

Revenue Ruling 2009-9, Issue 2 Losses

Issue 2. Deduction limitations.

Section 165 (h) imposes two limitations on casualty loss deductions, including theft loss deductions, for property not connected either with a trade or business or with a transaction entered into for profit.

Section 165 (h)(1) provides that a deduction for a loss described in § 165 (c) (3) (including a theft) is allowable only to the extent that the amount exceeds \$100 (\$500 for taxable years beginning in 2009 only).

Section 165 (h) (2) provides that if personal casualty losses for any taxable year (including theft losses) exceed personal casualty gains for the taxable year, the losses are allowed only to the extent of the sum of the gains, plus so much of the excess as exceeds ten percent of the individual's adjusted gross income.

Rev. Rul. 71-381, 1971-2 C.B. 126, concludes that a taxpayer who loans money to a corporation in exchange for a note, relying on financial reports that are later discovered to be fraudulent, is entitled to a theft loss deduction under § 165 (c) (3). However, § 165 (c) (3) subsequently was amended to clarify that the limitations applicable to personal casualty and theft losses under § 165 (c) (3) apply only to those losses that are not connected with a trade or business or a transaction entered into for profit. Tax Reform Act of 1984, Pub. L. No. 98-369, § 711 (1984). As a result, Rev. Rul. 71-381 is obsolete to the extent that it holds that theft losses incurred in a transaction entered into for profit are deductible under § 165 (c) (3), rather than under § 165 (c) (2).

In opening an investment account with B, A entered into a transaction for profit. A's theft loss therefore is deductible under § 165 (c) (2) and is not subject to the § 165 (h) limitations.

Section 63 (d) provides that itemized deductions for an individual are the allowable deductions other than those allowed in arriving at adjusted gross income (under § 62) and the deduction for personal exemptions. A theft loss is not allowable under § 62 and is therefore an itemized deduction.

Section 67 (a) provides that miscellaneous itemized deductions may be deducted only to the extent the aggregate amount exceeds two percent of adjusted gross income. Under § 67 (b) (3), losses deductible under § 165 (c) (2) or (3) are excepted from the definition of miscellaneous itemized deductions.

Section 68 provides an overall limit on itemized deductions based on a percentage of adjusted gross income or total itemized deductions. Under § 68 (c) (3), losses deductible under § 165 (c) (2) or (3) are excepted from this limit.

Accordingly, A's theft loss is an itemized deduction that is not subject to the limits on itemized deductions in §§ 67 and 68.