February 10, 2009

About This Series…

A periodic update of the tax, due diligence, and business fraud issues for those clients and friends of the firm affected by the alleged fraud of Bernard L. Madoff and his business.

MADOFF MATTERS

Pressure on the IRS to Issue Guidance Aiding Madoff Victims

It is a positive sign that current and former lawmakers are asking for help on behalf of Madoff victims. The questions are whether the IRS will, in fact, issue any guidance and how timely that guidance will be.

Uncertainty is the key word in the aftermath of the Madoff scandal – over how to recover some of the money lost, and how the losses will be treated for tax purposes. There are many possible scenarios, but without all the facts it is difficult to come to solid conclusions. That is why several current and former government officials are now calling for guidance.

For example, at a Senate Banking Committee hearing on the Madoff scandal in late January, Senator Robert Menendez (D-NJ) called for a task force specifically charged with providing guidance on how to assist Madoff victims.

Likewise, former New York Governor George Pataki has written a letter to the IRS asking that they provide assistance to Madoff victims. He specifically requested that they cover three key areas:

Reasonable expectation of recovery safe harbor.

A theft loss may be claimed in the year discovered, but only to the extent that there is no reasonable expectation of recovery. Pataki asked for IRS guidance since those investors with no claims at the end of 2008, other than SIPC claims, would not be considered to have a reasonable expectation of recovery in an amount greater than the higher of:

a. $500,000 or
b. 10% of the investor's "net investment" in the account.

Net investment is the sum of all amounts of cash and fair market value of all property transferred into the account, less the sum of all amounts of cash and fair market value of all property the investor received as distributions from the account.

Amount of theft loss.

Pataki asked for guidance from the IRS that the amount of the theft loss for 2008 should equal the investor's entire unrecovered tax cost basis in the account at December 31, 2008. This would include all amounts reported as income in years prior to 2008, less the investor's reasonable expectation of recovery as of December 31, 2008.

Nature of the loss.

Pataki wrote that, according to IRS Chief Counsel Advice issued with respect to another case, the "official position" of the IRS is that similar-type theft losses would have to be claimed as an itemized deduction, subject to reduction by 10% of adjusted gross income plus $100 per occurrence.

Pataki argues that investments with Madoff would fall under a section of the Internal Revenue Code that deals with transactions entered into for profit and, therefore, would not be subject to these restrictions.

Trustee Will Not Issue 1099s for 2008

The Trustee in the Madoff case has announced that he will not issue IRS Forms 1099-B or 1099 Substitute for the tax year 2008. Irving H. Picard states that there were "questions about the accuracy of the financial records" and that "the Trustee is not in a position to prepare and furnish information on interest, dividends, or securities transactions."

This could be enough support for investors to not include Madoff-related income on their 2008 tax returns. It would be advisable to disclose this on the tax return if that is the course of action taken.

Money Recovered

The Trustee, Irving H. Picard, also revealed at a court hearing last week that approximately $946.4 million in cash and securities have been recovered from Madoff's firm. According to Picard, the intention is to have all of the funds designated as customer property and that none of the funds will be used to pay administrative costs.

In order to have an opportunity to receive a share of whatever is recovered by the Trustee, a SIPC claim must be filed. SIPC claims must be <u>received</u> by July 2, 2009. Please note that simply mailing the claim before the due date does not seem to satisfy this requirement. It is recommended that you send the claim form by a method that can show proof of mailing and that can be tracked.

Picard pointed out that the March 4th due date mentioned previously is not the *final* due date. Claims <u>received</u> after March 4 "need not be paid in whole or in part out of customer property and if paid from SPIC advances, the Trustee has the option to pay in cash or securities (or both)." Because filing after March 4th (but before July 2nd) may result in delayed processing and less favorable terms, ***it may be advisable to file claims in time to be <u>received</u> by the March 4th due date***.

It is important to note that neither the Bankruptcy Court nor the Trustee can extend the final July 2nd deadline.

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