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INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

June 1, 2009

Number: **INFO 2009-0111**

Release Date: 6/26/2009

CONEX-123293-09

UIL: 165.10-00

The Honorable David Dreier
Member, U.S. House of Representatives
Washington, DC 20515

Attention:

Dear Congressman Dreier:

This letter responds to your inquiry dated April 16, 2009, on behalf of your constituent, _____, asked about the tax treatment of bank deposit losses arising from the foreclosure of financial institutions.

Unfortunately, the materials you enclosed did not provide enough information to address _____ specific circumstances. However, I hope the following general information is helpful.

A taxpayer can deduct any loss not compensated by insurance or otherwise (Section 165(a) of the Internal Revenue Code (the Code)). The taxpayer must incur the loss as a result of closed and completed transactions that are fixed by identifiable events, and except for a special rule relating to disaster losses that is not relevant here, actually sustained during the taxable year (Section 1.165-1(b) of the Income Tax Regulations). In the case of individuals, (section 165(c) and 165(h) of the Code) the law limits a deduction to:

- Losses incurred in a trade or business
- Losses incurred in any transaction entered into for profit, though not connected with a trade or business

- Losses of property not connected with a trade or business or a transaction entered into for profit, if such losses arise from fire, storm, shipwreck, or other casualty, or from theft

Certain taxpayers who experience a loss on their deposits in a qualified financial institution due to its bankruptcy or insolvency can elect to treat the loss as either a casualty loss under section 165(c)(3) incurred during the taxable year, or, (subject to certain limitations), as an ordinary loss incurred in a transaction entered into for profit under section 165(c)(2) (Section 165(l) of the Code). A qualified financial institution includes any bank (as defined in section 581), any institution described in section 591, any credit union where federal or state law insures, protects or guarantees deposits or accounts, or any similar institution chartered and supervised under federal or state law (Section 165(l)(3) of the Internal Revenue Code).

I am enclosing copies of Publication 547, Casualties, Disasters, and Thefts, and the instructions for Form 4684 which have more detail on the rules for reporting losses on deposits in insolvent or bankrupt financial institutions.

I hope this information is helpful. If you have further questions, please call me or
at .

Sincerely,

THOMAS D. MOFFITT
Chief, Branch 2
(Income Tax and Accounting)

Enclosures (2)