Tax Commission Offers Guidance on Ponzi Schemes

The Internal Revenue Service (IRS) issued guidance to taxpayers on the federal tax treatment of losses from criminally fraudulent investment arrangements that take the form of Ponzi schemes. This guidance included Revenue Ruling 2009-9 and Revenue Procedure 2009-19 and 2009-20. The following provides guidance for Idaho income tax purposes.

I. Rev. Rul. 2009-9

In Rev. Rul. 2009-9, the IRS describes the proper federal income tax treatment for losses resulting from Ponzi schemes.

(1) Is a loss from criminal fraud or embezzlement in a transaction entered into for profit a theft loss or a capital loss under section 165 of the Internal Revenue Code (IRC)?

IRS Holding: A loss from criminal fraud or embezzlement in a transaction entered into for profit is a theft loss, not a capital loss, under IRC section 165.

Idaho Law: Idaho law follows the federal determination that the loss is a theft loss, not a capital loss. Idaho Code section 63-3002.

(2) Is such a loss subject to either the personal loss limits in IRC section 165(h) or the limits on itemized deductions in IRC sections 67 and 68?

IRS Holding: A theft loss in a transaction entered into for profit is deductible under IRC section 165(c)(2), not IRC section 165(c)(3), as an itemized deduction that is not subject to the personal loss limits in IRC section 165(h), or the limits on itemized deductions in IRC sections 67 and 68.

Idaho Law: Idaho law follows the federal determination that the theft loss is not subject to the personal loss limits or the limits on itemized deductions. Idaho Code section 63-3002.

(3) In what year is such a loss deductible?

IRS Holding: A theft loss in a transaction entered into for profit is deductible in the year the loss is discovered, provided that the loss is not covered by a claim for reimbursement or recovery with respect to which there is a reasonable prospect of recovery.

Idaho Law: Idaho law follows the federal determination on the year the loss is deductible. Idaho Code section 63-3002.

(4) How is the amount of such a loss determined?

IRS Holding: The amount of a theft loss in a transaction entered into for profit is generally the amount invested in the arrangement, less amounts withdrawn, if any, reduced by reimbursements or recoveries, and reduced by claims to which there is a reasonable prospect of recovery. Where an amount is reported to the investor as income prior to discovery of the arrangement and the investor includes that amount in gross income and reinvests this amount in the arrangement, the amount of the theft loss is increased by the purportedly reinvested amount.

Idaho Law: Idaho law follows the federal determination of the loss amount. Idaho Code section 63-3002.

(5) Can such a loss create or increase a net operating loss under IRC section 172?

IRS Holding: A theft loss in a transaction entered into for profit may create or increase a net operating loss under IRC section 172 that can be carried back up to 3 years and forward up to 20 years. An eligible small business may elect either a 3, 4, or 5-year net operating loss carryback for an applicable 2008 net operating loss.

Idaho Law: Idaho law requires the addback of the federal net operating loss deduction used in arriving at federal taxable income. Idaho Code section 63-3022(b).

Idaho Net Operating Loss - In Rev. Rul. 2009-9, the IRS held that the theft loss in a transaction entered into for profit is deductible as a business itemized deduction under IRC section 165(c)(2), not IRC section 165(c)(3). One of the requirements in determining an Idaho net operating loss is the requirement to add back itemized deductions except for any deduction allowable under IRC section 165(c)(3) for casualty losses on property physically located within Idaho; therefore, Idaho law requires the loss be added back in determining the amount of an Idaho net operating loss. Idaho Code section 63-3021. See also Idaho State Tax Commission decision issued in Docket Number 19797 and published in 2007 at: http://tax.idaho.gov/s-results-decisions.cfm?dnum=19797.

(6) Does such a loss qualify for the computation of tax provided by IRC section 1341 for the restoration of an amount held under a claim of right?

IRS Holding: A theft loss in a transaction entered into for profit does not qualify for the computation of tax provided by IRC section 1341.

Idaho Law: Since the theft loss does not qualify for the computation of tax provided by IRC section 1341, Idaho law would not allow a claim of right adjustment under either Idaho Code section 63-3002 or 63-3022F.

(7) Does such a loss qualify for the application of IRC sections 1311-1314 to adjust tax liability in years that are otherwise barred by the period of limitations on filing a claim for refund under IRC section 6511?

IRS Holding: A theft loss in a transaction entered into for profit does not qualify for the application of IRC sections 1311-1314 to adjust tax liability in years that are otherwise barred by the period of limitations on filing a claim for refund under IRC section 6511.

Idaho Law: Not applicable. Idaho law does not contain provisions similar to the federal mitigation provisions.

II. Rev. Proc. 2009-20

In Rev. Proc. 2009-20, the IRS provides an optional safe harbor procedure for taxpayers who experienced losses in certain investment arrangements discovered to be criminally fraudulent. The IRS also describes how it will treat a return that claims a deduction for such a loss and does not use the safe harbor procedure.

(1) If a taxpayer chooses the federal safe harbor procedure, which allows a loss to be deducted in the discovery year, will Idaho allow the deduction in the discovery year?

Answer: Yes. However, see discussion under heading **I.**(5) in this document relating to the determination of an Idaho net operating loss.

(2) If a taxpayer does not choose the federal safe harbor procedure, the IRS allows the taxpayer to file amended returns for prediscovery years provided the statute of limitations is still open on those years. Should taxpayers also file Idaho amended returns?

Answer: Yes. The filing of a federal amended return does not extend the Idaho statute of limitations for filing a refund claim. Idaho Income Tax Administrative Rule 880.08.

III. Rev. Proc. 2009-19

In Rev. Proc. 2009-19, the IRS provides guidance to taxpayers as to the time and manner for making an election under IRC section 172(b)(1)(H), including the election of a 3, 4, or 5-year carryback period and an election to apply IRC section 172(b)(1)(H) to a net operating loss for a taxable year beginning in 2008, instead of a net operating loss for a taxable year ending in 2008.

(1) Does Idaho adopt the federal net operating carryback provisions, including the federal election allowing an eligible small business to elect either a 3, 4, or 5-year net operating loss carryback, for an applicable 2008 net operating loss?

Answer: No. The carryback and carryforward period for an Idaho net operating loss is governed by Idaho Code section 63-3022(c)(1). Idaho law only provides for a two-year carryback period.

(2) IRS Rev. Proc. 2009-19 allows for the revocation of the election to forego the carryback period for an applicable 2008 net operating loss for a tax year ending before February 17, 2009. The revocation of the election to forego and the new election to claim a 3, 4, or 5-year carryback period must be filed on or before April 17, 2009.

a. Does the revocation impact the Idaho election to forego the Idaho carryback period if the Idaho election was made by:
   i. Checking the box on the Idaho form, or
   ii. Attaching a federal election to forego the Idaho carryback period?

Answer: No. The revocation of the federal election to forego the federal carryback period does not revoke the Idaho election to forego the carryback period. An election to forego the Idaho net operating loss carryback period is an irrevocable election. Idaho Code section 63-3022(c)(1).

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