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- Graduate of Georgetown Law J.D. – Georgetown University
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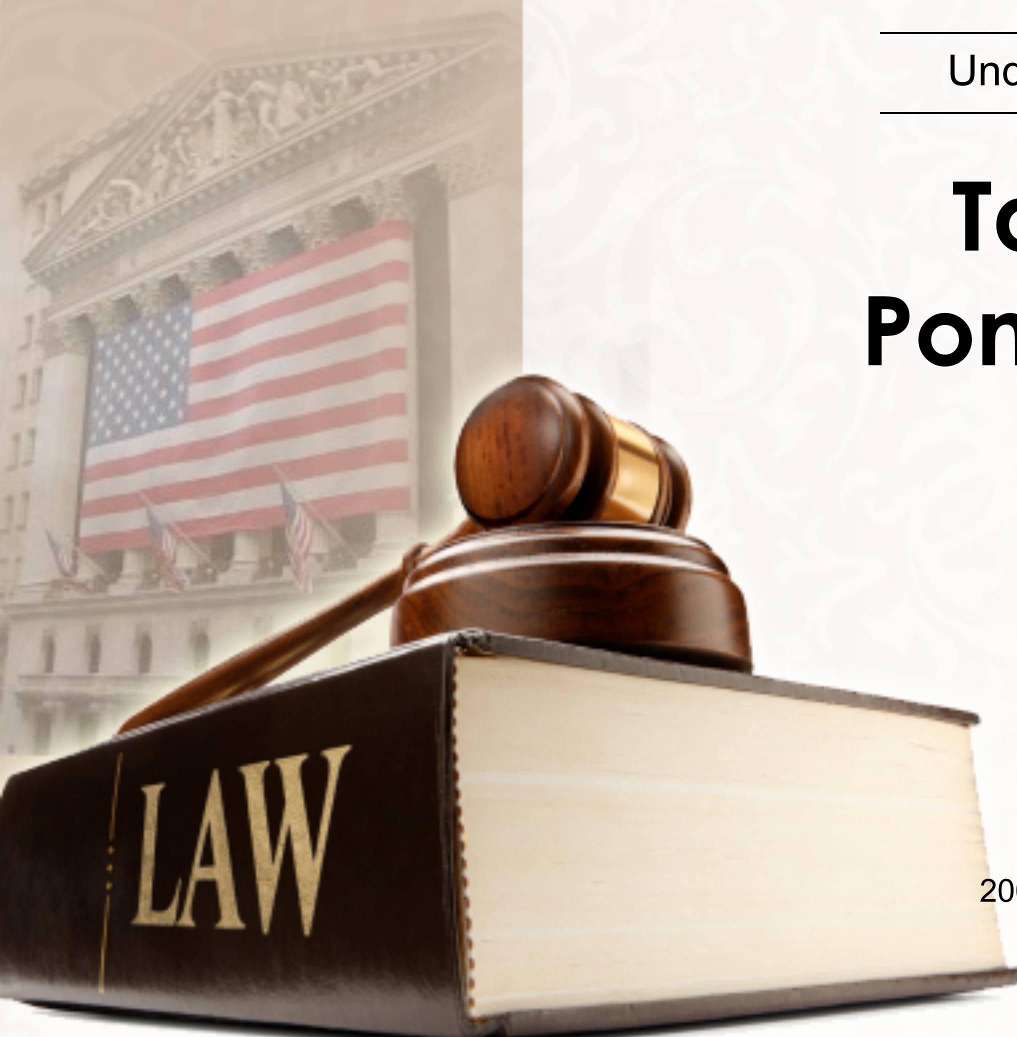
- U.S. Tax Court and Internal Revenue Service experience in Washington D.C.
  - » Served as a law clerk to the Honorable William M. Fay, U.S. Tax Court
  - » Senior Attorney, Interpretative Division, Chief Counsel's Office, Internal Revenue Service, Washington D.C
- The firm regularly works with law firms, accountants, businesses and individuals struggling to find their way through the complexities of the tax law.
- With nearly 50 years as a tax lawyer in Florida, Lehman has built a boutique tax law firm with a national reputation for being able to handle the toughest tax cases, structure the most sophisticated income tax and estate tax plans, and defend clients before the IRS.

The Ponzi Scheme & TAX LOSS

IRS

Under The New 2017 Tax Cut & Jobs Act

Tax Refunds from Ponzi Scheme Losses Are Extremely Valuable



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Tax Refunds from Ponzi Scheme Losses Are Extremely Valuable

- Ordinary Income Loss can be used against all types of income.
- Loss Carry Backs Eliminated
- Fast Process to Receive Cash – Tax Refund and Amended Returns – No Litigation Costs or Delays
- Most Secure Payer – United States Government
- Can be as High as 35% Return for each Dollar Loss and more for state income tax refunds and due to the absence of deduction limitations
- Can be a lower value in future due to reduced tax rates.
- Unlimited Carry Forward
- Possibility of Receiving Interest on Tax Refunds from Prior Years

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Value Can Be Lost Without Good Professional Advice

The Theft Loss allows a deduction for loss sustained during the taxable year and not compensated by insurance or otherwise.

For federal income tax purposes, "theft" is a word of general and broad connotation, covering any criminal appropriation of another's property to the use of the taker, including theft by swindling, false pretenses and any other form of guile.

A taxpayer claiming a theft loss must prove that the loss resulted from a taking of property that was illegal under the law of the jurisdiction in which it occurred and was done with criminal intent. However, a taxpayer need not show a conviction for theft.

The Ponzi Schemes

An Investment Scheme. . .
You Were Promised Large Profits.
Received Theft Loss.

The Law on Direct Ponzi Losses

Ordinary Loss

The revenue ruling clarified the benefits of a business oriented theft loss. The Ponzi scheme loss is an ordinary deduction for losses incurred in a transaction entered into for profits.

The Amount of The Loss (Basis) & Phantom Income

- ***Definition of Phantom Income:***

  The Revenue Ruling and the Revenue Procedure both acknowledge that:

  Theft loss resulting from a Ponzi scheme is generally. . .

  1. The initial amount invested in the arrangement

     plus

  2. Any additional investments upon which taxes have been paid, less amounts withdrawn

The I.R.S. agrees that if an amount is reported to the investor as income in years prior to the **year of discovery** of the theft and the investor includes the amount in gross income; then the amount of the theft loss is increased by the purportedly reinvested amount (the "Phantom Income").

Year of Discovery

The year of discovery is very important and evidence is critical here to show exactly when and how a taxpayer can pin down this time.

We look to several examples of CASE LAW to help us to define the “year of discovery” of a theft loss.

Year of Discovery

Definition of Taxable Year of Discovery

"…any loss arising from theft shall be treated as sustained during the taxable year in which the taxpayer discovers such loss." A loss is considered to be discovered when a reasonable person in similar circumstances would have realized that he or she had suffered an unrecoverable loss. Although a theft loss must be considered as sustained in the year of its discovery, [The code section] does not indicate that discovery of some false representation (even amounting to theft under applicable law) creates a theft loss as of the date of the discovery of the falsity of the representation. The statue "refers to the year of discovery of the loss, not of the theft."

The Amount & Timing Of The Theft Loss

Reasonable Prospect of Recovery

Definition of "Reasonable Prospect of Recovery"

The taxpayer must postpone taking loss if there is a reasonable prospect of recovery.

A reasonable prospect of recovery exists when the taxpayer has a bona fide claim for recoupment from third parties or otherwise, and when there is a substantial possibility that such claims will be decided in the taxpayer's favor. The taxpayer is not, however, required to be an "incorrigible optimist" and claims with only remote or nebulous potential for success will not postpone the deduction.

Reasonable Prospect of Recovery

1. In determining the reasonableness of a taxpayer’s belief of loss the courts had to be practical and aware of the individual facts of a case.

2. Circumstances are those that are known or reasonably could be known as of the end of the tax year for which the loss deduction is claimed. The only test is foresight, not hindsight.

3. Both objective and subjective factors must be examined.

Reasonable Prospect of Recovery

The taxpayer’s legal rights as of the end of the year of discovery are all important and need to be studied to make a proper decision.

One of the facts and circumstances deserving of consideration is the probability of success on the merits of any claim brought by the taxpayer.

The filing of a lawsuit may give rise to an inference of a reasonable prospect of recovery. However, the inference is not conclusive nor mandatory. The inquiry should be directed to the probability of recovery as opposed to the mere possibility. A “remote possibility” of recovery is not enough; there must be “a reasonable prospect of recovery at the time the deduction was claimed, not later”.

Helpful Documents

The Internal Revenue Service in the years 2009 published two very helpful documents to guide taxpayers about;

1) The law of Ponzi Scheme tax recoveries
(Revenue Ruling 2009-9)

2) A simplified method of claiming the tax deductions so long as the financial theft met certain standards
(Revenue Procedure 2009-20)

The Safe Harbor

The IRS Revenue Procedure

The Safe Harbor

There was also a **revenue procedure** that outlined an easy administrative process to claim refunds from **direct Ponzi losses only**. This was called the Safe Harbor.

The Safe Harbor is very meaningful for direct Ponzi Scheme victims.

By the end
of this presentation
you will better
understand how
these items relate
to ponzi scheme
tax loss:

THE LAW &

The Internal Revenue Ruling

—

THE SAFE HARBOR &

The Internal Revenue Procedure

—

TAX PLANNING

How the taxpayer will plan and implement his or her Ponzi scheme tax loss for maximum benefits now and in the future. This includes changes from the 2017 Tax Cut & Jobs Act.

Ponzi Schemes & Theft Loss

- Amount of the Theft Loss
- Year of Theft Loss Deduction
- Amount of Theft Loss Deduction in Year of Discovery
- Amount of Theft Loss Deduction in Later Years

Theft Loss
vs
Amended Returns

The 2017 Tax Cut & Jobs Act

- Loss carrybacks have been eliminated
- Now Unlimited carry forward as opposed to prior rules with a 20-year limitation.

Amended Returns

No Litigation Costs or Delays

- Instead of claiming a theft loss as a deduction that may be claimed in a lower tax bracket – a deduction may be obtained by amending tax returns to eliminate only the Ponzi Scheme income.
  - This may be more valuable than a theft loss deduction as an amended return from an open year will typically provide a refund from the income in a higher bracket.
- The claiming of a deduction by amending a tax return will not work if the tax year is closed.

Tax Refunds from Ponzi Scheme Losses Are Extremely Valuable

Summary

1. A financial theft occurs
2. In the year the loss is discovered a business deduction can be claimed.
3. The amount that can be claimed in the year of discovery may be limited if there is a reasonable prospect of recovery.
4. Those deductions that could not be taken because there was a “reasonable prospect of recovery” can be taken when it is **“ascertained with a reasonable certainty”** that they no longer can be recovered.

With the elimination of “**loss carrybacks”** under the new Trump Tax Cut and Jobs Act, it is important for Ponzi Scheme losses that could be deducted in 2016, 2017 to be **carefully studied**.

Refunds can be as high as 37% return for each dollar of loss, as high as 37% and 39.6 for losses <u>discovered prior to 2018.</u>

Plus additional refunds from state income taxes.

Non-Business

Another new change in the Trump tax bill which does not effect Ponzi Scheme Losses, but needs to be known, non-business theft losses are no longer deductible.

The 2017 Tax Cut & Jobs Act will no longer allow a theft loss deduction for non-income producing endeavors.

IT IS CRITICAL if you have higher tax bracket losses prior to the year 2018 that the taxpayer claim as much of these losses in the proper pre 2018 years as possible.

Non-Business

This means for most taxpayers that carryback refunds can be achieved for Ponzi Scheme theft losses in the years 2016, 2017 and possible 2015.

It is also critical to be able to substantiate the discovery of the fraud in a prior year and to maximize the amount to be recovered.

This depends upon when the “reasonable prospect” of recovery no longer exists.

The Law on Direct Ponzi Losses

The Revenue Ruling (The Law) and the Revenue Procedure (The Safe Harbor)

THEFT LOSS DEDUCTIONS

- The revenue ruling defined the word "theft" for tax purposes and held that a Ponzi scheme loss was a theft loss that resulted from a "transaction entered into for profit". It was not a capital loss.

The Law on Direct Ponzi Losses

ORDINARY LOSS

- The **revenue ruling** clarified the benefits of a business oriented theft loss. The Ponzi scheme loss is an ordinary deduction for losses incurred in a transaction entered into for profits.

The Law on Direct Ponzi Losses

DEDUCTION IS NOT SUBJECT TO CERTAIN LIMITATIONS ON ITS USE

- As an ordinary loss, the Ponzi Theft Loss is not subject to the limits on personal deductions or the limits on itemized deductions.

The Law on Direct Ponzi Losses

DEDUCTIBLE IN YEAR OF DISCOVERY

- The theft loss is deductible in the year the loss is discovered.

AMOUNT OF THEFT LOSS IN A PONZI SCHEME

Ascertainable Standard

How much might still be recovered?

Once the taxpayer has deducted all that could be deducted in the year of discovery by reducing the loss for all reasonable prospects of recovery the tax in year two, after the discovery year, from this point on will be able to claim continuing theft loss deductions until the loss is recovered in full.

- However, at this point the taxpayer cannot deduct any more of his or her un-deducted theft loss unless the deduction can be "ascertained with a reasonable certainty". This is a higher standard of proof.

Other Reductions to Qualified Investment Loss

SAME FOR SAFE HARBOR OR THE LAW

1. Loss Reduced by Actual Recovery Received in the year of Discovery
2. Loss Reduced by Insurance policies In the name of the Qualified investor
3. Loss Reduced by Contractual arrangements that guarantees or otherwise protects against loss of the qualified investment
4. Loss Reduced by Certain Amounts Payable from the Securities Investor Protection Corporation (SPIC)

Quantifying the Amount of Theft Loss Deduction in Year of Discovery

The IRS Revenue Procedure **SAFE HARBOR**	**COMPARISON OF LOSS PERMITTED**	The IRS Revenue Ruling **THE LAW**
100%	TOTAL AMOUNT OF QUALIFIED INVESTMENT LOSS	100%
95% Loss Allowed (Loss Reduced by 5%)	"RESPONSIBLE GROUP" RECOVERY SOUGHT	Loss Reduced by any Potential Recovery from the Ponzi Scheme "Responsible Group"
75% Loss Allowed (Loss Reduced by 25%)	THIRD PARTY RECOVERY SOUGHT	Loss Reduced by any Potential Third Party Recovery

The Elimination of Non-business

Theft losses and the continued availability of the “for profit” theft loss.

The new Trump Tax law will no longer allow a theft loss deduction for non income producing endeavors.

PROFESSIONAL

Tax Planning

With the professional team in place, the steps generally will be as follows:

1. Records
2. Basis Calculations
3. Sources of Recovery
4. Loss in Year of Discovery
5. Accounting Schedules and Forecasts

These projections will be critical.

Quantifying the Amount of Theft Loss Deduction in Year of Discovery

The IRS Revenue Procedure **SAFE HARBOR**	**COMPARISON OF LOSS PERMITTED**	The IRS Revenue Ruling **THE LAW**
100%	TOTAL AMOUNT OF QUALIFIED INVESTMENT LOSS	100%
95% Loss Allowed (Loss Reduced by 5%)	"RESPONSIBLE GROUP" RECOVERY SOUGHT	Loss Reduced by any Potential Recovery from the Ponzi Scheme "Responsible Group"
75% Loss Allowed (Loss Reduced by 25%)	THIRD PARTY RECOVERY SOUGHT	Loss Reduced by any Potential Third Party Recovery

The Safe Harbor

The IRS Revenue Procedure

The Safe Harbor

The *Safe Harbor* requires that the Ponzi scheme victims forego the opportunity to file amended returns for those years that are still open by the statute of limitations.

However, by amending a prior return instead of taking a theft loss deduction, a taxpayer can eliminate only the taxpayer's Ponzi scheme "phantom income" from the taxable income in the prior years. This will typically be the high bracket income.

Qualified 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 purpose of the Internal Revenue Code and of the Income Tax Regulations, under the law of the jurisdiction in which the theft occurred; **or**

Qualified Loss

(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 this revenue procedure, and either –

- ✓ The complaint alleged an admission by the lead figure, or the execution of an affidavit by that person admitting the crime; or
- ✓ A receiver or trustee was appointed with respect to the arrangement or assets of the arrangement were frozen.

Qualifying For Safe Harbor

In the event the taxpayer **does not qualify** for the Safe Harbor which is often the case since many Ponzi Schemes do not reach the level of the perpetrators being found to be criminals.

There is still the distinct possibility that victims of Ponzi Schemes may recover under the Code Section in the Internal Revenue Code that permits the deduction of a theft loss that is incurred in a trade or business or a theft “transaction” entered into for profit.

Qualifying For Safe Harbor

It is very helpful when seeking the deduction to make use of a **criminal attorney** who will look at the **fact pattern of the theft** and be able to opine that the theft loss rises to the level that may warrant criminal prosecution even though the authorities have not proceeded in that direction.

NOTE: Under the 2017 Tax Cut & Jobs Act a theft loss that is **not** a result of a trade or business loss or a loss incurred in **a transaction entered into for profit** will **no longer** be the subject of **a theft loss deduction**.

Comparison of Revenue Procedure *vs* Revenue Ruling

The Determination	The Revenue Procedure & THE SAFE HARBOR	vs. THE LAW & The Revenue Ruling
A Ponzi Scheme Loss is a Theft Loss Deductible as an Ordinary Loss	AGREED - Result similar to Revenue Ruling	AGREED - Result similar to Safe Harbor
The Amount of the Loss (Basis) Includes Phantom Income	AGREED - Result similar to Revenue Ruling	AGREED – Result similar to Safe Harbor
NO Loss Carry Back of Net Operating Losses Applies for years after taxable year 2018	AGREED - Result similar to Revenue Ruling	AGREED - Result similar to Safe Harbor
The Deduction is not Reduced by the Application of Certain Percentage or Dollar Limitations. It is a 100% Loss	AGREED – Result similar to Revenue Ruling	AGREED – Result similar to Safe harbor
Respect for Pass Through Entities Taxpayer is not the entity	AGREED -Result similar to Revenue Ruling	AGREED - Result similar to Safe Harbor

Comparison of Revenue Procedure *vs* Revenue Ruling

The Determination	The Revenue Procedure & THE SAFE HARBOR	vs. THE LAW & The Revenue Ruling
Year of Discovery Deductibility -	Agreement by I.R.S. to a defined set of events/ Criminal behavior	Taxpayer must rely on case law for similar results
Amount of Loss Recognized in Year of Discover	Agreement by I.R.S. to specific percentage amounts	Taxpayer must rely on on case law for the setting of deductible amounts.
Waiver of the Right to File Amended Returns	Potential Tax Benefit Not Available	Potential Tax Benefit Available
I.R.S. Administrative Issues	Administrative Ease	Increased Proof Requirement Increased Audit Potential

Estates & Trusts

- The theft occurs before the decedent dies and is discovered during estate administration; the estate may claim the income tax deduction.

- The theft occurs and is discovered during estate administration; the estate may claim an income tax deduction or an estate tax deduction.

- The theft occurs after the accounts have been distributed. The estate may not claim either deduction.

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