**(DISCLAIMER: The Claims Processing Agent cannot provide you with legal or tax advice. The information that follows was provided by the IRS. Any questions pertaining to this information should be referred to your own personal legal or tax representative or to the IRS.)**

# FREQUENTLY ASKED QUESTIONS (FAQs)
# Deducting IRA Amounts Lost Due to Theft or Fraud

The IRS has provided the following questions and answers relating to claiming a loss deduction for IRA amounts that are lost due to theft or fraud. These questions and answers are intended to provide general principles of well-defined law. They are not intended to provide a specific legal determination with respect to a particular set of circumstances and, thus, cannot be relied upon with respect to your particular situation. You may want to consult a tax advisor to address your situation.

**Q-1: If my IRA suffered a loss due to theft or fraud, may I claim a theft loss deduction on my federal tax return?**

**A-1:** You are not permitted to claim a theft loss deduction for amounts in your IRA that are lost due to theft or fraud. Your IRA, which is a separate tax-exempt entity, is the investor in the fraudulent scheme. However, depending on the circumstances, you may be able to claim a deduction for the loss of your investment in your IRA. See Q-2 below.

**Q-2: If my IRAs lose value due to theft or fraud, can I deduct the investment loss on my federal income tax return?**

**A-2:** Taxpayers are generally not permitted to recognize losses on the value of property held in an IRA because the IRA is exempt from tax. If you made deductible IRA contributions or excludable rollover contributions to the IRA, the amounts contributed, as well as any earnings on those amounts, have already been excluded from your taxable income.

You may only claim a tax deduction for a loss in the value of your IRA if:

1. All of your IRA assets have been distributed to you, **and**
2. You made nondeductible contributions (or otherwise have basis in your IRA).

A loss in the value of your IRA due to theft or fraud is treated as an investment loss and is reported as a miscellaneous itemized deduction on Schedule A of your Form 1040. Your deduction for an investment loss on Schedule A of your Form 1040 is subject to the 2 percent floor on miscellaneous itemized deductions, and is added back for purposes of determining alternative minimum taxable income.

**Additional Resources**:
Publication 590, *Individual Retirement Arrangements (IRAs)*

**Q-3: When do I have basis in my IRAs?**

**A-3:** If you made contributions to the IRA for which you did not claim a deduction from income, inherited the IRA that had basis, or rolled over nontaxable amounts into the IRA, you will have basis in your IRA. In a Roth IRA, all of the contributions are nondeductible and, therefore, all of the contributions (but not the earnings) constitute basis.

**Q-4: When can I deduct an IRA investment loss due to theft or fraud?**

**A-4:** Regardless of when you experience an investment loss in your IRA due to theft or fraud, you may only claim a deduction for your unrecovered basis after you take a distribution of all of the remaining assets in your IRA. You may only claim the deduction for such an investment loss for the taxable year in which you receive such a distribution.

**Example:** In 1995, Gary opened a traditional IRA with Able Investment Co. From 1995 to 2003, Gary made $10,000 of nondeductible contributions to the IRA, then he stopped contributing. In 2008, Gary's statements showed the value of his IRA as $25,000. In 2009, Able's investment manager was indicted for fraud, and Gary discovered that his IRA's true current value was $1,000. Gary did nothing until 2012. In 2012, at age 60, Gary liquidated his account and received $1,000. This traditional IRA was Gary's only IRA. Gary may deduct his $9,000 investment loss ($10,000 of contributions less $1,000 recovered value) on his 2012 tax return as a miscellaneous itemized deduction, subject to the 2-percent floor (this amount is added back for purposes of determining alternative minimum taxable income).

**Q-5: If I have different types of IRAs, do I have to withdraw all of the assets from all of them before I can claim a loss?**

**A-5:** You must withdraw all of the assets from all of your similar IRAs in order to deduct your IRA investment loss. All of your traditional IRAs, including SEP IRAs, and SIMPLE IRAs, are pooled together. Similarly, all of your Roth IRAs are combined.

The 10% additional tax on early distributions may apply if you withdraw taxable IRA assets before reaching age 59½.

**Q-6: How much of my IRA investment loss is deductible?**

**A-6:** When all amounts have been distributed, if your basis in the IRAs exceeds the total value of the property distributed, then you can recognize a loss as a miscellaneous itemized deduction, subject to the 2 percent floor (this amount is added back for purposes of determining alternative minimum taxable income).

Your deductible investment loss is generally the remaining basis in your IRAs (nondeductible contributions), less any amounts distributed to you from your IRAs, at the time you liquidate your IRAs.

Only losses of amounts attributable to nondeductible contributions to your IRA are deductible. You cannot take a deduction for any lost earnings with respect to amounts your IRA invested in a fraudulent scheme or that were stolen from your account.

**Traditional and SIMPLE IRAs:**

A loss in the value of your traditional, SEP and/or SIMPLE IRAs may be deductible, to the extent you have basis in your IRAs, as a miscellaneous itemized deduction, subject to the 2 percent floor (this amount is added back for purposes of determining alternative minimum taxable income). . Your basis is the amount of your nondeductible contributions in your IRAs. The amount of the loss is equal to your basis in your IRAs at the time of liquidation less the amount you receive from your IRAs upon liquidation.

**Example 1:** Bill makes a $2,000 nondeductible contribution to a traditional IRA for 2010, giving him a basis at the end of 2010 of $2,000. By the end of 2011, his IRA earns $400 in interest income. Bill then has an account balance of $2,400 ($2,000 + $400). In 2011, Bill receives a distribution of $600. The amount of the distribution that represents a return of basis is equal to 2,000 divided by 2,400 multiplied by $600, or $500. Therefore, $500 of the $600 distribution represents a return of basis, and the remaining $100 is taxable earnings. At the end of 2011, assuming there were no other transactions, the value of Bill's IRA is $1,800 ($2,000 + $400 earnings - $600 withdrawal). Bill figures the taxable part of the distribution in 2011 and his remaining basis on IRS Form 8606.

In 2012, Bill's IRA has a loss of $500 due to theft or fraud. At the end of 2012, assuming no earnings for that year, Bill's IRA balance is $1,300 ($1,800 - $500). Bill's remaining basis in his IRA in 2012 is $1,500 ($2,000 - $500 of basis recovered in his 2011 distribution). Bill receives a distribution in 2012 of the $1,300 balance remaining in the IRA. He has no other IRAs. For the 2012 taxable year, Bill can claim a loss of $200 (the $1,500 of basis minus the $1,300 distribution of the IRA balance) as a miscellaneous itemized deduction, subject to the 2 percent floor (this amount is added back for purposes of determining alternative minimum taxable income).

**Example 2**: Herman has one traditional IRA. At the end of 2011, it contained $20,000 of deductible contributions, $5,000 of nondeductible contributions and $4,000 of earnings. During 2011, Herman experienced an investment loss due to theft or fraud of $500.

In 2012, Herman liquidates his IRA. Assuming no additional earnings or losses in 2012, at the time of the liquidation of his IRA, Herman's account balance is $28,500 ($20,000 + $5,000 +$4,000 - $500). He has a basis in his IRA of $5,000. He cannot claim any of the 2011 investment loss due to theft or fraud because the amount he received ($28,500) is more than his basis ($5,000).

**Roth IRAs:**

Because all of the contributions to a Roth IRA are nondeductible, all of the contributions (but not the earnings) constitute basis in the Roth IRA. As with traditional IRAs, the amount of the loss that you may claim as a miscellaneous itemized deduction, subject to the 2 percent floor, is limited to your basis in the Roth IRA (this amount is added back for purposes of determining alternative minimum taxable income).

**Additional Resources**:
Publication 590, *Individual Retirement Arrangements (IRAs)*