DEPARTMENT OF THE TREASURY
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OFFICE OF CHIEF COUNSEL

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The Honorable Jon Kyl
United States Senator
1200 East Camelback Road
Suite 120
Phoenix, AZ 85018

Attention:

Dear Senator Kyl:

I am responding to your letter of August 4, 2010, on behalf of your constituent, . states that he invested in the notes of a limited partnership approximately years ago. He indicates that the notes have become worthless and asks whether he can deduct a loss on his federal income tax return for the amount of his investment. He also asks whether his losses qualify for the tax treatment provided to losses arising from financial criminal fraud or theft.

The law allows a deduction for any debt which becomes worthless within the taxable year (section 166(a) of the Internal Revenue Code (the Code)). A taxpayer can deduct nonbusiness bad debts (that is, debts other than those arising in the taxpayer's trade or business) as a capital loss. However, the law limits the net capital loss deduction to $3,000 per year. Any loss in excess of $3,000 may be deducted in future taxable years, subject to the same $3,000 limitation in each of those years (sections 1211 and 1212 of the Code and section 1.166-5(a)(2) of the Regulations).

The law provides specific rules for losses that arise from theft. Under these rules, theft losses are generally deductible in the year the taxpayer discovers the theft, and they are not subject to the $3,000 capital loss limitation of section 1211 of the Code. The theft loss rules apply to taxpayers whose investments were stolen from them, and not to taxpayers whose investments lose value due to business risk, market fluctuations, and economic conditions. does not indicate that the losses he suffered on his limited partnership notes were the result of fraud or theft.

can find additional information on the rules for reporting investment losses in Publication 17 (especially pages 104-107), *Your Federal Income Tax;* Publication 550, *Investment Income and Expenses (Including Capital Gains and Losses)*; and IRS Tax Tips 2010-35 (Feb. 19, 2010), *10 Facts About Capital Gains and Losses*. I am enclosing copies of these publications.

I hope this information is helpful. Please contact me at or at if we can be of further assistance.

Sincerely,

Andrew J. Keyso
Deputy Associate Chief Counsel
(Income Tax and Accounting)

Enclosures (3)