The Madoff Tax Losses
Is the Safe Harbor Worth it?

MUCH HAS BEEN WRITTEN ABOUT THE TWO DOCUMENTS released by the I.R.S. regarding the taxation of Ponzi schemes. There is Revenue Ruling 2009-9 (the "Rev. Rul.") in which the I.R.S. has clarified much of the unsettled law in this area. Likewise there is Revenue Procedure 2009-20 (the "Rev. Proc.") which provides an uncomplicated path through the law and will be helpful to thousands of Madoff victims who will have a short route to cash refunds from tax losses. This will be sorely needed by many. This is provided in what the I.R.S. calls a "safe harbor" procedure.

The two documents by IRS are a good package and drafted in record time for any government agency. The I.R.S. worked well.

HOWEVER, IT IS IMPORTANT TO REMEMBER IRS IS NOT IN BUSINESS TO GIVE BACK MONEY. The "safe harbor" ***needs to be carefully studied*** because it is a safe harbor that could be extremely expensive from a tax standpoint. It might be a safe harbor but the tax cost to dock your boat in this harbor could be very high.

ONE VERY SIMPLISTIC EXAMPLE. Assume that there is $30 Billion of Madoff losses that would be able to receive theft loss tax benefits. Assume this Madoff income or amounts of principal, when taxed were in the highest tax brackets. This is because most earners of Madoff phantom income had other sources of taxable income.

Therefore, again to keep it simple, assume the average tax bracket is **35%** for the Madoff income included in prior years. Taxes collected **[10.5 Billion)** (35% x $30 Billion).

Assume these Madoff losses are deducted in 2008 and used against income for the years 2003 through 2007 as loss carry backs from the theft loss deduction.

This will mean that Madoff income and Madoff investments of principal that have been taxed at the highest brackets will be carried back and applied against all of the income in a particular year. To a large extent these losses will offset income in each prior year that was earned at lower rates. Income and principal taxed at 35% might be offsetting income in a carry back year taxed at only 15%.

The amount of any refund from the loss carry back will suffer accordingly. If it is assumed that the refund paid on the $30 Billion in tax was a refund based at an average 25% tax rate, (25% x $30 Billion) the refunds paid to the taxpayer would total **($7.5 Billion)**. In this case the I.R.S. has made $3.0 Billion ($10.5 Billion in tax – 7.5 Billion in refunds)

Furthermore, the I.R.S. will have kept the $10.5 Billion in tax revenue for years without paying interest.

For reasons like this and for many other situations many Madoff victims may choose not to avail themselves of the safe harbor of Rev. Proc. 2009-20. This is especially so since the legal guidance offered by Rev. Ruling 2009-9 is so helpful.

I have chosen to use the Chart on the following page to explain and compare the effects of the Revenue Ruling and the Safe Harbor. I have also attached both the Ruling and the Procedure as an Appendix. I believe the Chart shows that for many taxpayers the "tax rights" that must be waived to take advantage of the "tax benefits" of the safe harbor could be very expensive and unnecessary. Many taxpayers will find that the tax benefits available by relying on the Revenue Ruling and the state of the law are preferable alternatives to the benefits of the safe harbor.

The Chart refers to a series of footnotes that are discussed as a narrative in this Report No. 3. As the Chart is being described and in closing we will look at some of the tax planning concepts that must be considered before choosing between the safe harbor and the law.

Introduction to the Chart

Prior to the issuance of Revenue Ruling 2009-9 there was a good deal of case law interpreting various aspects of the theft loss deduction. The cases relied on, were at times 40 to 50 years old and many reflect the absence of the type of forensic accounting that can be accomplished today. For this reason and others, though there was a great deal of case law interpreting the statutes and regulations, there remained a great deal of confusion on where certain lines were drawn. The Internal Revenue Service has done an extremely good job of clarifying that confusion by way of the Revenue Ruling. These clarifications are very helpful whether one chooses to be covered by the safe harbor or not.

The Chart shows that there are certain benefits to using the safe harbor, but it also shows that most of the tax benefits granted by the safe harbor are no different from the tax benefits that the taxpayer would receive under the law as interpreted by the Revenue Ruling. However to achieve these benefits, ***the safe harbor requires that the taxpayer must waive potential valuable tax rights.***

Finally, the Chart shows the I.R.S. is using a not so subtle form of administrative coercion to force the use of the safe harbor by announcing that those who do not choose the safe harbor may be subject to stricter standards of proof and an increased audit potential .

Therefore, it is imperative that Madoff victims meet with their accountants and financial advisors that have the knowledge and facilities to provide proper spread sheets that will compare the economic effect of the use of the safe harbor versus that of the reliance on the law in each individual situation.

The chart shows another extremely important economic factor. Under the alternatives to the safe harbor, Madoff victims could be entitled to significant interest payments on the I.R.S. refunds from amended returns and claw backs that are calculated on prior years, some of which may have occurred long ago.

The theft loss refunds under the safe harbor will not carry interest if they are timely paid once a claim is filed.

Madoff Ponzi Scheme

Footnote	The Determination	The Revenue Procedure and the Safe Harbor	The Law and The Revenue Ruling
(1)	A Ponzi Scheme Loss is a Theft Loss Deductible as an Ordinary Loss	AGREED Result Similar to Revenue Ruling	AGREED Result Similar to Safe Harbor
(2)	The Amount of the Loss (Basis) Includes Phantom Income	AGREED Result Similar to Revenue Ruling	AGREED Result Similar to Safe Harbor
(3)	The Five Year Loss Carry Back of Net Operating Losses Applies	AGREED Result Similar to Revenue Ruling	AGREED Result Similar to Safe Harbor
(4)	The Deduction is not Reduced by the Application of Certain Percentage or Dollar Limitations	AGREED Result Similar to Revenue Ruling	AGREED Result Similar to Safe Harbor
(5)	Respect for Pass Through Entities	AGREED Result Similar to Revenue Ruling	AGREED Result Similar to Safe Harbor
(6)	Year of Discovery Deductibility - 2008	Agreement by I.R.S. to a defined set of events	Taxpayer must rely on case law for similar results
(7)	Amount of Loss Recognized in Year of Discovery	Agreement by I.R.S. to specific percentage amounts	Taxpayer must rely on case law for similar results
(8)	Waiver of the Right to File Amended Returns	Potential Tax Benefit Waived	Potential Tax Benefit Available
(9)	Claw Backs and the Right to Use Code Section 1341	Potential Tax Benefit Waived	Potential Tax Benefit Available
(10)	Interest Paid on Refunds	Potential Economic Benefit Waived	Potential Economic Benefit Available
(11)	I.R.S. Administrative Issues	Administrative Ease	Increased Proof Requirement/Increased Audit Potential

The Footnotes

1. A Ponzi Scheme Loss is a Theft Loss Deductible as an Ordinary Loss.

Both the Revenue Ruling and the Revenue Procedure agree that a loss from a Ponzi scheme is a theft loss for tax purposes. The Revenue Ruling is a good guide to the standard that must be met for a loss to be considered a theft.

Both the Revenue Ruling and the Revenue Procedure. also make it clear that a theft loss from a Ponzi scheme is an ordinary loss and not a capital loss.

2. The Amount of the Loss (Basis) and Phantom Income.

The Revenue Ruling and the Revenue Procedure both acknowledge that the amount of a theft loss resulting from a Ponzi scheme is generally the initial amount invested in the arrangement, plus any additional investments, less amounts withdrawn. Furthermore, both agree that if an amount is reported to the investor as income in years prior to the year of discovery of the theft and the investor includes the amount in gross income; then the amount of the theft loss is increased by the purportedly reinvested amount (the "Phantom Income").

> The Revenue Ruling says it best:
> *The amount of a theft loss resulting from a fraudulent investment arrangement is generally the initial amount invested in the arrangement, plus any additional investments, less amounts withdrawn, if any, reduced by reimbursements or other recoveries and reduced by claims as to which there is a reasonable prospect of recovery. If an amount is reported to the investor as income in years prior to the year of discovery of the theft, the investor included the amount in gross income, and the investor reinvests the amount in the arrangement, this amount increases the deductible theft loss.*

3. Five Year Loss Carry Back of Net Operating Losses.

The safe harbor provides that the Section 1211 of the American Recovery and Reinvestment Act amends the IRS code to allow certain taxpayers, including individuals, to be eligible to elect a 3, 4 or 5 year net operating loss carry back that is applicable only to net operating losses in the year 2008. The Revenue Ruling also interpreted this change in the law to apply to individual investors. The Revenue Ruling that is attached is very instructive on the requirements that must be met to qualify for the five year carry back and the legal reasons why it does apply to individual Ponzi scheme victims.

4. The Deduction is not Reduced by the Application of Certain Percentage or Dollar Limitations.

The Revenue Ruling makes it clear that the theft loss is an **itemized deduction** and that several Code Sections that typically apply limitations to deductions are not applicable to theft losses from a Ponzi scheme. The 2% limit on itemized deductions does not apply to the theft loss; nor does the overall limit of itemized deductions that is based on a percentage of adjusted gross income apply. Finally, the $100 exclusion that must be met before taking a deduction for personal theft losses does not apply to Ponzi Scheme theft losses.

The safe harbor grants the same treatment.

5. Respect for Pass through Entities.

The safe harbor directly comments on the treatment of investors in Ponzi schemes through entities that are separate and apart from the Ponzi victims, such as partnerships. The safe harbor states that an investor that would otherwise be qualified for a theft loss will not be considered to be qualified to claim that deduction under the safe harbor. Instead, the safe harbor states that the actual **fund or entity** itself in which a Madoff investors has invested in ***will be considered the qualified investor for purposes of the safe harbor.***

There have been comments by I.R.S. officials and commentators that pass through entities such as partnerships and Sub Chapter S companies will report Madoff losses to each investor on their Schedule K-1 so that investors who can not use the safe harbor may file for their losses under the standard rules applied to pass through entities.

These "indirect investors" who want to avail themselves of the safe harbor need to make sure that the pass through entity in which they have invested is a "qualified investor" and complies with the safe harbor procedures.

Furthermore, in determining whether the five year extended loss carry back period will apply, again the I.R.S. will look to the pass through entity and its gross receipts. The five year carry back is only available to qualified investors whose annual gross receipts for 2006, 2007 and 2008 do not exceed $15 Million.

6. Year of Discovery and Deductibility - 2008.

The safe harbor, like the law both find that a Ponzi scheme will be treated as a theft loss and as a theft loss it is deductible in the year of discovery.

The safe harbor provides a specific definition of the discovery year by linking the year of discovery to a year in which certain actions may be taken against the perpetrators of a Ponzi scheme. The safe harbor provides that the taxpayers who do not follow the safe harbor must establish "that the theft loss was discovered in the year the taxpayer claims the deduction".

The safe harbor considers the discovery year to be the year in which an indictment, an information or a complaint is filed against the perpetrator(s) of the Ponzi scheme.

The taxpayer who is not choosing the "safe harbor" may have the responsibility to prove under the existing law that the year 2008 was the year of discovery. In essence I.R.S. is saying to the taxpayer prove there was a theft loss and prove the taxpayer knew about it in 2008.

The facts here speak for themselves. Madoff was arrested in December 2008 for crimes that would qualify as the theft under the safe harbor and the general law. Furthermore, Madoff's arrest and crimes were of broad public knowledge before the end of the year 2008. It would be rare to find even non Madoff related individuals who had not heard about the scheme by 12/31/08. In most cases, the taxpayer's records are meticulous.

The law and the Revenue Ruling interpret "the year of discovery" for theft losses in a more liberal way than the requirements of the safe harbor. **The safe harbor requires that certain specific actions be taken by authorities before a theft loss is discovered for tax purposes.** The law does not require that the taxpayer go to that extent to have a theft loss.

The case law defines the proof needed to pinpoint the year of discovery as follows:

> *A loss is considered to be discovered when a reasonable man in similar circumstances would have realized the fact that he had suffered a theft loss.*

The year of discovery has also been described as:

> *"The proper year in which to claim a theft loss . . . being the year when the taxpayer in fact discovers the loss".*

This author believes that the typical Madoff taxpayer will be in the position to prove, if necessary, that as far as they are concerned, the Madoff loss is in the year 2008. A review of the facts here finds that Madoff was indicted for his crimes in 2008. The safe harbor would find that this is sufficient enough. However, there is much more to the evidence that can prove that 2008 was the year of discovery.

Since the Madoff investment was so critical to many economic plans, every Madoff investor who had discovered the theft in 2008 will most likely have document upon document of proof. This will be in the form of communications between the taxpayers and their lawyers, accountants, family members and others. It will include documents received from the trustee in receivership and numerous professionals soliciting services and email communications. The list of evidence goes on.

As to the year of discovery, it would seem the I.R.S. will have very little **direct evidence** to overcome a well prepared tax return reflecting the strength of the taxpayer's position and the strength and depth of the proof of that position.

Finally, for whatever it is worth, the Revenue Ruling uses a factual example with facts much like the Madoff case and acknowledges that the year 2008 would be the year of discovery at least for victims in the ruling.

On the whole, when it comes to the year of discovery, the actual factual situations for the typical Madoff victims **that do not accept the safe harbor are very similar to those that accept the safe harbor.** Certainly, there will be highly unusual situations that will not fit this mold.

While there are no guarantees it would seem that the case law; the particular facts regarding the Madoff theft; and the finding by I.R.S. in the Revenue Procedure that the year of discovery was 2008, are all powerful proof for equal treatment on the issue of the year of discovery for all Madoff victims that are similarly situated whether the safe harbor rules would apply or not.

7. Amount of Loss in the Year of Discovery.

In their statements, the Revenue Ruling and the safe harbor both acknowledge as a legal matter that the **determination of the year of discovery** which is the year for the deduction of the theft loss and the **determination of the amount of the deduction in the year of discovery** are two different exercises.

The safe harbor actually acknowledges this legal principle by establishing percentage amounts of deductibility for the loss in the year of discovery.

Both acknowledge that if, in the year of discovery, there exists a claim for reimbursement with respect to which there is a reasonable prospect of recovery, **no portion of the loss for which reimbursement may be received is deductible** in that year. However, **the portion for which there is no prospect of recovery is deductible in the year of discovery.**

In the safe harbor, the I.R.S. makes a ***factual determination*** for all Ponzi schemes and not just Madoff. This determination is that a certain percentage amount of a theft loss can be deducted in the year of discovery of a Ponzi scheme when calculating the ultimate amount of the deductible loss.

The safe harbor provides two specific amounts that may be claimed as the amount of loss in the year of discovery. Those amounts fall into two categories. The Madoff victim will be permitted to take the amount of the entire theft loss and deduct 95% of that amount so long as the taxpayer is not seeking any third party recovery for theft loss tax purposes.

In the event that the Madoff investor is pursuing or intends to pursue any recovery from third parties, then the amount deductible in the year of discovery will be limited to 75% of the deductible loss.

A Revenue Ruling only comments on the law. It gives legal guidelines as to the timing of deductibility of a loss but cannot comment on the specific amount of the loss in the year of discovery. The Revenue Procedure says that if a taxpayer **does not use the safe harbor** it will be up to the taxpayer to rely on the case law in this area to prove that the 95% and 75% figures used in the safe harbor are accurate or close enough to be relied on by ALL Madoff victims.

It is important here to keep in mind that whether a taxpayer uses the Rev. Rul. or the safe harbor, whether the amount of the theft loss that is being deducted **in 2008** is 75%, 85% or 95% of the total theft loss; the ***balance of the theft loss that is not claimed in the year of discovery (2008) will be claimed in a later year when it is clear that no further recovery will be available.*** No theft loss deduction is "lost" just because it is not deducted in the year of discovery.

The taxpayer who does not use the Safe Harbor may still claim the 95% and 75% figures as correct. However, that taxpayer is going to be required to prove that the 95% and 75% figures used by the I.R.S. are accurate for the taxpayer's situation using evidence that is separate and apart from the I.R.S. findings. The I.R.S. has definitely done many taxpayers a favor in the safe harbor by determining a fixed percentage for Ponzi scheme loss in the year of discovery. However, for Madoff victims, the law may provide a similar result if there is the right proof to back it up.

The law provides that the taxpayer would be permitted to take 100% of the loss in the year of discovery **minus** any amounts for which there is a reasonable prospect of recovery. To determine what the safe harbor provides to the taxpayer, another comparative chart is necessary.

THE CHART SHOWS THAT THE FORENSIC ACCOUNTANT CAN PROVIDE THE TAXPAYER WITH THE CRITICAL PROOF THAT IS NEEDED TO SUPPORT THE TAXPAYER'S CALCULATION OF THE REASONABLE RECOVERY EXPECTED IN THE YEAR 2008.

If one does not use the safe harbor to pin down the amount of the loss in the year of discovery, success may depend upon the state of the taxpayer's books and records and the expertise of the taxpayer's tax lawyer and accountant.

Certainly if there is no solid proof of the taxpayer's potential recovery amount or lack thereof, the taxpayer may be well advised to take the safe harbor.

The Doctrine of Equality of Treatment and the Nature of a Safe Harbor

While tax law as a general rule does not look at the equities of a taxpayer's situation, Madoff and other Ponzi schemes might warrant that type of treatment.

To begin with, one needs to understand what generally is meant by a safe harbor and the "doctrine of equality of treatment".

A safe harbor is typically an I.R.S. procedure that permits taxpayer's certain tax treatment without administrative question because the permitted tax treatment is well within the outside boundaries of what I.R.S. believes is the law.

Furthermore, there is a Doctrine of Equality of Treatment that is applied sparingly but nevertheless requires the I.R.S. to exercise its discretion in a manner so that similarly situated taxpayers are treated equally.

It would seem difficult for the I.R.S. to make a factual finding that all of the taxpayers suffering Ponzi scheme theft losses, wherever and whenever they may be, will be permitted a deduction at certain fixed rates at 95% and 75%; while denying these same rates of deduction to a select group of similarly situated taxpayers who choose not to do it the I.R.S. way.

Quantifying the Amount of Theft Loss in Year of Discovery

Safe Harbor	Comparison	The Law
100%	Amount of Qualified Investment Loss	100%
95% Loss Allowed (Loss Reduced by 5%)	Amount of Qualified Loss Permitted. No Recovery Sought.	Loss Reduced by any Potential Recovery from the Ponzi Scheme "Responsible Group"
75% Loss Allowed (Loss Reduced by 25%)	Amount of Qualified Loss Permitted. Third Party Recovery Sought.	Loss Reduced by any other Potential Third Party Recovery.
	Other Reductions to Qualified Investment Loss	
Loss Reduced by Actual Recovery Received in 2008		Loss Reduced by Actual Recovery Received in 2008
Loss Reduced by Insurance Policies in the Name of the Qualified Investor		Loss Reduced by Insurance Policies in the Name of the Qualified Investor
Loss Reduced by Contractual Arrangements that Guarantee or Protect against Loss of the Qualified Investor		Loss Reduced by Contractual Arrangements that Guarantee or Protect against Loss of the Qualified Investor
Loss Reduced by Certain Amounts Payable from the Securities Investor Protection Corporation (SIPC)		Loss Reduced by Certain Amounts Payable from the Securities Investor Protection Corporation (SIPC)

The Waiver of Tax Rights

FOOTNOTES 1 THROUGH 7 compared the benefits of the safe harbor with the law as described by the Revenue Ruling.

FOOTNOTES 8, 9 AND 10 explore **The Waiver of Potential Benefits** in exchange for the benefits of the safe harbor and how costly that harbor may be from a tax standpoint.

8. Waiver of the Right to File Amended Returns.

The safe harbor requires that the Madoff victims forego the opportunity to file amended returns for those years that are still open by the statute of limitations. However, by **amending a prior return** instead of taking a theft loss deduction, ***a taxpayer can eliminate only the taxpayer's Madoff "phantom income"*** from the taxable income in the prior years. **This will typically be the high bracket income.** This manner of recouping loss in a Ponzi scheme generally has been acceptable under the law in limited circumstances. The theory is that if there was no "real income" at the time it was reported, the phantom income can be eliminated as taxable income instead of being claimed as a theft loss. In the Madoff situation this theory would seem to have a lot of merit. It is bolstered by statements by authorities that there was a lack of any real trading by Madoff for years.

Amending a prior return permits the taxpayer to **eliminate Madoff income** for the years 2005 through 2007 and other open years (if the statute of limitations for 2005 has been preserved). Many taxpayers will receive a significant benefit by amending their returns instead of claiming the theft loss for prior years. By amending prior returns to eliminate Madoff income, the taxpayers will generally be receiving a refund only for their Madoff "phantom income" tax payments. This will typically be from the higher tax brackets thus, ***a deduction obtained from amending tax returns to eliminate only the Madoff income may be more valuable than a theft loss deduction.*** Furthermore, refunds from amended returns may carry interest from the year of overpayment. (see below)

A taxpayer's waiver of this right to file amended returns could be very costly, depending upon the amount of the losses, the year of the losses and the taxpayers' financial situation in both the past and in the future.

The ability to use Madoff tax losses at the highest brackets **by amending prior tax returns** will leave more of those losses available to be carried forward into future years as opposed to being used to offset income from prior years and lower tax brackets. To the extent that amended returns do not use up all of the tax losses, these excess losses can be claimed as theft losses in the year 2008 and can then be used as a 20 year carry forward against ordinary income. With the Federal income tax already destined to become higher and state and cities raising their income taxes, theft loss deductions that are carried forward may have significantly more value in the future. They may in the future provide deductions for income that could be subject to federal, city and state income taxes totaling in excess of 50%.

SAFE HARBOR

9. Claw backs and the Right to Use Code Section 1341.

The safe harbor insists that the taxpayer waive their right to **Internal Revenue Code Section 1341. Code Section 1341** in essence provides that if a taxpayer paid tax on income that the taxpayer claimed a right to a prior year and the taxpayer then was required to pay that income in a different year, **the taxpayer would be able to take the deduction either** in the year in which the payback or claw back was made or in the year that the income which was clawed back was taxed. ***This is the case even if the statute of limitations is closed in the year that the original tax was paid.***

The Revenue Ruling did comment on the use of this **Code Section 1341** and stated that it was not applicable under the circumstances of the Revenue Ruling. However, the Revenue Ruling did not go far enough since it ***did not describe or comment on whether Code Section 1341*** applies to a claw back situation. A full discussion of a taxpayer's possible rights under Code Section 1341 is beyond the scope of this Report. However, many taxpayers that are required to make claw backs might find that Code Section 1341 would apply to their claw backs and that waiving the rights to the use of this section could be extremely costly.

The tax bracket comparisons here could be significantly different for those taxpayers who may have to pay claw backs in future years. Taxpayers that pay claw backs and have very little taxable income in future years may take a deduction for the amount of the claw back payment. However, those taxpayers might make only minimal use of the claw back deduction. **By using Code Section 1341 there is the potential for taxpayers to claim that claw back payments should be applied against taxable income in old years (otherwise closed by the statute of limitations)** where they would be much more valuable as tax deductions if income was reported at high tax brackets in these years.

For example, a claw back of $500,000 that provides a tax refund of only 15% in a year when income is low, ($75,000); might provide a cash return at the 35% high tax bracket from a prior high tax bracket year of ($175,000). The difference of 20% in the brackets is $100,000 of real money. Furthermore, the interest paid on a refund going back in years could be significant. By waiving the benefits of Code Section 1341 the taxpayer eliminates the potential for these increased earnings from tax refunds.

10. Interest on Refunds.

An unstated benefit in the Ruling and the Revenue Procedure that is being waived when taxpayers choose the safe harbor is **the possibility of receiving interest** paid in those circumstances where either the use of Code Section 1341 or the use of amended returns will result in refunds.

Taxpayers that receive **refunds** as a result of the safe harbor will receive those refunds as a result of the ***loss carry back*** to prior years **from the year 2008.** Tax refunds from the carry back of net operating losses are calculated from the filing date in **the year in which the net operating loss arose.**

Furthermore, in the case of a refund from such a loss, the interest will start on the filing of the claim, plus a further interest free 45 day period within which I.R.S. may pay the claim after it is filed.

However, where the refund of an overpayment as a result of an amended tax return or because of Section 1341, the interest on that refund amount is calculated ***from the prior year when the overpayment was made.***

IRS

11. I.R.S. Administrate Issues.

Finally we reach Footnote No. 11. This deals with the Internal Revenue Service indications that there may be administrative difficulty for tax returns by Madoff victims that do not choose to use the safe harbor. The Service has clearly stated that those people who do not choose the safe harbor will need to be concerned with proving the year of the theft loss and proving the amount of the theft loss under the existing rules. However, this statement by I.R.S. is tempered since it also states that taxpayers that are not covered by the safe harbor will also not be challenged on the issue of whether "phantom income" is deductible when the phantom income amounts shown on the taxpayer's return were based on information received from the Ponzi scheme, in the taxable years.

Finally, the Service added a caveat that tax returns claiming Ponzi scheme type deductions that do not use the safe harbor may be subject to increased audit exposure.

12. Tax Planning.

There are many that may significantly benefit by making use of the safe harbor. For many, the Revenue Ruling and the law will be helpful. This will depend upon each individual circumstance. Large Madoff tax losses and smaller ones all need to pay attention to the traps and opportunities.

Taxpayer's that use the "safe harbor" are also going to need sound advice on the valuation of their SIPC claims. They must focus on how this might reduce the amount of the theft loss in the year 2008. For example, a taxpayer with a maximum $500,000 Madoff loss and a claim against SIPC for $500,000 that is not resolved by the time the tax return is filed, ***may be forced to delay claiming any theft loss deduction in 2008*** since there is a "reasonable prospect of recovery" of the investor's loss. The inability to use the theft loss in 2008 could significantly affect the amount of any tax refund.

AMENDED RETURNS MIGHT PERMIT THE MADOFF VICTIMS
TO HAVE THEIR TAX BENEFITS AND A SIPC RECOVERY.

2008

ESTATES AND TRUSTS

There will be a host of estate and income tax issues that will not be covered by the safe harbor and that have not been answered by the Revenue Ruling. Not to be overlooked is the effect on the deductibility of theft losses from a standpoint of an income tax versus an estate tax value.

IRA'S AND PENSIONS

Losses in IRAs and Pension accounts will generally not be deductible for tax purposes since they represent the loss of funds with no tax basis. However, ***there may be recoveries of funds*** by these entities or claw backs that will be taken from them that will need to be addressed if millions are not to be lost in potential tax deductions.

LOSS CARRY FORWARDS

One also can not overlook the general tax planning thinking that needs to occur in planning for **loss carry forwards** that may result from the Madoff tax theft. In the case amended returns have been filed, it is also important to file for the theft loss in year 2008 for the balance of losses. This will apply to those who take advantage of the safe harbor and those who do not. Going forward there will be many who will have Madoff tax losses to offset against future income. These losses may be permitted for a period of 20 years from the date of discovery of the theft. These future tax losses may go unused and be wasted for taxpayers who pass away. Those that have greatly reduced income against which tax deductions may be used will need special attention if those deductions are not to be wasted.

A GOOD DEAL OF THINKING IS IN ORDER

for family members and related parties to determine how to legally take the best advantage of the Madoff tax loss that are carried forward. They could be very valuable or wasted assets.

There will be many tax planning tools available to meet these needs.

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