

BOLINGER, SEGARS, GILBERT & MOSS, L.L.P.

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November 6, 2009

Mr. Fernando M. Bustos, Esquire
McClesky, Harriger, Brazill & Graf, L.L.P.
P.O. Box 6170
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Dear Mr. Bustos:

In response to your request to provide information regarding the deductibility of "fraud losses" of investors on their federal income tax returns, we provide the following information for your reference:

In March of 2009, the Internal Revenue Service issued Revenue Procedure 2009-20, and Revenue Ruling 2009-9 to address the deductibility of certain fraud losses. In the Headnote to Revenue Ruling 2009-9, it is stated that in situations involving a cash-method taxpayer who invested sums of money with another individual who held himself out as an investment advisor but was later shown to have used funds in a Ponzi-type scheme, the IRS ruled that the loss incurred was a theft loss, not a capital loss, and as it arose from a transaction entered into for profit, it isn't subject to limitations under Code Sec. 165(h).

Revenue Procedure 2009-20 basically states that this loss deductibility is available to qualified investors, who have suffered a qualified loss, as the result of a specified fraudulent arrangement. As such, the following definitions are provided in Revenue Procedure 2009-20:

Qualified Investor: A United States person, as defined in Code Section 7701(a)(30) –

- 1) That generally qualifies to deduct theft losses under Code Sections 165 and 1.165-8;
- 2) That did not have 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 Code Sections 6662(d)(2)(C)(ii); and
- 4) That transferred cash or property to a specified fraudulent arrangement

Qualified Loss: A loss resulting from a specified fraudulent arrangement in which, as a result of the conduct that caused the loss,

- 1) The lead figure was charged by indictment or information (not withdrawn or dismissed) under state or federal law with the commission of fraud, embezzlement or a similar crime that, if proven, would meet the definition of theft for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

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- 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 above, 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.

Specified Fraudulent Arrangement: An arrangement in which the 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. These arrangements are often referred to as Ponzi-type schemes.


These three definitions drive the deductibility of the loss as a theft loss and represent the wording necessary to analyze the situation.

This letter is not intended to provide information regarding the steps to be taken by the taxpayer to properly measure, document and secure the deduction on the federal income tax return. Rather, it is provided to reference the wording that is used in IRS regulations for the proper identification and analysis of certain situations that may apply to taxpayers that have suffered "fraud losses".

Please review this information and let me know if you have any questions or need anything further.

Very truly yours,

BOLINGER, SEGARS, GILBERT & MOSS, L.L.P.

 CPA, CFE

Steve Dawson, CPA, CFE