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May 7, 2009

Mr. Michael Mundaca
Deputy Assistant Secretary -
International Tax Affairs
Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

Honorable Douglas H. Shulman
Commissioner
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224

Re: Report on Private Foundation Investors in Ponzi Schemes

Dear Sirs:

We write to respond to a request by the Internal Revenue Service (the "IRS") for assistance in identifying and addressing issues confronting private foundation investors in Ponzi schemes and other frauds.

Private foundations with losses from Ponzi scheme investments face many difficult reporting and compliance issues for which there is little or no precedent or guidance. The enclosed report primarily is intended to identify the relevant issues that private foundations and the IRS need to address. In view of the need by the IRS for immediate assistance in identifying private foundation issues and the shortage of time

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to fully consider the impact of various alternative approaches to addressing these issues, the report makes only very limited recommendations for any particular approach for dealing with the identified issues. If you would like us to follow up with more detailed recommendations on any or all of the issues raised, we would be pleased to do so.

On March 17, 2009, the IRS issued Rev. Rul. 2009-9 and Rev. Proc. 2009-20 providing general guidance to taxpayers who invested in Ponzi schemes. Rev. Rul. 2009-9 holds that an individual investor in a Ponzi scheme is entitled to a theft loss deduction in the year the fraud is discovered. Rev. Proc. 2009-20 provides a safe-harbor approach for taxpayers to claim a theft loss for Ponzi scheme investments. To avail themselves of this safe harbor, taxpayers must agree not to file amended returns. This IRS guidance is not aimed at exempt organizations and does not squarely address the issues facing private foundations.

There are many difficult questions that need to be addressed in this context, including whether IRS guidance should impose a single approach that private foundations must follow in addressing losses from Ponzi scheme investments (or give any one approach safe-harbor status) or rather, whether IRS guidance should give foundations a choice of actions. Critically, should foundations be given a choice on whether or not to amend prior year returns? In this regard, the report acknowledges that the recent guidance provided by Rev. Rul. 2009-9 and Rev. Proc. 2009-20 strongly evidences a preference by the IRS that taxpayers not amend prior year returns, but rather deal with Ponzi scheme losses, as theft losses, in the tax return for the year of discovery. Notwithstanding that, our initial conclusion is that there are too many differences between foundations (multibillion dollar foundations vs. small family foundations; foundations with minor losses from a Ponzi scheme vs. foundations with all or most of their assets lost in a Ponzi scheme, etc.) to come out with a one-size-fits-all approach. Different institutions inevitably will have different needs and administrative capabilities for dealing with Ponzi scheme losses.

The report treats private foundation issues as falling broadly into two categories. Sections 4940 and 4942 involve the measurement of income and asset values. In our view, a critical initial question relevant to both Section 4940 and Section 4942 is whether a foundation should go back in time and measure its income and asset values for prior years based on current knowledge and information or whether the foundation should view prior year income and asset values as correct and deal with Ponzi scheme losses only in the year of discovery. Sections 4941, 4944 and 4945 involve a second category of issues that address or relate to the foundation's process for making the Ponzi scheme investment in the first place. With respect to these provisions, the critical question in our view is whether making the investment involved some prohibited conduct that should be punished by the imposition of a penalty excise tax.

The most important issue identified by the IRS for foundations that invested in Ponzi schemes is the potential application of the penalty excise taxes on foundations and foundation managers under Section 4944, concerning jeopardizing investments. Under the applicable Treasury Regulations ("Regulations"), a jeopardizing investment occurs where it is determined that the foundation managers, in making such investment, have failed to exercise ordinary business care and prudence, under the facts and circumstances prevailing at the time of making the investment, in providing for the financial needs of the foundation to carry out its exempt purposes. The report points out that the Regulations clearly provide that the

determination of whether an investment is a jeopardy investment is made at the time of the investment and that therefore, if a foundation or a foundation manager conducted proper due diligence, there should be no penalty. The report discusses a number of considerations that should be taken into account on the key question of what constitutes adequate due diligence.

Another related group of important issues arise under Section 4940 (which imposes a 1% or 2% excise tax on a foundation's net investment income) and Section 4942 (which imposes a mandatory payment requirement based on the value of a foundation's assets). Since these provisions are inextricably intertwined, the report generally recommends that a consistent approch be followed to address issues under these Sections. It presents three possible approaches to addressing Section 4940 and 4942 issues. First, the foundation could amend its Forms 990 PF for all open years to correct its asset values and to exclude illusory Ponzi scheme income and gains from its net investment income. Second, rather than amending prior year returns, the foundation could file its Form 990 PF for the year of discovery and attach a schedule adjusting its Section 4942 carryforwards to reflect the impact of the Ponzi scheme on its asset values for prior years. Third, the foundation could assume its asset values and income were correctly reported for prior years.

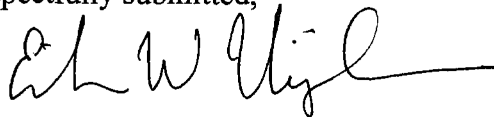
Additional private foundation issues raised by investments in Ponzi schemes and similar frauds involve whether penalty excise taxes under Sections 4945 (dealing with expenditures other than for charitable or investment purposes) or 4941 (self-dealing rules) should be imposed on the foundation and/or the foundation's managers (or other disqualified persons) who caused the foundation to make the investment. In our view, the fact that an investment is subsequently discovered to be a Ponzi scheme may be indicative of a failure of diligence or business judgment, but does not indicate the foundation's purpose was not a valid, bona fide investment purpose to earn a profit. The mere fact that an investment turns out to be a Ponzi scheme therefore should not give rise to Section 4945 penalty excise taxes. The report concludes that Ponzi scheme investments do not raise any new or novel Section 4941 self-dealing issues that are not addressed by existing guidance.

Finally, the report also identifies other issues, including whether the statute of limitations might be extended to six years and the possible need for foundations to disclose Ponzi scheme investments on Form 8886, Reportable Transaction Disclosure Statement, as a loss transaction.

The IRS may want to consider the benefits of quickly coming out with a notice or other announcement that it is considering the issues of foundations that invested in Ponzi schemes and it will allow affected foundations an extended period of time to correct any filings, without penalties, to be consistent with any IRS guidance ultimately provided on these issues.

We appreciate your consideration of our comments. Please let us know if you would like to discuss these matters further or if we can assist you in any other way.

Respectfully submitted,



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