



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

OFFICE OF
CHIEF COUNSEL

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Dear _____ :

Thank you for your letter of February 27, 2009, to Commissioner Douglas Shulman about guidance on the tax consequences to victims of the investment fraud Mr. Bernard L. Madoff perpetrated. On March 17, 2009, we issued guidance, Revenue Ruling 2009-9 and Revenue Procedure 2009-20, on the tax treatment of losses from so-called "Ponzi schemes" similar to that Mr. Madoff operated. I am enclosing copies for your information.

Revenue Ruling 2009-9 explains the income tax law that applies to an investor who loses money in a fraudulent investment arrangement. It provides that:

- An investor who was the victim of a fraudulent investment arrangement is entitled to a theft loss deduction that is not limited by the rules that apply to capital losses.
- Investment theft losses are not subject to limitations that apply to personal casualty and theft losses.
- The theft loss is deductible in the year the fraud is discovered, except to the extent the investor has a reasonable prospect of recovery.
- The amount of the theft loss includes not only the investor's unrecovered investment, but also amounts reported as income from the investment in prior years and reinvested in the fraudulent investment arrangement.
- A theft loss deduction that creates a net operating loss for the investor can be carried back and forward according to the timeframes prescribed by law to generate a refund of taxes paid in other taxable years.

To claim a theft loss deduction in any taxable year, an investor must prove that the loss was due to theft and that no reasonable prospect exists of recovering the investment. Investors often cannot make highly factual determinations with certainty in the year the loss is discovered. For this reason, we published Revenue Procedure 2009-20 to provide a simplified method for investors to compute and report their losses from fraudulent investment schemes. This revenue procedure generally allows an investor who was a victim of Mr. Madoff's fraud to claim a theft loss in 2008. The amount the investor may deduct is up to 95 percent of the loss, less the amount of reimbursement he or she expects to receive as an advance for customer claims from the Securities Investor Protection Corporation (SIPC) or from private insurance or other contractual arrangements that guarantee the investor against loss.

I hope this information is helpful. If you have any questions, please call me or
 , Office of Chief Counsel, Income Tax and Accounting Division, at

Sincerely,

John P. Moriarty
Chief, Branch 1
(Income Tax and Accounting)

Enclosures (2)