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March 23, 2009

Re: Income Tax Guidance for Victims of the Madoff Fraud

Dear Client:

As many of you undoubtedly have heard, the Internal Revenue Service has issued Revenue Ruling 2009-9 and Revenue Procedure 2009-20, which address the federal income tax treatment of losses resulting from the Madoff fraud. The IRS also issued Revenue Procedure 2009-19, which clarifies the application of the extended (up to five year) carryback provision contained in the recently enacted so-called "Economic Stimulus Act" to taxpayers that suffered losses from the Madoff fraud, and provides instructions as to how to elect the extended carryback period. A memorandum is attached that describes how to treat losses suffered from the Madoff fraud in filing your income tax returns and highlights certain issues raised by the revenue ruling and the two revenue procedures (referred to collectively in this letter and the attached memorandum as the "Guidance"). Also attached, for your convenience, is a copy of the Guidance.

Overall, the IRS is to be commended for taking a practical and constructive approach to the income tax issues raised by the Madoff fraud. They also are to be commended for issuing lucid and fairly comprehensive guidance in what is a remarkably short period of time for this government agency. It is quite helpful that they issued that guidance in time for the initial April 15 filing date for 2008 income tax returns.

Not unexpectedly, there are some aspects of the Guidance that we view as incorrect or unfair. Most notably, although there are equitable provisions in the Internal Revenue Code that could allow losses from the Madoff fraud to be carried back to years generally barred by the three year statute of limitations (and even to years preceding the extended five year carryback period), the IRS guidance does not contemplate allowing that. To make matters worse, the Guidance directly targets the elimination of one of those equitable Code provisions.

For many Madoff victims, the Guidance provides important certainty and what amounts to a generally favorable "safe harbor." Accordingly, we believe it will be advantageous for many victims to file on the safe harbor basis.



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However, other victims may not derive adequate relief under the safe harbor approach, particularly those victims who paid taxes for many years on fictitious Madoff income and who did not have sufficient income in 2003 through 2007 (and do not anticipate having sufficient income in the foreseeable future) with which to offset their 2008 theft loss. Those victims will have to weigh the risks of forgoing the safe harbor in favor of retaining their options for further relief under the equitable provisions of the Code – specifically, IRC § 1341 (the “claim of right” provision).

In addition, clients who invested with Madoff through a fund, a partnership or other entity must be cognizant of the way the Guidance applies to them. For example, they should be aware – as is discussed in the attached memorandum – that the safe harbor election must be made by the entity that directly invested with Madoff, and cannot be made by the individual (or other intervening entities).

This letter and the attached memorandum are being provided as general advice regarding the federal income tax consequences of the Madoff fraud, but should not be relied upon for any specific situation without consulting us.

Sincerely yours,

Meltzer, Lippe, Goldstein & Breitstone, LLP

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MEMORANDUM

To: Madoff Clients

From: Stephen M. Breitstone, José L. Berra and Richard A. Lippe

Date: March 23, 2009

Subject: FEDERAL INCOME TAX TREATMENT OF MADOFF LOSSES
PURSUANT TO THE IRS SAFE HARBOR

This memorandum describes the manner in which federal income tax returns for clients who suffered losses from the Madoff fraud are to be filed pursuant to the safe harbor (the “Safe Harbor”) provided by Revenue Procedure 2009-20 (the “Procedure”), which was issued in conjunction with Revenue Ruling 2009-9. The Procedure allows simple, and in many cases favorable, tax treatment for taxpayers that suffered losses from the Madoff fraud, especially when combined with the extended carryback period clarified by Revenue Procedure 2000-19. Many, but not all, victims will want to avail themselves of the Safe Harbor and the extended carryback period. This memorandum also describes certain aspects of the Guidance that may be of concern to some clients and also considerations that are relevant for those clients who instead of investing directly with Madoff, made their investment through a partnership, fund or other entity.

THE BOTTOM LINE: For Taxpayers that avail themselves of the Safe Harbor, the federal income tax reporting with respect to their Madoff losses will boil down to the following:

1) Do not include reported 2008 earnings on Madoff investments on the 2008 income tax return.

Note: For many of our clients who paid estimated taxes for the first three quarters of 2008 with respect to anticipated earnings on their Madoff accounts, the refund of those estimated taxes will provide an important source of cash.

2) Comply with the procedural filing requirements set forth in the Procedure, which are listed in the next section of this memorandum.

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Note: The Procedure provides that a Safe Harbor election only can be made by a “qualified investor.” Only the individual or entity that directly invested with Madoff (the “Direct Investor”) is considered a qualified investor. Therefore, individuals wishing to avail themselves of the Safe Harbor that invested with Madoff through a partnership, fund or other entity, must ensure that the Direct Investor complies with the Procedure’s filing requirements.

3) Claim a Safe Harbor theft loss on the 2008 income tax return, for the anticipated net loss, as described in further detail below.

Note: The Guidance makes clear that the theft loss deduction is not subject to various limitations, namely: (i) neither the 10% of adjusted gross income floor, nor the \$100 floor, that applies to personal theft losses; (ii) the two percent of adjusted gross income floor that applies to miscellaneous itemized deductions; or (iii) the overall limit on itemized deductions based on a percentage of adjusted gross income or total itemized deductions.

Note: Taxpayers should not file amended returns for years prior to 2008 with respect to reported income from Madoff investments.

4) Carry back the claimed theft loss for up to five years (i.e., 2003 through 2007) to offset taxable income in the carryback tax years, and request an expedited (“quicky”) refund of taxes paid in those prior years. A theft loss in excess of the amount that can be utilized in the carryback period may be carried forward up to 20 years.

Note: Theft losses generally are eligible for a three year carryback period. However, subject to certain restrictions described below, Madoff victims are eligible to carry back their theft losses for up to five years, but are not required to do so by the Safe Harbor. The extended carryback provision is not part of – or predicated upon choosing – the Safe Harbor.

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Note: By virtue of the carryback, taxpayers that had significant amounts of income in the carryback tax years (potentially, 2003 through 2007) will be able to obtain refunds of taxes paid in those years to the extent that the amount of the theft loss claimed in 2008 is sufficient to offset the income from those prior years. Those refunds can be obtained on an expedited basis by filing for a “quicky” refund on Form 1045, Application for Tentative Refund.

Note: Taxpayers that wish to elect the extended carryback period must do so in accordance with Revenue Procedure 2009-19.

5) In future taxable years, report adjustments to the amount of the theft loss deduction. Those adjustments will arise to the extent that the actual amount of the net theft loss proves to be more or less than the amount claimed on the 2008 income tax return. Future clawbacks also should be taken into account in future years.

SAFE HARBOR FILING REQUIREMENTS IN THE PROCEDURE:

The Procedure provides that to file a tax return pursuant to the Safe Harbor, a taxpayer must do the following (for your convenience, the list below is reproduced from the Procedure):

- (1) Mark "Revenue Procedure 2009-20" at the top of the Form 4684, Casualties and Thefts, for the federal income tax return for the discovery year. The taxpayer must enter the “deductible theft loss” amount from line 10 in Part II of Appendix A of this revenue procedure on line 34, section B, Part I, of the Form 4684 and should not complete the remainder of section B, Part I, of the Form 4684;
- (2) Complete and sign the statement provided in Appendix A of this revenue procedure; and

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- (3) Attach the executed statement provided in Appendix A of this revenue procedure to the qualified investor's timely filed (including extensions) federal income tax return for the discovery year. Notwithstanding the preceding sentence, if, before April 17, 2009, the taxpayer has filed a return for the discovery year or an amended return for a prior year that is inconsistent with the safe harbor treatment provided by this revenue procedure, the taxpayer must indicate this fact on the executed statement and must attach the statement to the return (or amended return) for the discovery year that is consistent with the safe harbor treatment provided by this revenue procedure and that is filed on or before May 15, 2009.

ADDITIONAL DETAILS:

Amount of the Theft Loss: The Procedure specifies that the amount of the theft loss generally equals 95 percent of the amount of the "qualified investment" (which is described below), less the sum of any actual or potential recovery from either: (i) SIPC (the Securities Investor Protection Corporation); (ii) insurance policies in the name of the investor; or (iii) other contractual arrangements (other than insurance) that guaranteed or otherwise protected against loss of the investment.

Note: Being allowed to claim such a large portion of the loss in 2008 is a favorable result for many taxpayers.

Note: The requirement that potential SIPC recoveries be deducted in computing the net amount of the loss provides a further indication that SIPC will in fact honor claims for losses from the Madoff fraud even though it initially had been thought that SIPC might argue that it was not obligated to. It is a virtual certainty that were senior level discussions among officials of the IRS, the U.S. Treasury Department, the SEC and SIPC that lead the IRS to conclude that SIPC would honor claims for losses from the Madoff fraud.

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Some clients will be permitted to deduct only 75 percent (instead of 95 percent) of the amount of the qualified investment (as reduced by the amount of actual or potential recoveries described above). The 75 percent threshold applies to clients that are pursuing or intend to pursue a potential recovery against parties other than the "Responsible Group." The Responsible Group in, general terms, consists of individuals, entities or investment vehicles that participated in the fraud, the bankruptcy estate being administered by the trustee, Irving Picard, (the "Trustee") or parties that are subject to claims brought by the Trustee.

Calculating the Qualified Investment: As indicated above, to calculate the amount of the 2008 theft loss deduction, it is necessary to determine the amount of the taxpayer's "qualified investment." The qualified investment basically is calculated as follows:

The total amount that the taxpayer invested with Madoff in **all years**

Plus: the total amount of reported net income that the taxpayer included on their tax return **for all prior years through 2007** (including taxable years for which the statute of limitations has closed)

Minus: the total amount withdrawn by the taxpayer in **all years**

Note: The amount of the "qualified investment" is calculated with respect to the total amounts invested, reported as income and withdrawn by the Direct Investor, and not (in the case of an individual that invested with Madoff through a fund, a partnership or other entity) the individual.

The Safe Harbor Only May Be Elected By "United States Persons": To be eligible to elect Safe Harbor treatment, a Direct Investor that is an entity generally must be a domestic partnership or corporation, an estate that is not a foreign estate or a trust with a specified degree of nexus to the U.S.

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The Five Year Carryback Is Not Available To All Taxpayers: As noted above, many clients will be entitled to avail themselves of an extended carryback period of up to five years. However, this extended carryback period (in contrast to the three year carryback period that generally applies to theft losses) is available only if the Direct Investor had average annual gross receipts for 2006, 2007 and 2008 that did not exceed \$15 million.

Note: The average annual gross receipts calculation is more favorable to Madoff victims than might initially appear. Since previously reported 2008 earnings on Madoff investments will not be reported on the 2008 income tax returns, in many instances, the gross receipts for 2008 will be \$0. As a result, the taxpayers may qualify for the extended carryback period if their average annual gross receipts for 2006 and 2007 were \$22.5 million. Furthermore, for purposes of the gross receipts calculation, Taxpayers reduce the reported proceeds from Madoff's security transactions in 2006 and 2007 by the presumed cost of those securities.

Some Considerations In Choosing (Or Not Choosing) The Safe Harbor: Taxpayers with Madoff losses are not required to follow the Safe Harbor approach contained in the Procedure. It is the taxpayer's choice whether or not to avail themselves of the Safe Harbor (unless the choice is made for them by a Direct Investor that is an entity). For those wishing to choose Safe Harbor treatment, the choice must be made on the timely filed (including extensions) income tax return for 2008.

Although the treatment provided by the Safe Harbor is favorable to many of our clients, that approach may not necessarily be the best course of action for everyone. In any event, it is important to know that the IRS exacts a price in the Procedure from those taxpayers who avail themselves of the Safe Harbor by requiring them to agree not to: (i) deduct a theft loss in 2008 in excess of the amounts permitted by the Safe Harbor; (ii) file returns that treat (or amend returns in a manner that treats) reported Madoff income as not being taxable; (iii) apply the alternative computation in IRC § 1341 with respect to the theft loss allowed by the Safe Harbor; and (iv) avail themselves of the Code provisions in IRC § 1311 et seq that mitigate the effect of the statute of limitations in certain equitable situations.

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Note: The waiver required with respect to IRC § 1311 is of little practical significance because the IRS has taken a fairly deft stab in the Guidance at precluding taxpayers from availing themselves of the mitigation of limitation provisions in IRC § 1311 et seq even if they choose not to avail themselves of the Safe Harbor. That is not the case, however, with respect to the equitable relief available pursuant to IRC § 1341.

It also is important to know that the Safe Harbor just may not provide sufficient tax relief for longtime Madoff investors whose losses materially exceed their aggregate taxable income for the past five years (or the past three years if they are ineligible for the extended carryback period) and for the foreseeable future. The most likely avenue for obtaining appropriate tax relief for investors who paid significant amounts of taxes for an extended period on fictitious earnings reported by Madoff, is the equitable relief available pursuant to the “claim of right” provisions contained in IRC § 1341.

Special Considerations For Those Who Invested With Madoff Indirectly, I.E., Through Funds, Partnerships, Trusts or Other Entities: For a number of reasons, the application of the Guidance is not as simple, helpful or clear for Madoff victims who invested through funds, partnerships or other entities (rather than individually). For example, as indicated above, the Procedure does not allow individuals that invested with Madoff through a fund, a partnership or other entity to individually choose to avail themselves of the Safe Harbor. To avail themselves of the Safe Harbor, those individuals should ensure that the Direct Investor is a “qualified investor” and properly complies with the Procedure’s Safe Harbor filing requirements.

Another potential lurking problem for those who invested with Madoff through an entity is that the amount of the Qualified Investment (on which the amount of the theft loss is predicated) is calculated by the Direct Investor, as is the amount of the Safe Harbor theft loss (which generally passes through in some fashion to the underlying Madoff victim). As a result, an individual taxpayer’s theft loss can be dependent upon the history of others who invested with Madoff through the same Direct Investor. In addition, the cap on the average annual gross receipts (upon which eligibility for the extended carryback period is predicated) is calculated with respect to the gross receipts of the Direct Investor (as opposed to the underlying individual Madoff victim). Accordingly, additional careful consideration may be merited for those who invested with Madoff through a Direct Investor instead of individually.