowing taxpayers with no basis in a retirement plan or IRA to take a loss deduction for amounts that were deducted or excluded from gross income would provide those taxpayers two deductions, or both a deduction and an exclusion, for the same dollars. Two deductions also would put those taxpayers in a more favorable tax position than other taxpayers who contributed to a retirement plan or IRA on an after-tax basis and sustained a Ponzi scheme economic loss of the same or a similar amount (and thus received only one tax deduction).

The Code requires the payment of minimum distributions from retirement plans after age 70 ½. Exceptions to this requirement would require a legislative change. For example, Congress amended the Code to provide that the required minimum distribution rules do not apply to certain retirement plans for 2009.

I hope this information is helpful. I am sending a similar letter to your colleagues. If you have any questions, please contact me or at .

Sincerely,

Andrew J. Keyso
Deputy Associate Chief Counsel
(Income Tax and Accounting)

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The Honorable Doug Lamborn
U.S. House of Representatives
Washington, DC 20515

Dear Mr. Lamborn:

This letter responds to your inquiry dated June 18, 2009. You asked for clarification of certain definitions in Revenue Ruling 2009-9, 2009-14 Internal Revenue Bulletin 735, and Revenue Procedure 2009-20, 2009-14 I.R.B. 749. You also asked that we expand the definition of a "qualified investor" to include indirect investors and recognize the economic loss to holders of IRAs and other tax deferred accounts.

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Schedule K-1. In this way, each indirect investor can benefit from the safe harbor in Rev. Proc. 2009-20 and claim the theft-loss deduction to which the investor is entitled.

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The Honorable Ed Perlmutter
U.S. House of Representatives
Washington, DC 20515

Dear Mr. Perlmutter:

This letter responds to your inquiry dated June 18, 2009. You asked for clarification of certain definitions in Revenue Ruling 2009-9, 2009-14 Internal Revenue Bulletin 735, and Revenue Procedure 2009-20, 2009-14 I.R.B. 749. You also asked that we expand the definition of a "qualified investor" to include indirect investors and recognize the economic loss to holders of IRAs and other tax deferred accounts.

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The Honorable Jared Polis
U.S. House of Representatives
Washington, DC 20515

Dear Mr. Polis:

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