ProVision
Wealth Strategists

MEMORANDUM

To: The Elevation Group

From: ProVision

Date: January 9, 2013

Re: Casualty Loss Deduction for Prophet Max Losses

In light of the recent criminal actions brought against Senen Pousa and Investment Intelligence Corp. (d/b/a Prophet Max), the question has been raised as to whether or not the funds lost by those who invested in the Prophet Max scheme are tax deductible. In short, they are deductible – but to a certain extent.

On September 18th, 2012, the Securities and Exchange Commission filed suited against Investment Intelligence Corporation and Senen Pousa for securities fraud. That same day, the Commodity Futures Trading Commission filed a parallel lawsuit charging Pousa and his company with operating a fraudulent off-exchange foreign currency (forex) scheme. Shortly after the complaints were filed, the U.S. District Court for the Western District of Texas issued an emergency order freezing the assets of Pousa and Investment Intelligence Corp.

Typically, if you were to lose money investing in stocks or securities, your loss would be considered a capital loss and you would be limited to offsetting it against any capital gains you may have. If you had excess loss, you would only be allowed to deduct $3,000 against your ordinary income per year. While the remaining loss is carried forward indefinitely, this treatment would do little to help those who lost the magnitude of funds as most did investing in Prophet Max.

As an increasing amount of fraudulent investment arrangements, like Prophet Max, have surfaced over recent years, the IRS has taken action to minimize the burden on the victims of Ponzi schemes and similar fraudulent activities. Taxpayers may be able to deduct their theft losses as an ordinary deduction in the year the theft was discovered and some of the income-based limitations for this deduction have been removed.

In April of 2009, the IRS issued Revenue Procedure 2009-20. This announcement provides an optional safe harbor treatment for taxpayers that experienced losses in certain investment arrangements discovered to be criminally fraudulent. The IRS will not challenge the timing of your theft loss deduction if you comply with certain requirements. Specifically, a defrauded investor may deduct 95% of the qualified investment lost if there is no potential third party recovery. Investors that do have a prospect of third party recovery may deduct 75% of their qualified investment losses.

It should be noted that if the investment is eventually recovered, that amount must be picked up as income in the year of recovery. There is good reason to believe the appointed Receiver on this matter, Guy Hohmann, will be able to return a meaningful amount of the money lost to investors. Likewise, if the investment is ultimately found unrecoverable, the remaining loss can then be deducted for tax purposes.

To qualify for the safe harbor relief, there are a number of specific steps that need to be taken. Investors must file Form 4684, *Casualties and Thefts*, with their individual income tax return. The form must be marked with proper Revenue Procedure across the top (Revenue Procedure 2009-20). There is a specific worksheet that must be used to calculate the amount of the qualified loss, and a statement must be signed by the investor and submitted with Form 4684. We recommend that you consult with a tax advisor to ensure you have properly filed the documentation to qualify for the deduction. If you have not complied with the reporting instructions outlined in the Revenue Procedure, the IRS may not allow the deduction.

We would like to bring to your attention that each state may treat these losses differently. Some states recognize and have adopted the federal approach to Ponzi scheme theft losses, while others have not. There may be additional differences in the way states calculate their itemized deductions and taxable income. While the scope of this memo is to cover the general rules, you may want to consult a tax advisor to discuss your specific state income tax treatment.

For those individuals who invested in Prophet Max indirectly, through IRAs and similar tax-deferred investment vehicles, the IRS does not offer the same favorable treatment. IRS Informational Letter 2009-0154 explains that only taxpayers with basis in their IRA, or other tax-favored retirement account, may eventually realize some tax benefit from the loss *after* the entire account is distributed. In addition, the deduction is also subject to the 2% floor for miscellaneous itemized deductions. As with any distribution from an IRA or retirement account, there may be additional tax implications to consider.

While the burden to victims of Ponzi schemes and similar fraudulent activities is often a large and unexpected one, the IRS has taken action to try to minimize the effect of significant losses as well as alleviate compliance and administrative encumbrances on taxpayers. As always, you should consult with your tax advisor concerning the proper tax procedure and any potential questions you may have.

To ensure compliance with requirements imposed by the IRS, we inform you that any US federal tax advice contained in this communication (including any attachments) is not intended or written to be used, and it cannot be used for the purpose of (i) avoiding penalties under the Internal Revenue Code or (ii) promoting, marketing, or recommending to another party any transaction or matter addressed herein. If you are not the original addressee of this communication, you should seek advice based on your particular circumstances from an independent advisor.