



OFFICE OF THE CHIEF COUNSEL

DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
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Dear \_\_\_\_\_ :

Thank you for your letter of May 20, 2009 to \_\_\_\_\_ about tax consequences to victims of the investment fraud Mr. Bernard L. Madoff perpetrated. You 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 as a theft loss.

The Internal Revenue 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.

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).

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 & Accounting)