



IRS ISSUES GUIDANCE ON THEFT LOSSES STEMMING FROM SCAMMERS

March 31, 2025

Internal Revenue Code § 165 provides a deduction for losses sustained during the current taxable year and not compensated by insurance or otherwise, and for which there is no reasonable prospect of recovery. In the case of an individual, IRC § 165(c) limits the deduction to losses (1) incurred in a trade or business, (2) incurred in a transaction engaged in for profit, or (3) arising from a casualty or theft (i.e., personal casualty losses). However, the Tax Cuts and Jobs Act (“TCJA”) generally disallows personal casualty losses for the tax years 2018-2025.

In IRS Chief Counsel Advice memorandum CCA 202511015, the IRS addressed the deductibility of theft losses under IRS § 165 in the following five hypothetical scenarios in which the taxpayers were the victims of various scams in 2024:

- **Taxpayer 1 - Compromise Account Scam:** A scammer contacted Taxpayer 1 claiming to be a “fraud specialist” at Taxpayer 1’s financial institution. The scammer fraudulently induced Taxpayer 1 to authorize distributions from his IRA and non-IRA accounts and transfer the funds into new overseas investment accounts controlled by the scammer. There was little to no prospect of recovery.
- **Taxpayer 2 - Pig Butchering Investment Scam:** Taxpayer 2 responded to an unsolicited email advertising a cryptocurrency investment opportunity. Taxpayer 2 established a cryptocurrency account and after a few small, successful investments and withdrawals from the account, Taxpayer 2 made a more significant investment with funds taken from his IRA and non-IRA accounts. Taxpayer was unable to withdraw the funds from the account and there was little to no prospect of recovery.
- **Taxpayer 3 - Phishing Scam:** Taxpayer 3 received a phishing email from a scammer claiming to be a “fraud protection analyst” and claiming that Taxpayer 3’s accounts had been compromised. Taxpayer 3 was tricked into providing his login information for his IRA and non-IRA accounts which the scammer used to distribute all the funds in these accounts to an overseas account. Unlike Taxpayers 1 and 2, Taxpayer 3 did not authorize the distributions, but there was little to no prospect of recovery.
- **Taxpayer 4 - Romance Scam:** Taxpayer 4 developed an online romantic relationship with a scammer. Taxpayer 4 eventually authorized distributions from an IRA and non-IRA account and transferred the funds to the scammer’s overseas account to cover purported medical expenses of the scammer’s relative. The scammer stopped responding and there was little to no prospect of recovery.
- **Taxpayer 5 - Kidnapping Scam:** A scammer contacted Taxpayer 5 claiming to have kidnapped Taxpayer 5’s grandson for ransom. Under duress and believing a cloned voice of the grandson, Taxpayer 5 authorized distributions from his IRA and non-IRA accounts and transferred the funds to an overseas account. Taxpayer 5 learned the kidnapping was false, but there was little to no prospect of recovery.

Based on its analysis, the IRS made the following conclusions:

Taxpayers 1, 2 and 3:

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- Each taxpayer sustained a theft loss under IRC § 165. The loss in each case is deductible in 2024 because the loss was discovered in 2024, there is no reasonable prospect of recovery and the loss was incurred in a transaction entered into for profit.
- The amount of the deductible loss is limited to the taxpayer's basis in the stolen funds. The taxpayer is liable for federal income tax on the IRA distribution and is required to recognize gain or loss from the disposition of assets in the non-IRA account.

Taxpayers 4 and 5:

- Each taxpayer sustained a theft loss under IRC § 165. However, the loss in each case is a personal casualty loss rather than a loss suffered from a transaction engaged in for profit. Under the TCJA, the loss is not deductible because it occurred in 2024.
- Each taxpayer is liable for federal income tax on the IRA distribution and will be required to recognize gain or loss from the disposition of assets in the non-IRA account.

In connection with its analysis, the IRS concluded that none of Taxpayers 1 through 5 are eligible to use the Ponzi loss safe harbor under Rev. Proc. 2009-20 because the theft losses induced by the scammer in each hypothetical are not the result of a criminally fraudulent investment arrangement, commonly known as a "Ponzi scheme".

The IRS memorandum is extremely helpful in providing guidance on the conditions under which theft losses from scams can be deducted, emphasizing the need for a profit motive and the lack of a reasonable prospect of recovery. The guidance also confirms the inapplicability of a the Ponzi scheme safe harbor for taxpayers who have been the victims of these scams.

If you have any questions regarding this alert, please contact your Cummings & Lockwood private clients attorney.