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October 9, 2009

DEPARTMENT OF TAXATION ANNOUNCEMENT NO. 2009-31

RE: Hawaii Income Tax Treatment of Theft Losses from "Ponzi" Schemes

I. Internal Revenue Service Pronouncements

On March 17, 2009, the Internal Revenue Service (IRS) issued Revenue Ruling 2009-9, 2009-14 I.R.B. 735, determining that in a situation involving a cash-method taxpayer who invested sums of money with another individual who held himself out as investment advisor but was later shown to have used funds in a Ponzi-type scheme, the loss incurred was theft loss, and not capital loss. The Ruling describes the proper federal income tax treatment and provides guidance on the character, timing, and amount of the loss deduction.

On March 17, 2009, the IRS also issued Revenue Procedure 2009-20, 2009-14 I.R.B. 749, providing an optional safe harbor method for qualified investors to deduct theft losses from "Ponzi" schemes under Internal Revenue Code (IRC) §165(c)(2) where the discovery year is a taxable year beginning after December 31, 2007. For individuals, these losses are deductible as a miscellaneous itemized deduction on their federal income tax return.

Qualified taxpayers that choose the safe harbor method compute their deductible theft loss using the computation provided in Appendix A of Revenue Procedure 2009-20, and report their losses on federal Form 4684. The qualified taxpayers must also complete, sign, and attach the statement contained in Appendix A to their timely filed federal income tax returns.

II. Hawaii Income Tax Treatment

A. Conformity to IRC

Pursuant to Act 133, Session Laws of Hawaii 2009, Hawaii conforms to IRC §165 as amended as of December 31, 2008 with modifications under Hawaii Revised Statutes (HRS) §235-2.4(e). Accordingly, Revenue Ruling 2009-9 and Revenue Procedure 2009-20 are applicable for Hawaii income tax purposes to the extent that Federal and Hawaii laws are the same.

B. Losses Deductible as a Miscellaneous Itemized Deduction

For individuals, "Ponzi" scheme theft losses that are deductible under IRC §165(c)(2) may be deducted as a miscellaneous itemized deduction on their Hawaii income tax returns. Generally, miscellaneous itemized deductions must be reduced by 2% of the taxpayer's adjusted gross income (AGI), and may also be subject to further reduction if the taxpayer's income exceeds certain threshold limits. Pursuant to IRC §§67(b)(3) and 68(c)(3), which Hawaii conforms to under HRS §235-2.4, these limitations do not apply to losses deductible under IRC §165(c)(2).

C. Net Operating Loss (NOL)

Under HRS §235-7(d), Hawaii conforms to the general NOL provision which allows a NOL to be carried back two years and carried forward twenty years under IRC §172(b)(1)(A). Hawaii also conforms to the NOL provision that allows the portion of an individual's NOL attributable to a theft loss under IRC §165(c)(2) to be carried back three years pursuant to IRC §172(b)(1)(f). On February 17, 2009, amendments to the IRC pertaining to NOLs were made through provisions of the American Recovery and Reinvestment Act of 2009. Hawaii has not conformed to these amendments. Generally, amendments to the IRC made in any given year are considered for adoption by Hawaii's Legislature during its next legislative session in the following year; therefore, IRC amendments made in 2009 will not be considered until Hawaii's Legislature convenes in 2010.

D. Filing Procedure

Qualified taxpayers who choose the optional safe harbor method provided by Revenue Procedure 2009-20 must attach to their Hawaii income tax return a copy of their federal Form 4684, and a copy of the statement executed pursuant to Revenue Procedure 2009-20.

For more information, please contact the Rules Office at 808-587-1577.



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