



America Counts on CPAs

Money Management

Money Management is a weekly personal finance column prepared and distributed by certified public accountants. It is part of the 360 Degrees of Financial Literacy effort focused on improving the financial understanding of Americans.

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Tax Relief for Ponzi Scheme Losses

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 Indiana CPA Society 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.

TURN TO YOUR LOCAL CPA

With any investment offer, remember that when something sounds too good to be true, it usually is. There also are often clues that a fraud is being committed, including claims of unrealistic profits or unbelievable potential. If you have suspicions about any investment opportunity, be sure to turn to your local CPA with questions. He or she can help you evaluate any offers, and consider warning signs of trouble. Your CPA also can provide guidance on tax relief for victims of investment fraud and answer any other tax or financial questions you may have.

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