

LAW OFFICES
MELTZER, LIPPE, GOLDSTEIN & BREITSTONE, LLP

190 WILLIS AVENUE, MINEOLA, NY 11501

TELEPHONE: (516) 747-0300

FASCIMILE: (516) 747-0653

INTERNET: www.meltzerlippe.com

December 3, 2009

Re: New Income Tax Relief for Victims of the Madoff Fraud and
Other Ponzi Schemes

Dear Client:

It has been a long time coming, but new federal legislation was enacted recently that provides additional welcome income tax relief for some of those who suffered losses from the Madoff fraud or other Ponzi schemes (“Ponzi Losses”). The legislation (the “New Act”) was co-sponsored in the Senate by Chuck Schumer. It will provide widespread benefits to many who invested with Madoff indirectly through partnerships (as well as certain other investors) but did not qualify for previous extended carryback relief because they did not satisfy the definition of an “eligible small business,” which is described below. The relief comes in the form of an expanded ability to carryback Ponzi Losses for five years, instead of the generally applicable three-year period for theft losses, without regard to whether the taxpayer claiming the Ponzi Loss is an eligible small business.

While the latest relief will provide a valuable benefit to many, there is a growing awareness that further tax relief is called for and we are cautiously hopeful that there will be additional legislative tax relief in the coming months. In the meantime, we are sending you this letter to explain the relief provided by the New Act. Since it has been several months since we have provided guidance about the income tax treatment of Ponzi Losses, we will start this letter with an overview to help put the New Act in context.

In our letter to our clients dated March 23, 2009, we described how the Treasury Department and the Internal Revenue Service issued guidance in February in the form of one Revenue Ruling and two Revenue Procedures (the “Guidance”). You may recall that the Guidance provided a generous “safe harbor” for claiming theft loss deductions for Ponzi Losses. The Guidance also made clear that Ponzi Losses in many instances qualified for the extended (up to five year) carryback period provided by the so-called Stimulus Act for those taxpayers that met the requirements of an eligible small business.



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The length of the carryback period can be crucial for taxpayers who suffer major Ponzi Losses. That is because a theft loss puts dollars in the pocket of a taxpayer that suffers Ponzi Losses only to the extent that the theft loss can be used to offset other taxable income. The theft loss suffered by Madoff's victims generally exceeds (often vastly) their taxable income in 2008, the year of the loss. Therefore, the principal way to realize a hard dollar benefit from the theft loss is to use it to offset taxable income in prior years (through a carryback) or future years (through a carryforward). Unfortunately, for many who suffered losses the prospect of substantial future income is doubtful, and therefore, the only practical way to benefit from the Ponzi Losses is by carrying them back to prior years to offset income reported in the earlier years. Carrying back losses to prior years to reduce taxable income reported in those prior years generates a tax benefit in the form of a refund of some or all of the income taxes paid in those prior years. Therefore, for many who suffered Ponzi Losses, a longer carryback period translates into a larger refund of previously paid income taxes.

As indicated above, theft losses (which include Ponzi Losses) generally can be carried back three years to reduce taxable income reported in those prior years. Many of you will recall that the Stimulus Act allowed taxpayers who suffered Ponzi Losses to carryback those losses up to an additional two years (for a total of up to five years). However, that additional two-year carryback period was not available to everyone. Most significantly for many, it was not available unless the direct investor in the Ponzi scheme was an "eligible small business," i.e., the direct investor had average annual gross receipts of \$15 million or less for 2006, 2007 and 2008. This meant that many who invested with Madoff or in other Ponzi schemes indirectly through partnerships that aggregated the investments of many (often relatively small) investors, were not able to avail themselves of the extended (up to five-year) carryback period generally available to those who invested directly. As a result, indirect investors often suffered a double indignity because they had the misfortune to invest through large partnerships instead of directly. In addition to effectively being denied SIPC coverage (because SIPC's position is that the \$500,000 of SIPC insurance is available only to those who invest directly and not through a partnership) they did not qualify for the extended carryback period.

The New Act recognizes the inequity of denying the extended carryback period for Ponzi Losses simply because an investor had the misfortune to invest through a large partnership. Accordingly, those who suffered Ponzi Losses on investments made through partnerships will now be able to carryback those losses up to five years irrespective of whether the partnership through which they invested had average annual gross receipts in excess of the permissible \$15 million threshold. However, in contrast to the five-year carryback provision in the Stimulus Act, NOLs carried back five years will only be able to offset only one-half of the taxpayer's taxable income in that fifth year. (This limitation

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appears to have been motivated by budgetary constraints that made it necessary to limit the expense of the New Act, a sad but real constraint in this time of ballooned deficits.)

A few other aspects of the New Act are worthy of mention. First, the New Act generally applies to losses incurred in either 2008 or 2009. (The Stimulus Act only applied to losses incurred in 2008.) Furthermore, for those that qualify as an eligible small business, the New Act applies to Ponzi Losses incurred in both 2008 and 2009. It seems unlikely that many will benefit from the extra year, but it is worth being aware of its availability. Taxpayers also should be aware that the New Act provides additional relief for those taxpayers subject to the alternative minimum tax ("AMT"). Under the Stimulus Act, an NOL could only be used to offset 90% of the relevant taxable income for purposes of computing the AMT. The New Act allows NOLs to be used to offset 100% of the relevant taxable income. Therefore, clients subject to the AMT will want to consider amending their income tax returns.

Many taxpayers who are not residents of Florida (which does not have an income tax) also will want to know whether the extended carryback relief provided by the New Act will also apply to their state income taxes. In many instances the answer will be yes. The relief provided in the New Act should apply to New Yorkers (and potentially to residents of other states as well) to the same extent as the carryback relief provided by the Stimulus Act. You should consult with your accountant to determine whether the relief provided by the New Act applies for purposes of your state income tax as well.

Those wishing to avail themselves of the relief provided by the New Act generally will need to make an election by the due date (including extensions) for filing their 2009 tax returns. For most calendar year individuals on extension, that deadline will be October 15, 2010. As was the case for taxpayers who wished to avail themselves of the extended carryback period under the Stimulus Act, taxpayers who wish to avail themselves of this latest extended carryback relief should be aware – and should confirm that their accountant is aware – that the four- or five-year carryback period generally must be elected earlier than the deadline that generally applies to carryback elections. The deadline that generally applies to carryback elections is 12 months after the taxable year of the carryback (December 31, 2010 for a calendar year taxpayer's 2009 tax return). However, as noted above, a carryback election under the Act generally cannot be made later than October 15, 2010 (six months after the extended due date for the 2009 tax return). Some accountants may not be aware of the shorter election period, and missing the deadline could be an expensive mistake.

Whether or not you availed yourself of the extended carryback period provided by the Stimulus Act, we generally recommend that you consult with your accountant to determine whether the New Act will provide you with new or additional relief. To that

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end, taxpayers and their accountants should be aware that the Internal Revenue Service has issued detailed guidance relating to the relief provided by the New Act and its interaction with elections pursuant to the Stimulus Act. That guidance is contained in Rev. Proc. 2009-52. Although the Rev. Proc. is not scheduled to be formally published until December 7, 2009 it is available and a copy is attached.

This letter is being provided as general advice regarding the income tax consequences of the Madoff fraud and should not be relied upon for any specific situation without consulting us. Should you have a specific situation that you wish to discuss, please contact us.

We wish to take this opportunity to extend our best wishes to you and your loved ones for a happy and healthy holiday season.

Sincerely yours,

Meltzer, Lippe, Goldstein & Breitstone, LLP

Stephen M. Breitstone

José L. Berra

and Richard A. Lippe

Part III

Administrative, Procedural, and Miscellaneous

26 CFR 601.105: Examination of returns and claims for refund, credit or abatement; determination of correct tax liability.
(Also Part I, §§ 172, 6411)

Rev. Proc. 2009-52

SECTION 1. PURPOSE

.01 This revenue procedure provides guidance under § 13 of the Worker, Homeownership, and Business Assistance Act of 2009, Pub. L. No. 111-92, 123 Stat. 2984 (November 6, 2009) (the Act). Section 13 of the Act amends §§ 172(b)(1)(H) and 810(b) of the Internal Revenue Code to allow taxpayers to elect to carry back an applicable net operating loss (NOL) for a period of 3, 4, or 5 years, or a loss from operations for 4 or 5 years, to offset taxable income in those preceding taxable years. This revenue procedure applies to losses from operations of a life insurance company under § 810 in the same manner as to NOLs under § 172.

.02 This revenue procedure prescribes when and how to elect under § 172(b)(1)(H)

to carry back an applicable NOL for a period of 3, 4, or 5 years for (1) taxpayers that have not claimed a deduction for an applicable NOL; (2) taxpayers that previously claimed a deduction for an applicable NOL; and (3) taxpayers that previously filed an election under §§ 172(b)(3) or 810(b)(3) to forgo the NOL carryback period.

SECTION 2. BACKGROUND

.01 Section 172(a) allows a deduction equal to the aggregate of the NOL carryovers and carrybacks to the taxable year. Section 172(b)(1)(A)(i) provides that an NOL for any taxable year generally must be carried back to each of the 2 years preceding the taxable year of the NOL. Section 172(b)(3) provides that any taxpayer entitled to a carryback period under § 172(b)(1) may make an irrevocable election to relinquish the carryback period for an NOL for any taxable year.

.02 Section 810(b)(1)(A) provides that life insurance companies may carry back an NOL for any taxable year to each of the 3 years preceding the taxable year of the loss. Section 810(b)(3) provides that any taxpayer entitled to a carryback period under § 810(b)(1) may make an irrevocable election to relinquish the carryback period for a loss from operations for any taxable year.

.03 Section 6411(a) provides that a taxpayer may file an application for a tentative carryback adjustment of the tax for the prior taxable year affected by an NOL carryback from any taxable year. Section 6411(a) also provides that the application must be filed on or after the date of filing for the return for the taxable year of the NOL from which the carryback results and within a period of 12 months after that taxable year or, for any portion of a business credit carryback attributable to an NOL from a subsequent taxable year, within a period of 12 months from the end of the subsequent taxable year.

Section 6411(b) provides a 90-day period during which the Internal Revenue Service will make a limited examination of the application to discover omissions and errors of computation and determine the amount of the decrease in tax attributable to the carryback. The Service may disallow, without further action, any application that contains errors of computation that cannot be corrected within the 90-day period or that contains material omissions. The decrease in tax attributable to the carryback is applied against unpaid amounts of tax. Any remainder of the decrease is credited or refunded within the 90-day period.

.04 Section 1211 of the American Recovery and Reinvestment Tax Act of 2009, Div. B of Pub. L. No. 111-5, 123 Stat. 115 (February 17, 2009) (ARRA), amended § 172(b)(1)(H) to allow an eligible small business (ESB) to elect to carry back a 2008 applicable NOL for a period of 3, 4, or 5 years (the ARRA election). Unlike the § 172(b)(1)(H) election under the Act (referred to in this revenue procedure as the § 172(b)(1)(H) election), the ARRA election is applicable only to an NOL attributable to an ESB. The ARRA election is irrevocable and may be made for only one taxable year. Rev. Proc. 2009-26, 2009-19 I.R.B. 935 (April 25, 2009), modifying and superseding Rev. Proc. 2009-19, 2009-14 I.R.B. 747 (March 16, 2009), advises taxpayers how to make the ARRA election.

.05 Section 172(b)(1)(H)(i), as amended by the Act, permits a taxpayer to elect to carry back its applicable NOL to 3, 4, or 5 years preceding the taxable year of the applicable NOL. This election is not limited to an ESB. Section 172(b)(1)(H)(ii) provides that the term “applicable net operating loss” means the taxpayer’s NOL for a taxable year ending after December 31, 2007, and beginning before January 1, 2010.

.06 Section 172(b)(1)(H)(iii) provides that the election under § 172(b)(1)(H) is required to be made in a manner prescribed by the Secretary, and must be made by the due date (including extensions) for filing the return for the taxpayer's last taxable year beginning in 2009. The election is irrevocable and, in general, may be made for only one taxable year. However, § 172(b)(1)(H)(v) allows a taxpayer that made or makes an ARRA election also to make an election under § 172(b)(1)(H) for another taxable year.

.07 Section 172(b)(1)(H)(iv) limits the amount of an NOL that a taxpayer elects under § 172(b)(1)(H)(i) to carry back to the 5th taxable year preceding the taxable year of the loss to 50 percent of the taxpayer's taxable income for the carryback taxable year. The taxable income for the carryback taxable year is computed without regard to the NOL for the loss year or any taxable year thereafter. The excess of the amount of the loss over 50 percent of the taxable income, as determined under § 172(b)(2), for the carryback taxable year is carried to later taxable years. For the carryback of an alternative tax NOL to the 5th taxable year preceding the taxable year of the loss, the 50 percent limitation is applied separately based on the alternative minimum taxable income. The § 172(b)(1)(H)(iv) limitation does not apply to an NOL carryback under the ARRA election.

.08 Section 13(e)(4) of the Act provides that a taxpayer that has elected under §§ 172(b)(3) or 810(b)(3) to forgo a carryback for a loss for a taxable year ending before the date of enactment of the Act (November 6, 2009) may revoke that election before the due date (including extensions) for filing the return for the taxpayer's last taxable year beginning in 2009. An application under § 6411(a) for the applicable NOL is treated as timely if filed before that due date.

.09 Section 13(c) of the Act amends § 810(b) to allow life insurance companies to elect to carry back an applicable loss from operations for 4 or 5 taxable years. An applicable loss from operations is a loss from operations for a taxable year ending after December 31, 2007, and beginning before January 1, 2010.

.10 Section 13(f) of the Act provides that § 172(b)(1)(H) does not apply to any taxpayer that received certain benefits (whether or not repaid) under the Emergency Economic Stabilization Act of 2008, Title I of Div. A of Pub. L. No. 110-343, 122 Stat. 3765 (TARP recipients), or to members of the taxpayer's affiliated group.

SECTION 3. SCOPE

Except as provided in § 13(f) of the Act, this revenue procedure applies to taxpayers that incurred an applicable NOL or an applicable loss from operations for a taxable year ending after December 31, 2007, and beginning before January 1, 2010.

SECTION 4. APPLICATION

.01 Time and manner of making the election under § 172(b)(1)(H).

(1) In general. A taxpayer within the scope of this revenue procedure may make the election under § 172(b)(1)(H) or § 810(b)(4) by following the procedure described in either section 4.01(3) or section 4.01(4) of this revenue procedure. The procedures under this revenue procedure that apply to NOLs and the election under § 172(b)(1)(H) also apply to a loss from operations of a life insurance company and the election under § 810(b)(4).

(2) Affiliated groups. For purposes of this revenue procedure, "taxpayer" includes an affiliated group filing a consolidated return, "applicable NOL" includes a consolidated net operating loss (CNOL), and the common parent of the group makes

the § 172(b)(1)(H) election. See § 1.1502-21(b); § 1.1502-77(a). However, nothing in this revenue procedure permits a consolidated return group to otherwise make or revoke a carryback waiver election for the CNOL attributable to a member acquired from another group, described in § 1.1502-21(b)(3)(ii)(B). The conditions under which this election may be permitted will be the subject of separate guidance.

(3) Electing on a federal income tax return for the taxable year of the applicable NOL.

(a) What to file. A taxpayer may make the election under § 172(b)(1)(H) by attaching a statement to the taxpayer's federal income tax return for the taxable year in which the applicable NOL arises. A taxpayer that filed its federal income tax return for the taxable year of the applicable NOL may make the election by attaching a statement to an amended return for the taxable year of the applicable NOL. The election statement must state that the taxpayer is electing to apply § 172(b)(1)(H) or § 810(b)(4) under Rev. Proc. 2009-52, and that the taxpayer is not a TARP recipient nor, in 2008 or 2009, an affiliate of a TARP recipient. The statement must specify the length of the NOL carryback period the taxpayer elects (3, 4, or 5 years).

(b) When to file. A taxpayer must file the election statement with the taxpayer's original or amended federal income tax return for the taxable year of the applicable NOL on or before the due date (including extensions) for filing the return for the taxpayer's last taxable year beginning in 2009.

(c) Carryback applications or refund claims. A taxpayer that makes the § 172(b)(1)(H) election under this section 4.01(3) must attach a copy of the election statement to the taxpayer's claim for tentative carryback adjustment (Form 1045,

Application for Tentative Refund; or Form 1139, Corporation Application for Tentative Refund) or amended return applying the applicable NOL to the carryback year. The due date for timely filing a claim for tentative carryback adjustment on Form 1045 or 1139 for a taxpayer that makes the § 172(b)(1)(H) election is extended to the due date (including extensions) for filing the return for the taxpayer's last taxable year beginning in 2009.

(4) Electing on an appropriate form. In lieu of the procedures described in section 4.01(3) of this revenue procedure, a taxpayer may make the § 172(b)(1)(H) election on an appropriate form under this section 4.01(4).

(a) What to file.

(i) A taxpayer may make the § 172(b)(1)(H) election by attaching an election statement to the appropriate form the taxpayer files applying the NOL carryback period the taxpayer elects. The election statement must state that the taxpayer is electing to apply § 172(b)(1)(H) or § 810(b)(4) under Rev. Proc. 2009-52, and that the taxpayer is not a TARP recipient nor, in 2008 or 2009, an affiliate of a TARP recipient. The statement must specify the length of the NOL carryback period the taxpayer elects (3, 4, or 5 years). The appropriate form is--

(A) For corporations, Form 1139 or Form 1120X, Amended U.S.

Corporation Income Tax Return;

(B) For individuals, Form 1045 or Form 1040X, Amended U.S. Individual

Income Tax Return;

(C) For estates or trusts, Form 1045 or amended Form 1041, U.S.

Income Tax Return for Estates and Trusts.

(D) For tax exempt organizations with unrelated business income, Form

1139 or amended Form 990-T, Exempt Organization Business Income Tax Return (and proxy tax under section 6033(e)).

(b) When to file. When using an appropriate form to make the election under this paragraph 4.01(4), the taxpayer must file the form on or before the due date (including extensions) for filing the return for the taxpayer's last taxable year beginning in 2009. The taxpayer's time for claiming a tentative carryback adjustment on Form 1045 or 1139 also is extended to this date.

.02 Taxpayers that previously filed a carryback application or claim.

(1) In general. A taxpayer that previously filed an application for a tentative carryback adjustment (whether or not the Service has acted upon the application) or an amended return (except to the extent that the application or claim was for an applicable NOL for which an ESB made an ARRA election) may make the election under § 172(b)(1)(H) by following the procedures under section 4.01(3) or (4) of this revenue procedure. The taxpayer's election statement must state that the election amends a previous carryback application or claim.

(2) Additional rules. A taxpayer's amendment of a carryback application or claim also applies to a carryback of any alternative tax NOL for the same taxable year. In the case of an amended application for a tentative carryback adjustment, the 90-day period described in § 6411(b) begins on the date the taxpayer files the amended application.

.03 Revocation of the election to waive NOL carryback period. A taxpayer within the scope of this revenue procedure that previously elected under § 172(b)(3) or § 810(b)(3) to forgo the carryback period for an applicable NOL for a taxable year ending before November 6, 2009, may revoke that election and make the election under §

172(b)(1)(H). Any revocation of the election to forgo the NOL carryback period also will apply to a carryback of any alternative tax NOL for the same taxable year. The taxpayer may make the revocation and the election by following the procedures under section 4.01(3) or (4) of this revenue procedure. The election statement must state that the taxpayer is revoking an NOL (or loss from operations) carryback waiver and electing to apply § 172(b)(1)(H) or § 810(b)(4) under Rev. Proc. 2009-52, and that the taxpayer is not a TARP recipient nor, in 2008 or 2009, an affiliate of a TARP recipient. The statement must specify the length of the NOL carryback period the taxpayer elects (3, 4, or 5 years). The taxpayer must file the revocation and the election under § 172(b)(1)(H) before the due date (including extensions) for filing the return for the taxpayer's last taxable year beginning in 2009.

SECTION 5. EFFECTIVE DATE

This revenue procedure is effective for NOLs arising in taxable years ending after December 31, 2007.

SECTION 6. PAPERWORK REDUCTION ACT

The collection of information contained in this revenue procedure has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under the following control numbers: 1545-0074 Form 1040 (U.S. Individual Income Tax Return) and Form 1040X (Amended U.S. Individual Income Tax Return); 1545-0123 Form 1120 (U.S. Corporation Income Tax Return); 1545-0132 Form 1120X (Amended U.S. Corporation Income Tax Return); 1545-0128 Form 1120-L (U.S. Life Insurance Company Income Tax Return); 1545-0092 Form 1041 (U.S. Income Tax Return for Estates and Trusts); 1545-0687 Form 990-T

(Exempt Organization Business Income Tax Return (and proxy tax under section 6033(e))); 1545-0098 Form 1045 (Application for Tentative Refund); 1545-0582 Form 1139 (Corporation Application for Tentative Refund). For further information, please refer to the Paperwork Reduction Act statements accompanying these forms.

DRAFTING INFORMATION

The principal authors of this revenue procedure are Seoyeon Park and Forest Boone of the Office of the Associate Chief Counsel (Income Tax and Accounting). For further information regarding this notice, contact Ms. Park or Mr. Boone at (202) 622-4960 (not a toll-free call).