

Tennessee Society of CPAs
201 Powell Place
Brentwood, TN 37027
1-800/762-0272
Visit our Web site at
www.tscpa.com

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CONTACT:
Lindsey Deweese
Public Relations Coordinator
ldeweese@tscpa.com

TAX RELIEF FOR PONZI SCHEME LOSSES

BRENTWOOD, Tenn. – The name Bernard Madoff will forever be associated with investment fraud. Unfortunately, however, Madoff is not the only bad apple involved in handling the money of trusting investors. With the softening in the stock market, many fraudulent investment schemes across the country have come tumbling down like a house of cards. If you have fallen victim to one of these schemes, the Tennessee Society of CPAs advises that you may qualify for tax relief on your losses in an investment scam.

TAX DEDUCTION AVAILABLE

Fraud victims may never recover most of the money that they lose from a con artist like Madoff, but they may be able to lower their tax burden as a result of their loss by using an optional safe harbor method for computing and reporting these losses. That's because the Internal Revenue Service announced last year that Ponzi scheme victims generally can deduct as much as 95 percent of their qualified investment, as long as they are not involved in a lawsuit to recover those losses. If they are suing for recovery, they can deduct up to 75 percent of their qualified investment. The deductible amount is reduced by any actual recovery and potential recovery claims under insurance policies or through an appeal to the Securities Investor Protection Corp. (SIPC), which reimburses victims of investment fraud, theft or failure.

DOES NOT APPLY TO INVESTMENT LOSSES

Keep in mind that the tax relief does not apply to investment losses you may have incurred due to a drop in stock market prices or similar trading losses. It is aimed at fraudulent business practices, not bad investment choices. It is only in force for those who fall victim to

what the IRS refers to as “specified fraudulent arrangements.” In these cases, the con artist must have received cash or other property directly from the investors, falsely told the investors that the money was invested and earning income, reported income amounts to the investors that are partially or totally fictitious, stolen some or all of the investor’s money, and made payments to some investors using money obtained from other unwitting investors in the scam. In other words, the fraud must essentially meet the definition of a classic Ponzi scheme, as Madoff’s scam did.

CHARGES REQUIRED

You are not allowed to deduct losses unless there is some official acknowledgement that a crime may have occurred. To that end, the person or group leading the scheme must have been charged under federal or state law with fraud, embezzlement or a similar crime that would be considered a theft under the definition of theft in the Internal Revenue Code, or must have been the subject of a state or federal complaint alleging such a crime. In addition, the victims must have been unaware of the fraud. Although the scam may have gone on for a long period, taxpayers are eligible to take the deduction in the year they became aware of the fraud. That means that on the tax returns being prepared now, you can deduct losses on frauds you discovered in 2009.

About Money Management

Money Management is a weekly column on personal finance prepared and distributed by the Tennessee Society of Certified Public Accountants (TSCPA) as a part of its financial literacy initiative.

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