

Form <b>886-A</b>	U.S. Treasury Department-Internal Revenue Service <b>EXPLANATION OF ITEMS</b>	Schedule No.
Name of Taxpayer  USA Capital DTFD		Year / Period  200912

Per Return: \$82,216,302  
Per Exam: 82,216,302  
Adjustment: -0-

***Issue:***

Whether the USA Capital DTFD (USA) incurred a theft loss as shown on Schedule K and correctly computed that loss?

***Facts:***

USA has claimed a loss of \$82,216,302 on Line 11 of Schedule K attached to its Form 1065 tax return for 200912.

USA allocated this loss to each of the 1393 investors per their allocable share of profits and losses. (See separate write up regarding allocation to investors.)

USA has provided a PLR from the National Office stating that USA may claim the loss in 200912, but limiting it to 75%, to allow for future claims and recoveries.

They have provided a detailed explanation for the calculation of the loss. In addition, they have provided the detailed documentation for each sum considered in the calculation. The TP limited the entire loss to the 75% limitation due to outstanding claims on 3<sup>rd</sup> parties for potential recovery.

Total contributions and total withdrawals were traced to the source documents. All amounts were reconciled to the prior tax returns.

***Taxpayer's Position:***

TP is in agreement with the PLR and has stated that they have complied with all aspects of the PLR.

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***Government's Position:***

*The conclusion stated in the PLR:* Based on the information submitted and representations made, we conclude that:

1. The National Office determined that the taxpayer is a qualified investor for purposes of claiming a theft loss deduction under Rev. Proc. 2009-20.
2. The discovery year for purposes of claiming a theft loss deduction under Rev. Proc. 2009-20 is 200912.

*Analysis of the calculation of the loss:*

It appears that the loss has been properly calculated. The formula is proper and the amounts used have been substantiated. The amounts were traced to source documents on file with the IRS.

***Law:***

IRC 165(a) allows a deduction for losses sustained during the taxable year and not compensated by insurance or otherwise. A loss arising from criminal fraud or embezzlement in a transaction entered into for profit is a theft loss, not a capital loss, under § 165. Rev. Rul. 2009-9, 2009-14 I.R.B. 735.

Section 165(e) states that any loss arising from theft shall be treated as sustained in the taxable year the taxpayer discovers the loss. Under §§ 1.165-8(a)(2) and 1.165-1 (d), however, if, in the year of discovery, there exists a claim for reimbursement with respect to which there is a reasonable prospect of recovery, no portion of the loss for which reimbursement may be received is sustained until the taxable year in which it can be ascertained with reasonable certainty whether or not the reimbursement will be received. Whether a reasonable prospect of recovery exists is a question of fact to be determined upon examination of all facts and circumstances.

Rev. Proc. 2009-20 provides an optional safe harbor treatment for qualified investors that experience losses in certain investment arrangements discovered to be criminally fraudulent. Rev. Proc. 2009-20 applies to losses for which the discovery year, as defined in § 4.04 of Rev. Proc. 2009-20, is a taxable year beginning after December 31, 2007.

Section 5.01 of Rev. Proc. 2009-20 provides that if a qualified investor follows the procedures described in Rev. Proc. 2009-20, the Service will not challenge the following

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treatment by the qualified investor of a qualified loss: (1) the loss is deducted as a theft loss; (2) the taxable year in which the theft was discovered within the meaning of § 165(e) is the discovery year described in the revenue procedure; and (3) the amount of the deduction is the amount specified in the revenue procedure.

Section 4.03 of Rev. Proc. 2009-20 defines a qualified investor as a United States person, as defined in § 7701 (a)(30)

(1) That generally qualifies to deduct theft losses under § 165 and § 1.165-8;

(2) That did not have actual knowledge of the fraudulent nature of the investment arrangement prior to it becoming known to the general public;

(3) With respect to which the specified fraudulent arrangement is not a tax shelter, as defined in § 6662(d)(2)(C)(ii); and

(4) That transferred cash or property to a specified fraudulent arrangement. A qualified investor does not include a person that invested solely in a fund or other entity (separate from the investor for federal income tax purposes) that invested in the specified fraudulent arrangement. However, the fund or entity itself may be a qualified investor within the scope of the revenue procedure.

Section 7701 (a)(30) provides that the term "United States person" includes a domestic partnership.

Section 4.01 of Rev. Proc. 2009-20 defines a specified fraudulent arrangement as an arrangement in which a party (the lead figure) receives cash or property from investors; purports to earn income from investors; reports income amounts to the investors that are partially or wholly fictitious; makes payments, if any, of purported income or principal to some investors from amounts that other investors invested in the fraudulent arrangement; and appropriates some or all of the investors' cash or property.

**Conclusion:**

It has been determined that USA Capital DTDF has incurred a theft loss and all facts are as presented to the National Office. The computation of the theft loss appears to be accurate. No adjustment is required and no further exam is warranted.

In addition, it appears that the 2009 investors of USA are entitled to their share of the theft loss as allocated on their 200912 Schedule K-1 from USA.