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

OFFICE OF CHIEF COUNSEL

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Dear :

This letter responds to your letter dated February 28, 2009, to Commissioner Douglas Shulman recommending procedures for the administration of protective claims filed in connection with the tax treatment of investor losses arising from .

The allegations against are that he was operating a large scale Ponzi scheme. If these allegations are true, investors may qualify to claim a theft loss deduction. Generally, the law considers investor losses from a Ponzi scheme as arising from theft. Theft generally includes the taking of money or property through blackmail, burglary, embezzlement, extortion, kidnapping for ransom, larceny, robbery, fraud, or misrepresentation. The taking of property must be illegal under the law of the state where it occurred and carried out with criminal intent.

Individuals can deduct a theft loss in the year they discover the theft, except where a reasonable prospect of recovery exists. Whether a reasonable prospect of recovery exists depends on all the facts known at the end of the tax year. Therefore, until individuals can determine the potential recovery with reasonable certainty (either through insurance, asset recovery, or other means), they cannot establish the year of the loss deduction.

We appreciate your suggestions concerning the filing of protective claims and are closely following the developments relating to the allegations against and are aware of questions about taxpayers' ability to amend returns to remove previously reported "phantom earnings" and file refund claims. As further information develops, we will be in a better position to advise you on the tax consequences with more specificity.

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)