



FAQs Related to Ponzi Scenarios for Clawback Treatment

Question: How does a taxpayer treat the repayment of a clawback?

Answer:

Clawback repayments of amounts previously reported as income from a Ponzi scheme are not additional theft loss deductions. Instead, they are repayments of claim-of-right income that result in either a deduction as a non-theft investment loss, or a credit calculated under IRC § 1341, whichever results in lower tax.

A theft loss deduction from a Ponzi scheme is not a deemed repayment of Ponzi income that is eligible for IRC § 1341 treatment, see Rev. Rul. 2009-09, and a taxpayer that attempts to claim § 1341 treatment for all or part of a theft loss deduction cannot use the safe harbor in Rev. Proc. 2009-20. However, an actual clawback repayment is not a theft loss deduction and § 1341 treatment is not barred by Rev. Proc. 2009-20.

If, as will generally be the case, a clawback exceeds \$3,000, § 1341 applies and the taxpayer would compute the tax for the year of the clawback payment (the clawback year) under two methods (see the discussion of "Repayments" in Pub. 525):

Method 1: Figure the tax for the clawback year claiming a nontheft investment loss deduction for the clawback payment. It is not a capital loss and it is not subject to the 2% floor on miscellaneous itemized deductions.

Method 2: Figure the tax for the clawback year with a credit computed as follows:

1. Figure the tax for the clawback year without deducting the repaid amount.
2. Refigure the tax for the year the clawed-back income was originally reported (the income year) without including in income the amount of the clawback payment.
3. Subtract the hypothetical tax for the income year in (2) from the actual tax shown on the return for the income year. This is the § 1341 credit.
4. Subtract the answer in (3) from the tax for the clawback year figured without the deduction (step 1).

The taxpayer is entitled to the benefit of either the deduction under Method 1 or the credit under Method 2, whichever results in less tax (or a greater refund) for the clawback year. Note that the § 1341 credit is a refundable credit. Therefore, the credit may result in a refund payment for the clawback year even if, in that year, the taxpayer had no taxable income and made no tax payments. However, although the § 1341 credit is based on the amount of tax the taxpayer would have saved in the income year if the taxpayer had not reported the clawed-back income, it is not an actual credit or refund for the income year, and does not bear overpayment interest from the income year.

For information on where an individual reports the IRC § 1341 credit on the Form 1040, please see [Pub. 525](#) and the [Instructions to Form 1040](#).

Question: What does the taxpayer need to establish as to whether the repayment of a clawback is allowable as a deduction (or a § 1341 credit)?

Answer:

The taxpayer would have to establish that the clawback amount was required to be repaid to the trustee. The taxpayer would also have to substantiate that payment was made. The substantiation could include a letter from the trustee.

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