

BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO

In the Matter of the Protest of

██████████
██████████
██████████

Petitioners.

DOCKET NO. 1-890-247-680

DECISION

██████████ (Petitioners) protested the Notice of Deficiency Determination (Notice) dated August 8, 2024. Petitioners disagreed with the changes the Income Tax Audit Bureau (Bureau) made to their individual income tax returns filed for tax years 2022 and 2023 (audit period). The Idaho State Tax Commission (Tax Commission) reviewed the matter and for the reason stated below upholds the Notice.

BACKGROUND

Petitioners filed their 2022 income tax returns, claiming \$1,210,643 of itemized deductions for a Ponzi loss¹, on line 16, Schedule A, federal Form 1040, which resulted in an Idaho net operating loss (NOL) on their Idaho return. Petitioners carried over the 2022 Idaho NOL to tax year 2023 and utilized it to decrease their Idaho tax due.

The Bureau disallowed Petitioners' Ponzi loss deduction, which reduced total itemized deductions to \$0 for tax year 2022. Upon disallowance of the Ponzi loss deduction, there is no Idaho NOL to be carried over to tax year 2023; therefore, the Bureau disallowed the deduction of the Idaho NOL carryover. The Bureau made these adjustments and issued a Notice.

¹ Petitioners claimed Ponzi loss as a result from their investments with ██████████ the lead figure (address: ██████████) identified by Petitioners on their Form 4684, Section C, Part II. Required Statements and Declarations.

Petitioners protested the Notice, disagreeing with the Bureau’s determination, and argued that “there is missing documentation that led to misinterpretation” of their tax returns for the audit period; however, Petitioners did not provide any information warranting a modification to the Notice. The Bureau acknowledged the protest and referred the matter to the Tax Commission’s Appeals Unit (Appeals) for administrative review.

Appeals sent Petitioners a letter explaining the options available for redetermining a Notice. Petitioners responded and requested an informal hearing, which was held on October 17, 2024. During the hearing, Mr. [REDACTED] indicated that he would provide additional information; however, Appeals has yet to receive any additional information. Having reviewed the file, the Tax Commission hereby issues its final decision.

LAW AND ANALYSIS

Internal Revenue Code section 165 states in pertinent part, as follows:

(a) General Rule. There shall be allowed as a deduction any loss sustained during the taxable year and not compensated for by insurance or otherwise.

(c) Limitation on Losses of Individuals. In the case of an individual, the deduction under subsection (a) shall be limited to--

(1) losses incurred in a trade or business;

(2) losses incurred in any transaction entered into for profit, though not connected with a trade or business; and

(3) except as provided in subsection (h), losses of property not connected with a trade or business or a transaction entered into for profit, if such losses arise from fire, storm, shipwreck, or other casualty, or from theft. (emphasis added)

(h) Treatment of Casualty Gains and Losses

(5) Limitation for Taxable Years 2018 through 2025

(A) In general

In the case of an individual, except as provided in subparagraph (B)², any personal casualty loss which (but for this paragraph) would be deductible in a taxable year beginning after December 31, 2017, and

² IRC section 165(h)(5)(B) “Exception Related to Personal Casualty Gains”, which is not relevant to this case.

before January 1, 2026, shall be allowed as a deduction under subsection (a) only to the extent it is attributable to a Federally declared disaster (as defined in subsection (i)(5)). (emphasis added)

Treasury Regulation (Treas. Reg.) section 1.165-8(d) states that theft is “deemed to include, but shall not necessarily be limited to, larceny, embezzlement, and robbery.” Revenue Ruling (Rev. Rul.) 72-112 expands on the definition of “theft” as a taking of property that was illegal under the law of the jurisdiction in which it occurred and was done with criminal intent. Internal Revenue Procedure (Rev. Proc.) 2009-20 addresses the tax treatment of losses from criminally fraudulent investment arrangements³ and confirms that a Ponzi loss may be deductible under IRC section 165(c)(2), without the IRC section 165(h) limitation, if a “qualified investor⁴” elects to use the safe harbor treatment and claims a “qualified loss” in the proper “discovery year⁵”.

Rev. Proc. 2009-20, Section 4.02, provides the following definition:

A qualified loss is a loss resulting from a specified fraudulent arrangement in which, as a result of the conduct that caused the loss —

(1) The lead figure (or one of the lead figures, if more than one) 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 § 165 of the Internal Revenue Code and § 1.165-8(d) of the Income Tax Regulations, under the law of the jurisdiction in which the theft occurred; or

(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 in section 4.02(1) of this revenue procedure, 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.

³ Revenue Ruling 2009-9

⁴ Rev. Proc. 2009-20, Section 4. 03

⁵ Rev. Proc. 2009-20, Section 4. 04

Section 4.04 of Rev. Proc. 2009-20 provides that “a qualified investor’s discovery year is the taxable year of the investor in which the indictment, information, or complaint described in section 4.02 of this revenue procedure is filed.” If a taxpayer claims the loss in years after the discovery year, the taxpayer is not entitled to the loss deduction. *Giambrone v. Commissioner*, TC Memo 2020-145 (10/19/2020)

In the present case, Petitioners federally filed Form 4684 with their Form 1040 as they elected to use the safe harbor treatment. On their federal Form 4684, Section C, Part II, Petitioners chose to limit the loss deduction to ninety-five percent (95%)⁶ of the total Ponzi loss because of no potential third-party recovery. Petitioners claimed \$1,210,643 (\$1,184,743 of Ponzi loss deduction, plus \$25,900 of standard deduction for married filing joint) for their itemized deduction on Schedule A, federal Form 1040. The Internal Revenue Service (IRS) and Idaho allow a taxpayer to claim either the standard deduction or itemized deductions⁷ but not both.

Petitioners have filed a complaint regarding the Ponzi scheme with the United States Department of Justice, Federal Bureau of Investigation. As the investigation is ongoing, there are no indictments or state and/or federal criminal cases charged against the lead figure. While the lead figure may be the subject of a federal criminal complaint, there is no evidence of the lead figure admitting to the alleged complaint, nor is there an affidavit executed by the lead figure admitting to the crime. Therefore, the Tax Commission finds Petitioners’ loss is not a “qualified loss” under Rev. Proc. 2009-20, and their allowable deduction from gross income for tax year 2022

⁶ Federal Form 4684, line 46 “Enter 0.95 (95%) if you have no potential third-party recovery. Enter 0.75 (75%) if you have potential third-party recovery.” Petitioners entered “0.95” on line 46. In this case, \$1,184,743 is 95% of total Ponzi loss.

⁷ IRC section 63 and Idaho Code section 63-3022(j).

is \$25,900, the standard deduction. The change to the standard deduction creates a tax due for 2022 and eliminates the loss carryover going into 2023.

During the hearing, Petitioners raised the question, if the IRS allows a Ponzi loss as an itemized deduction, which results in a federal NOL, does that constitute an Idaho NOL?

Idaho has its own state specific NOL statute as outlined in Idaho Code section 63-3021. To calculate an Idaho NOL, Idaho Code section 63-3021(b) requires the following amounts to be added to Idaho taxable income:

- (1) The amount of any net operating loss deduction included in Idaho taxable income.
- (2) In the case of a taxpayer other than a corporation:
 - (i) Any amount deducted due to losses in excess of gains from sales or exchanges of capital assets; and
 - (ii) Any deduction for long-term capital gains provided by this chapter.
- (3) Any deduction allowed under section 151 of the Internal Revenue Code (relating to personal exemption) or any deduction in lieu of any such deduction.
- (4) Any deduction for the standard or itemized deductions provided for in section 63 of the Internal Revenue Code, or section 63-3022(j), Idaho Code, **except for any deduction allowable under section 165(c)(3) of the Internal Revenue Code (relating to casualty losses)** pertaining to property physically located inside Idaho at the time of the casualty.

Idaho Code section 63-3021(b)(4) requires itemized deductions to be added back unless the deduction is allowable under IRC section 165(c)(3). Under the Tax Cuts and Jobs Act of 2017, only losses under IRC section 165(c)(3) may be used to calculate an Idaho NOL in taxable years 2018 through 2025 and only if they are attributable to a federally declared disaster⁸. A Ponzi loss is a deduction under IRC section 165(c)(2), not IRC section 165(c)(3); therefore, it must be added back to calculate Idaho taxable income. Even if the Ponzi loss is a qualified loss claimed in the

⁸ IRC section 165(h)(5)

proper discovery year, because of the addback of the itemized deduction, there is no Idaho NOL for 2022; therefore, there is no Idaho NOL to be carried over to 2023.

CONCLUSION

The Tax Commission finds that the Ponzi loss claimed by Petitioners is not a loss qualified for deduction. Furthermore, even if it was a qualified loss and deductible as an itemized deduction for federal purposes, it does not generate an Idaho NOL as Idaho requires individuals to add back federal itemized deductions. Either way, Petitioners do not have an Idaho NOL. The Notice added penalty and interest to the tax due amount shown on Petitioners' return. The Tax Commission finds these additions appropriate and in accordance with Idaho Code sections 63-3045 and 63-3046.

THEREFORE, the Tax Commission AFFIRMS the Notice dated August 8, 2024, directed to Petitioners.

| <u>YEAR</u> | <u>TAX</u> | <u>PENALTY</u> | <u>INTEREST</u> | <u>TOTAL</u> |
|-------------|------------|----------------|-----------------|-----------------|
| 2022 | \$8,640 | \$432 | \$436 | \$9,508 |
| 2023 | 7,752 | 388 | 116 | 8,256 |
| | | | Total Due | <u>\$17,764</u> |

DEMAND for immediate payment of the foregoing amount is hereby made and given.

An explanation of Petitioners' right to appeal this decision is enclosed.

DATED this _____ day of _____ 2025.

IDAHO STATE TAX COMMISSION

CERTIFICATE OF SERVICE

I hereby certify that on this _____ day of _____, 2025,
a copy of the within and foregoing DECISION was served by sending the same by United States
mail, postage prepaid, in an envelope addressed to:

██████████ ██████████ ██████████
██████████ ██████████

Receipt No.

