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Madoff Victims Turn to IRS to Get Relief

'Theft Loss' Claims May Help Investors Recoup Some Money; 'A Lot of Them Are Desperate'

By JANE J. KIM and TOM HERMAN

Many investors burned by accused fraudster Bernard Madoff are hoping to get help from an unlikely white knight: the Internal Revenue Service.

Since Mr. Madoff's arrest on Dec. 11 for running an alleged multibillion-dollar Ponzi scheme, a booming cottage industry of tax attorneys and accountants has sprung up to provide advice and counsel to his alleged victims. But a number of thorny questions remain, especially since the IRS has yet to provide any guidance -- and the best advice for one investor may not be smart for someone else with significantly different circumstances.

Disaster Recovery

Some Madoff investors are seeking relief from tax agencies:

- Lawyers recommend claiming Madoff-related losses as theft losses, which can be used to offset ordinary income.
- Some advisers are also telling investors to file amended returns for prior years.
- Even tax experts aren't sure how the IRS will rule on these and other issues.

Several lawyers say many of those who invested with Mr. Madoff may be able to deduct their losses as ordinary "theft losses," which could be used to offset other income. But it's unclear whether the IRS will agree on this or other issues, such as what investors should do about recouping taxes they paid in prior years on income they thought they had received at the time but now appears to have been illusory.

It's not even clear how investors should figure out exactly how much they've lost, or how far back in time they can go to calculate their losses. And then there are the investors who received payouts from Mr. Madoff that may now be "clawed back" from them.

"This is a mess," says Leslie B. Samuels, a former assistant Treasury secretary for tax policy and now a lawyer at the Cleary Gottlieb Steen & Hamilton law firm in New York. "Nobody knows yet what all the facts are," and all the confusion over tax issues "just adds insult to injury" for the alleged victims.

Among Mr. Madoff's alleged victims is Ronnie Sue Ambrosino, a 56-year-old retiree from Florida who says she and her husband were visiting Surprise, Ariz., when the scandal broke. She now is waiting for IRS guidance on how to handle her losses.

"I can't file my taxes until I know what's happening," says Ms. Ambrosino, who has organized a support group for Madoff victims.

"I feel terrible for these people. Some of these people are destitute," says Michael Kosnitzky, a partner at the Boies, Schiller & Flexner law firm. "For many of them, it looks like tax refunds are the main benefits they'll receive." But he says victims also need to consider other issues, such as whether to file insurance claims on homeowner policies to recoup some money or make a claim with the Securities Investor Protection Corp., or SIPC, an organization designed to help investors at failed brokerage firms.

Some law firms have set up special Madoff groups and have arranged conference calls with clients and professionals. At least one Web site focusing on Madoff-related tax issues has sprung up. Many accountants are also weighing in.

Despite all this, there still isn't unanimity of opinion on how to answer all the Madoff-related tax questions -- or even what taxpayers should do right away.



Associated Press

Allan Goldstein, a retiree and investor with Bernard L. Madoff Investment Securities, testifies before the House Committee on Financial Services.

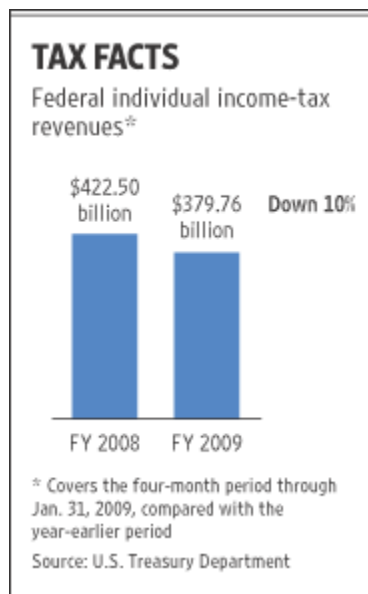
In some cases, investors have already filed amended returns for prior years in hopes of getting back taxes they paid, says Stephen Breitstone, a partner in Meltzer, Lippe, Goldstein & Breitstone LLP in Mineola, N.Y. "They wanted to get their money back as fast as possible," he says. "A lot of them are desperate." However, he says, the IRS may not accept those returns because "it's arguably contrary to long-standing tax policies."

Nobody knows precisely where all the Madoff money went, or how much will eventually be recovered. It's also unclear whether the IRS will issue any guidance. Asked for comment, IRS spokeswoman Michelle Eldridge replied: "Under disclosure rules, IRS can't discuss any specific cases. In general, it's important for individual investors to discuss their tax situations with their tax adviser. There are a lot of personal facts and circumstances that can come into play."

One thing lawyers agree on is that there are far more questions right now than answers. Among the key issues:

Claiming losses. Several lawyers agree that theft losses on money that victims invested with Mr. Madoff shouldn't be subject to limits that apply to personal casualty or theft losses. With such losses, your deduction for 2008 generally would be limited to the extent those losses exceeded 10% of your adjusted gross income -- after reducing each loss by \$100. To the extent that any eligible losses exceed gross income, those losses can be carried back three years or forward 20 years.

But it's unclear whether the IRS will agree on this point. There is also debate about what investors should do if they received Madoff-related income in past years, reported it and paid taxes on it.



Another thorny issue: whether investors can claim a theft loss on their tax returns this year as long as there is some reasonable prospect of recovering money. Robert Willens, a New York tax adviser, says some investors may have to delay taking the deduction until any claims for potential recoveries are resolved. But others say they expect the IRS to be lenient and allow people to deduct theft losses minus the amount of SIPC claims.

It's also uncertain how much investors could include as part of their theft-loss deduction. One federal district court case could have "devastating consequences" for Madoff victims, says Mr. Willens. In that decision, the court concluded that the victims of a Ponzi scheme could only deduct their original principal as a theft loss; any phantom income paid -- including taxes paid on that income -- could not be included as part of the theft loss, he says.

Making amends. How should investors handle losses for years prior to 2008? Charles Rettig, a tax lawyer at Hochman, Salkin, Rettig, Toscher & Perez PC in Beverly Hills, Calif., says that investors should amend their returns for the past three tax years, removing any income reported from Madoff-related investments. "They should likely attach a disclosure statement" explaining what they've done, he says.

He also says the net investment loss -- generally the difference between how much an investor put in and the amount he received -- should be deducted on his 2008 return.

Accounting firm Holtz Rubenstein Reminick LLP in Melville, N.Y., has been advising Madoff investors to file protective claims for all open tax years -- 2005, 2006 and 2007 -- in order to keep those years open before the three-year statute of limitations closes, says Timothy Mulcahy, chairman of the firm's tax department. Mr. Mulcahy is also suggesting that Madoff investors file extensions for their 2008 returns since he doesn't expect that the IRS will come out with guidance before April 15. Other advisers say there may be ways to recover back taxes going back even further than the usual three-year time limit.

A Madoff bailout fund. Will Congress step in and pass special legislation designed to help Madoff victims? Don't count on it, advisers say. Congress is preoccupied with too many other issues -- and is already coping with the prospect of massive budget deficits for years to come.

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