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Greater and Lesser Potpourri Regarding Madoff, Starting with the IRS and Then Moving to Other Matters
Part 1
National Affairs

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Because of the press of other business - running a law school, creating a new college of history that will open next year, sometimes dealing with the war crimes problem (although Madoff has *deeply* impinged on that, has virtually eliminated it for the time being) - there are times when I simply can't write on Madoff matters. And commenting on the political situation, which I've done for years (to the tune of three books worth of on-line commentaries, actually), is simply impossible despite strong feelings on various things that have occurred.

In the realm of politics, I would dearly wish, for example, to have time to write on an idea that may underlie a matter which has many people deeply upset. That matter is Obama's efforts to placate the right wing, at the cost of (increasing?, *greatly* increasing?) lack of support from his own base. Is it possible that the brilliant fellow who is President cannot grasp that there are people in this world with whom one cannot "make nice" because they will screw you every time, so you are better off hammering them and pleasing those who are on your side and *will* assist you instead of fruitlessly trying to placate and/or obtain the help of those who will *never* help you?

With regard to multi billion dollar bailouts of guilty banks, failure to assist innocent people who were bamboozled into subprime mortgages by Wall Street, increasing the size of the war in Afghanistan instead of withdrawing from that Godforsaken war, prosecution for torture, health care, and who knows how many other disasters, Obama has tried to make nice to the right wing in hopes that the right wingers will help him.

No soap, Barack. What Obama got for his troubles - ever more are saying for his spinelessness - is bailed out banks that wouldn't lend, huge bonuses paid to Wall Streeters, tens, scores or more thousands of people losing their homes, an ever bigger, ever more disastrous war, and solid, rocklike Republican opposition on health care.

You know, Obama says in regard to torture that he wants to move forward, not look back. He is a brilliant guy who, despite his brilliance, seems never to have learned the truth in Faulkner's line that the past is not prologue; it is not even past. When those who do evil get away with it because nobody wants to think about what was done, and people instead want to focus on "moving forward," the door is open, both ideologically and practically, for recurrence of the same evil in the future. Not for nothing was the desire to begin overlooking the Civil War followed, starting in 1876, by 90 years of Jim Crow - the very Jim crow which made it a miracle that Obama could be elected as "early" as 2008. Not for nothing was the Philippines Insurrection succeeded by the Viet Nam War, which was succeeded by Iraq II, which has now given way to Afghanistan. Not for nothing was the waterboarding of the Philippines Insurrection followed by the waterboarding of the so-called War on Terror. It has all happened before and history shows it will all happen again if we put it all aside in the name of moving forward.

I will add here only that one wonders whether Obama's brilliance and articulateness have now played him false. That is, one wonders whether his immense intelligence and skill enabled him to succeed and succeed without ever having to realize and act upon the fact that there are some people who simply will never be placated, who will always be bitter enders in opposition. One wonders whether it is possible that he has never before had to face this fact because, for his entire life, he was always able to persuade so many people by virtue of intelligence, grace and fluency, until he ran up against the hard case Republicans who seem to control that party in Congress and who seem intent on running this nation into the ground.

Well, these are the sort of political matters that I would like but have no time to write about (except for what I just wrote). And there is even much too little time to write about the all-consuming Madoff mess. Thus it is that sometimes, when I do find myself with some time to write about Madoff, I write a series of commentaries, published successively, on a variety of subjects. This is the situation I find myself in now and is what I shall attempt to do now, since there has been no time to write for awhile and there will be no ability to do so for at least most of the first half of September. After this commentary, I shall write about as many more topics of a potpourri as I can before the ability to do more temporarily runs out, and may or may not be able to deal with more topics before it does run out. Topics left undone will hopefully be discussed later in September, although the truth is that I may never get to them then because so much else will then be pressing both in the Madoff matter and in other matters.

So . . . . something of a potpourri follows. But let it be said that the first item in the

potpourri is *very* important, *crucially* important. For, courtesy of the Internal Revenue Service itself (to my vast surprise), I seem to have now sniffed out how it was that Madoff got approved by the IRS as a non-bank custodian of IRAs in 2004. For my money (pun not intended), the story is in one way even uglier than the story of the SEC's incompetence and malfeasance regarding Madoff. For at various times the SEC at least attempted an investigation on the ground, although wholly incompetently. But, as you will see, the IRS apparently did not even attempt an investigation on the ground, but was instead content to rely on lies Madoff put on pieces of paper without doing anything to check out his statements.

* * * * *

Let us start with what the mainstream media likes to call the back story. This begins, for present purposes, with a lengthy essay that was published (and re-printed below) on April 17, 2009 after a Madoff victim alerted me to the fact that the IRS had approved Madoff as a so-called non-bank custodian of IRAs. The commentary was called *Was The IRS As Culpable As The SEC In The Madoff Scam?* (and appears at page 110 of *Madoff: the first six months")*. The essay discussed a large number of matters related to the IRS' approval of Madoff as a non-bank custodian of IRAs. I shall merely advert here to a significant number of them, but, because they are so important, the commentary of April 17th is appended to this first installment of *Greater And Lesser Potpourri* so that a reader can get a fuller appreciation of the pertinent matters if he or she wishes.

In brief, some of the relevant points discussed in the commentary of April 17th were that Congress considered it vital to safeguard the life savings of people with IRAs so that they '"will have adequate incomes to meet their needs when they retire.'" Congress placed upon the IRS the duty of enforcing the "fiduciary standards" that would assure the desired safety of retirement incomes. Congress desired the IRS to insist on *evidence* that a nonbank had the appropriate capability to handle IRAs. Congress authorized appropriations of "*$70 million per year"* (emphasis added) to enable the IRS to create an office that would handle IRAs and other tax exempt matters; and in 1984 the IRS, saying it had reason to believe various non-bank custodians might not be in compliance with applicable regulations, insisted that it had the power to demand access to a non-bank's books and records and proposed a program to verify compliance with the applicable standards.

The commentary went on to say that the IRS had approved of Madoff as a non-bank custodian in 2004 although he was in complete violation of regulations that had been established for non-bank custodians of IRAs, and it raised the possibility that the IRS had in effect not done a thing to carry out its duty to insure that the fiduciary standards it was supposed to enforce had in fact been adhered to. Set forth below are relevant portions of a few paragraphs from the commentary.

Alright, so here is a guy who comes to the IRS and says he wants to become an approved nonbank custodian of securities, and who gets approved by the IRS in 2004. How did *that* happen? Did the IRS simply ignore its own regulations? For instance, did it ignore its own requirement that he not own more than fifty percent of the company? Did it not check to see whether he had a separate trust division. Did it not check to see whether securities were kept in an adequate vault and not commingled, and whether

there was a permanent record of assets put into and taken out of the vault? Did it not check to see whether fiduciary records were kept separate from other records? Did the IRS not examine Madoff's books and records, as it had been claiming a right to do for two decades, since 1984?

Had the IRS done these things to determine compliance with its own regulations regarding becoming an approved nonbank custodian for IRAs, had it done these things which it seems that it must *not* have done, it almost surely would have discovered Madoff was a fraud. Madoff's game almost surely would have been up. The IRS would have found, for example, no vault with securities. It would not have found any securities. It would have found no separate trust division. It would have found no books and records of the kind needed to be a nonbank custodian of IRAs. It would have found that Bernie Madoff owned almost the whole damn business, not a "mere" 50 percent.

But since the IRS approved Madoff as a nonbank custodian in 2004, it must not have done these things.

The lengthy commentary of April 17th concluded with mention - with warning - of the possibility that the IRS' apparent malfeasance might have occurred in other cases, too, in addition to Madoff:

And there is one other point, too, one that might be called earth shaking in its implication. If the IRS acted with the extreme negligence and incompetence, if not complicity, that seems all too possible here with regard to Madoff, did it do the same with regard to other Ponzi schemes or frauds in which companies might have sought to elide suspicion by becoming an approved nonbank custodian? Almost daily, it seems, we hear of more frauds and more Ponzi schemes. Did the perpetrators of those frauds likewise seek and obtain IRS approval to shield themselves from suspicion? The thought is almost too terrible to contemplate. But it cannot be ignored. Just how many Ponzi schemes and frauds, if any in addition to Madoff, may have hidden behind some form of negligent or complicitous IRS approval?

After the commentary of April 17th, I sent the IRS a freedom of information request on May 6, 2009. It was brief, identified me as being a victim, and simply requested "All documents relating to the IRS' 2004 approval of Bernard L. Madoff Co. as an approved non-bank custodian for IRAs."

By a letter dated only one week later, May 13th, the IRS refused the request. (No surprise there.) Its reason was priceless. It said,

> Tax records are confidential and may not be disclosed unless specifically authorized by law. We must receive Mr. Madoff's, or his authorized representative's written consent before we can consider releasing the information you requested.
>
> The consent must be a separate written document pertaining solely to the authorized disclosure. It must include the following . . . .
>
> Signature of the taxpayer and date signed

Can you beat that? Here is a guy and a company who were the largest frauds in history. The guy, Bernie Madoff, had already confessed and pleaded guilty. The company had ceased operating. But the records by which Madoff obtained IRS approval to hold victims' IRAs must remain confidential, and the only way to overcome this is to get *Madoff's* signature authorizing release of the records. This would be a complete joke, and very funny, were the IRS not absolutely serious, which makes it far worse than a joke. Does anyone wonder why millions of Americans apparently oppose Obama's health plan because they figure you can rely on the government to be incompetent and to screw up a health plan just like it screws up so much else? Obtain Madoff's authorization and signature, indeed!

Not being intelligent enough to take no for an answer in a hopeless situation, shortly after receiving the IRS' May 13th rejection of the FOIA request, I wrote a two page letter to the Commissioner of Internal Revenue, Douglas Shulman, on May 22nd. The letter asked whether Shulman was aware of what the IRS had done in 2004 (long before his time there), described what Congress did in 1974, described the safeguarding regulations that Madoff had not met and the specific ways in which he failed to meet them, said his fraud would have been uncovered by the IRS if it had done its job, and asked Shulman to look into and publicly disclose how and why the IRS' malfeasance had occurred - e.g., was there mere rubber stamping, were there bribes or other criminal conduct, was the IRS influenced by the SEC? This letter is of sufficient importance to the story that it too has been appended to this first installment of *Greater And Lesser Potpourri.*

I did not expect to even hear back from Shulman or the IRS in response to the letter sent to him on May 22nd. But to my vast surprise I did receive a response three months later, under date of August 21st, from an official of the Internal Revenue Service named William Hulteng, whose response makes it virtually certain, if you ask me, that in the process of approving Madoff as a non-bank custodian of IRAs, the IRS did absolutely nothing except require him to submit pieces of paper - on which he lied. I think the IRS' letter makes it crystal clear that the IRS engaged in no on-the-ground verification of what Madoff said, did not examine his books and records although in 1984 it had correctly claimed that very power of inspection in order to insure against failure to adhere to regulations, and simply rubber stamped Madoff - in other words, simply accepted vast lies he wrote down on pieces of paper without checking to see whether he was telling the truth or had lied like a rug (to use an old Chicago expression).

The letter from Hulteng is so important that, it too is appended to this commentary so that the reader can review it for himself/herself.

Here are some of the more important statements in the letter. It starts by reiterating the claim that "The rules of governing taxpayer privacy preclude us from discussing any specific nonbank trustee application." In other words, it reiterates the absurd position that taxpayer privacy forbids it from telling victims or anyone else what was done by the now jailed perpetrator of the largest fraud in history and by the defacto defunct company (which has been bought for a relative pittance by somebody) through which he perpetrated his scam. But then comes a very large "but," since the next sentence says "However, we can provide general information concerning the nonbank trustee

application requirements and process." The IRS will, in other words, give one the general drill followed by all applicants and therefore presumably followed by Madoff, especially since the very next sentence says "The IRS processes *every* nonbank trustee application under the *same procedure*." (Emphasis added.)

Then, beginning with the just quoted sentence, the IRS' letter sets forth two paragraphs making it plain that its review is entirely a paper review. Here are the two paragraphs:

The IRS processes every nonbank trustee application under the same procedures. The application must be submitted pursuant to Revenue Procedure 2009-4, 2009-1 I.R.B. 118. This Revenue Procedure sets forth the standard procedural requirements applicable to all private letter ruling requests involving employee plans matters, not just nonbank trustee applications. Thus, an applicant must submit complete information and documentation in support of its application. Importantly, the applicant must personally sign a statement under penalties of perjury which attests that the application "…contains all of the relevant facts relating to the request, and such facts are true, correct, and complete."

The IRS reviews the application to ensure that it satisfies all of the requirements of the regulations. This review covers, for example, the applicant's ownership structure to ensure that it has sufficient continuity and diversity to ensure that it will be able to continue in business after the death or change of its owners; the applicant's certified financial statements to ensure that it meets the net worth standards in the regulations; and the applicant's rules of fiduciary conduct. The IRS often asks for additional information and documentation during its review. If the applicant satisfies the regulatory requirements, the IRS issues a letter approving the application. If the applicant fails to satisfy these requirements, the IRS rejects the application.

It is *obvious* that there is no way to read those two paragraphs as meaning anything other than the IRS' review is *strictly a review of pieces of paper only*. That is the inevitable meaning of statements saying that the applicant must provide "complete information and *documentation*," that "*Importantly,* the applicant must personally sign a [sworn] statement . . . which attests that the application 'contains all of the relevant facts . . . and such facts are true, and correct and complete," and "The IRS *reviews the application* to ensure that it satisfies all of the requirements of the regulations" and "often asks for additional information and *documents* during its review." (Emphases added.) All of these statements are typical, and symptomatic, of a government review only of submitted pieces of paper. There is not one word in the IRS' letter about going into the field to verify the truth of what the pieces of paper say, or even of merely calling independent parties (counterparties in Wall Street lingo) to find out if they do the business with the applicant which the latter claims it is engaging in. (The whole deal smacks of the Billy Sol Estes situation, in which the tanks had no oil or soybeans or whatever it was.)

That the review is only of pieces of paper is also shown by another comment made in the paragraphs of the IRS letter quoted above. Referring to the relevant formal statement of procedures to be followed, the letter says "This Revenue Procedure sets forth the standard procedural requirements *applicable to all private letter ruling requests involving employee plans matters, not just nonbank trustee applications.*

Thus, an applicant must submit complete information and documentation in support of its application." The ordinary reader would have no idea about it, but having briefly been a tax lawyer 46 years ago, I seemed to remember, and verified with both an accountant and a tax lawyer, that "private letter ruling requests" are given strictly on the basis of facts set forth as allegedly true in the letter requesting the ruling. The ruling is good only for that taxpayer *on those facts*; *there is no effort by the IRS to check the facts*; and if the taxpayer has lied about the facts, well, it's his tough luck because the ruling *will be of no use to him, will be inapplicable, when the IRS later discovers the true facts.*

So use by the IRS, when assessing an application to be a non-bank custodian, of the same regulations as it uses for all private letter rulings is another fact showing that the IRS' review of non-bank custodian applications is strictly a review of pieces of paper.

But there is also more to it than just this. The point of giving a taxpayer a private letter ruling is emphatically *not* to determine whether he has lied to the IRS about the facts presented in his request for a ruling. It emphatically is *not* to catch him in, and to stop him from committing, a fraud. It is, rather, to provide him with the IRS' view of the tax consequences *attaching to the facts he has presented*, so that he can proceed with his plans in safety if the IRS' private ruling is satisfactory to his purposes. If the IRS later discovers he has lied about the facts, the private letter ruling he has obtained will provide him with no succor, since it pertains to *different* facts. All he will have done by lying about the facts is that he will have screwed *himself* over. In any event, the key here is that the point of issuing a private letter ruling is *not* to ensure against fraud. It has no such purpose.

But a key reason for the IRS' Congressionally-mandated duty to apply fiduciary standards to applications to be a non-bank custodian *is* to ensure against fraud, peculation, and loss of monies. The IRS has been given the fiduciary duty to protect against them in order to protect the life savings, in IRAs, of persons who need the money for their old age. Yet the IRS is using the same paper-only-review method, that does *not* uncover fraud but is perfectly appropriate for private rulings, when it performs the very different duty of considering applications to be a non-bank custodian in order to uncover and insure against fraud, peculation or lies - it is using a paper-only-review that will *not catch fraud and peculation because the applicant can lie in the papers submitted as part of his application*. That is what Madoff *must* have done, isn't it? He *must* have lied on paper to the IRS (just as he lied to others) about his percentage of ownership of the company, he *must* have lied to it about the existence of a vault, he *must* have lied to it about non-commingling*,* he must have submitted false financial statements to the IRS, etc. Otherwise he could not have been approved by the IRS because in truth he failed to meet its regulations.

At this point in time, then, it seems pretty likely, almost dead certain, that the IRS, for which Congress had authorized appropriations of scores of millions of dollars per year to run the relevant office, used a horribly negligent, completely incompetent method that was an open invitation to crooks like Madoff to lie to it about their capacity and their right to be a non-bank custodian of IRAs. The IRS thereby opened the door to gigantic frustration of Congress' intent that people's life savings be protected for their old age by application of fiduciary principles. Just as there needs to be a major Congressional investigation of how the SEC came to act with thoroughgoing

incompetency, or worse, in regard to Madoff, so too there needs to be a Congressional investigation of how the IRS decided to combat potential fraud by adopting a technique - a paper review only - that was unable to detect even the most serious fraud, and that was, indeed *not* designed to catch and stop lies and fraud, but only to enable the IRS to issue tax advice on the basis of whatever uncontested facts a taxpayer *claimed* to be true. IRS investigations *on the ground*, which did *not* take place, should have revealed the truth: that Madoff had no vault, that he did not segregate accounts and records, that he had 90 or 100 percent ownership, that no securities were bought, that no options were bought, that his books were crooked, etc., etc.

But there was no investigation on the ground, and one is left to wonder how many other crooks may, like Madoff, have taken advantage of the IRS' malfeasance to become approved non-bank custodians in order to run scams that defraud people. The IRS list of approved non-bank custodians that our librarians found had approximately 260 names on it - how many of those may prove not to be honest companies that met the regulations imposed to carry out Congress' intent that people's IRAs be protected, but lying crooks who used the IRS' negligence - the IRS' paper-review-only program - in order to be able to steal. Is Madoff possibly the canary in the coal mine on this score as well as others?

Aside from possibly being the canary in the mine, it is evident that the amount of money lost in the Madoff case because of the IRS' incompetence is gigantic, even though it is not yet precisely measurable because only the government and Picard currently possess the facts needed for measurement. Had the IRS done its job in 2004 and exposed Madoff then, all the money put into Madoff and not withdrawn from it since then, and therefore lost as of December 11th, would have been saved. For all this principal would not have been put into Madoff in the first place had his scam been exposed in 2004.

As said, only Picard and the government know how much this is, but almost surely this principal is many, many billions of dollars, especially since - unlike some of Madoff's fellow crooks in large feeder funds such as the Fairfield family of funds, and unlike JP Morgan, Chase - so many investors left all their money with Madoff until December 11th.

In addition to the loss of all principal put into Madoff, and not withdrawn, after early 2004, the losses include all appreciation on that principal since 2004. In terms of this case, those losses are called the appreciation shown on account statements from Madoff, and are in the mucho billions, although once again only Picard and the government know their amount. And, even if one follows Picard and says these were not truly losses because the appreciation was phony and losses therefore should not be measured by the legitimate expectations shown on the statements of November 30th, losses still exist in the billions of dollars because of what the economists call opportunity costs. Which is to say that, had the money not been invested in Madoff, it would likely have been invested elsewhere and earned interest and appreciation. (Since so many Madoff investors were essentially conservative investors, their market losses of principal in 2008-09 might not have been too bad because they might have been heavily in Treasuries or bonds that maintained their value. As well, any partial losses of principal would have been partially recouped in recent months and might be still further recouped in future. And, in any event, *interest* was lost - my understanding is that a

New York law sometimes sets interest in pertinent cases at nine percent – that's a hell of a chunk of change over the years. Even interest at three to five percent would be a major chunk of money.)

Taxes were also lost. Take the question of federal income taxes paid on phony profits since 2004. According to the rules followed, or imposed, by the IRS, refunds can be obtained for those taxes for only three or five years, depending on the taxpayer's circumstances. (I *think* I am right about five years.) So, as I understand it, according to the IRS, refunds can be obtained only for taxes paid on phantom profits from 2005 onward or 2003 onward. But suppose the IRS had exposed the scam in 2004. In that case, not only would one not have paid income taxes in phony profits from 2004 onward, but, even according to the IRS, refunds would have been obtainable for the years 2001-2003 or 1999-2003 - refunds of doubtlessly billions of dollars which are not available now according to the IRS.

In addition, theft deductions could have been carried back for earlier years than are now available had the IRS blown the whistle on Madoff in 2004, and there are people who would not have paid huge sums in estate taxes from 2004 onward because large chunks of the supposed estate would have been known not to exist.

So, as said, the amount of tax money that was lost by investors, due to the IRS' failure to catch and expose Madoff in 2004, must be gigantic even if not currently known to the public. Also, what this additionally means is that not only are losses since 1992 partially attributable to one government agency, the SEC, because of its moral and criminal incompetence then and later and because its unbelievable 1992 public statement that there was no fraud made it a co-cause with Madoff of sucking people into his scam, but a second government agency, the IRS, is partly responsible for all losses since 2004 because its malfeasance enabled Madoff to successfully continue his scam from then until nearly the end of 2008. *And the fact that two government agencies, not just one, bear heavy responsibility for the success of the scam and the losses of investors makes it even more appropriate for the government to take action to relieve their plight, which it has not yet done for the most part*. Nor - with only one exception that I know of (a complaint filed against FINRA (The Financial Industry Regulatory Authority) which assails it for general incompetence or worse with regard to far more than Madoff) - has anyone really considered in this regard that the malfeasance and incompetence of a body set up by a *federal statute,* FINRA, also was a contributing factor to the success of the scam from the very beginning of the fraud, whenever that was. Except for the one complaint which attacks it for a wide variety of failures in addition to its failure in Madoff, FINRA has thus far gotten pretty much a free pass in the Madoff disaster. It bears heavy responsibility, however, and most certainly should *not* get a free pass.

One must add that, even though the IRS bears responsibility for extensive losses, and a fellow government agency bears responsibility for all losses since 1992, the government - the IRS - wants to keep the lion's share, in years, of the taxes which were paid to it but should not have been because they were paid on *phantom* income, on phony income - on money the government does not even have the constitutional authority to tax because its constitutional power is only to tax *real* income, not phantom income. The IRS is allowing people to recover refunds for only three or five years, and, if people wish to use its safe harbor provision for theft deductions, they

have to give up the right to assert various doctrines that would allow them to obtain refunds of income taxes paid before that, e.g., refunds on taxes wrongly paid at least back to the early 1990s when the scam is known to have already been in operation. So not only is the IRS one of the causes of investors' losses, but it demands to keep more than a decade of taxes that should never have been paid (and it does so though it reserves the right to collect back to infinity if the shoe is on the other foot).

Given all these matters relating to the IRS - given its malfeasant use of a paper-review-only process when approving Madoff, given this incredible misuse of a process designed for private letter rulings in which the goal is *not* to prevent fraud, given the IRS' consequent flouting of Congress' intent that it effectively enforce fiduciary standards to protect IRAs, given its consequent responsibility for the last four and one half years of the Madoff scam, given the possibility that the case is a canary in the coal mine - given all this, the question arises of why did Doug Shulman have a letter written to me that disclosed how the IRS (malfeasantly) goes about approving non-bank custodians? The question is fascinating though one cannot presently know its answer. There are all kinds of possible speculations, with mine presupposing that Shulman and/or other high IRS officials saw the letter before it went out - which seems to me likely when the matter is of such importance as the matter addressed in the letter of August 21st from Hulteng. My supposition that Shulman and other high officials saw the letter could be wrong, of course, and, if it *is* wrong, maybe they just didn't realize that the game was explosive and thus gave my letter to Hulteng's office to answer without the top guys like Shulman vetting the answer before it went out. But let us assume my speculation that the letter was vetted is correct. Why was the letter sent out?

My speculation begins with the fact that Shulman, as far as I know, is reputed to be a good guy. I am prone to believe this reputation on the theory that apples don't fall far from trees. My wife and I have known his parents for 50 years (his mother and my wife roomed together in Ann Arbor one semester and his father was my classmate there in law school), they are good people, and it is therefore likely their son is too. Further to the point, he was nice enough to personally call me (unexpectedly) to tell me why he would be unable to write a response to a letter (not discussed in this commentary) that I sent him on March 3, 2009. Being a good person might well cause someone to be sympathetic to the disaster that has befallen so many Madoff victims and to therefore think that, even if privacy rules preclude discussion of Madoff's case in particular, and even if that would justify a refusal to set forth any kind of answer to my inquiry (just as the IRS refused to answer my previous FOIA request), a response that at least sets forth the general process should be sent to an inquiry from a victim about how did the IRS come to approve Madoff.

There is also the possibility that, realizing how badly so many people have been hurt, Shulman, being a good guy, decided to give me information that did not on the surface seem damaging to the IRS, but which he knew might nonetheless be used by victims in efforts to recoup. Possibly knowing this, perhaps he even decided to give out the information as a vehicle for attempting to circumvent those in the IRS, or Treasury, or higher who don't want to do anything to help Madoff's victims. These latter speculations will be regarded as Machiavellian (though we all know it's how Washington works). But they are not impossible, although one must keep in mind that they are *only* speculations.

Finally, before turning from the question of the IRS to another piece of this potpourri, let me say one last thing; let me echo a point I once made previously in a commentary on a different subject. If readers do not remember anything else written in this commentary or in its continuations, *I beseech them to remember this: the IRS now appears* to *have surely admitted, in the letter of August 21st, that its review of Madoff was a paper-only-review - was a review that was an open invitation for any liar, any Madoff, to receive IRS approval as a non-bank custodian by means of egregious fraudulent misstatements, and to thereby receive aid from the IRS in defrauding victims*. *The IRS has admitted that it did no on the ground review and inspection, used a process that destroyed Congress' powerfully expressed intent that it effectively impose and carry out fiduciary rules, and, for all we know, may have approved other fraudsters as well as Madoff.* This is all crucial because (i) astounding, perhaps even criminal, government malfeasance was a major contributing cause to the huge losses suffered by Madoff victims; (ii) the government's incredible and even criminal malfeasance is a major reason why the government should provide restitution to Madoff victims - regardless of what it does in other cases; (iii) the mass media seem not to care a whit so far about what the IRS did - although legislators or their aides are sometimes astonished when they hear about it; *and (iv) it is crucial, at least in my judgment, that the victims make a continuous major point of the malfeasance of both the SEC and the IRS if they, the victims, are to receive appropriate restitution to any significant degree*.

To Be Continued If Possible.

> April 17, 2009
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> Was The IRS As Culpable As The SEC In The Madoff Scam?
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> This commentary raises the question whether the IRS may be as culpable as the SEC and FINRA for the continued success of Madoff's Ponzi scheme. If the possibility raised here turns out to be true, as I suspect will be the case, this would be a disaster for the country. For it would mean that what is perhaps the one agency which above all others must be kept competent and clean as a whistle, the agency that collects taxes, was instead a witting or unwitting facilitator of the worst kind of fraud. The consequences of this might accurately be called incalculable.
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> It is unknown to most people that, as part of its extensive authority over pension plans of all types, the IRS has the authority to approve so called non-bank custodians for IRAs and various other kinds of accounts (e.g., medical health plans). This goes back to the Employment Retirement Income Security Act of 1974. Congress, greatly concerned over many aspects of pension plans - it wanted them, for example, to vest and be portable - passed the 1974 act because
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> One of the most important matters of public policy facing the nation today is how to assure that individuals who have spent their careers in useful and socially productive work will have adequate incomes to meet their needs when they retire. This legislation is concerned with improving the fairness and effectiveness of qualified retirement plans in their vital role of providing

retirement income. In broad outline, the objective is to increase the number of individuals participating in employer-financed plans; to make sure to the greatest extent possible that those who do participate in such plans actually receive benefits and do not lose their benefits as a result of unduly restrictive forfeiture provisions or failure of the pension plan to accumulate and retain sufficient funds to meet its obligations; and to make the tax laws relating to qualified retirement plans fairer by providing greater equality of treatment under such plans for the different taxpayer groups concerned.

Congress had found that problems with pension plans had included, among others, "Inadequate coverage," "Discrimination against the self-employed and employees not covered by retirement plans," "Inadequate vesting," "Inadequate funding," "Misuse of pension funds and disclosure of pension operations." Congress determined that "It is time for new legislation to conform the pension provisions [of prior legislation] to the present situation and to provide remedial action for the various problems that have arisen . . . ." (Emphasis added.) Congress provided "additional rules regarding fiduciary requirements," and relied heavily on the IRS to enforce fiduciary standards:

Your committee believes that primary reliance on the tax laws represents the best means for enforcing the new improved standards imposed by the bill. Historically, the substantive requirements regarding nondiscrimination, which are designed to insure that pension plans will benefit the rank and file of employees, have been enforced through the tax laws and administered by the Internal Revenue Service. As a result, the Internal Revenue Service is already required to examine the coverage of the retirement plans and their contributions and benefits as well as funding and vesting practices in order to determine that the plans operate so as to conform to these nondiscrimination requirements. Also, the Internal Revenue Service has administered the fiduciary standards embodied in the prohibited transactions provisions since 1954.

Your committee believes that the Internal Revenue Service has generally done an efficient job in administering the pension provisions of the Internal Revenue Code. The very extensive experience that the Service has acquired in its many years of dealing with these related pension matters will undoubtedly be of great assistance to it in administering the new requirements imposed by the committee bill.

However, because the bill increases the administrative job of the Service in this respect, your committee believes that it is desirable to add to its administrative capability for handling pension matters. For this reason, the committee bill provides for the establishment by the Internal Revenue Service of a separate office headed by an Assistant Commissioner of Internal Revenue to deal primarily with pension plans and other organizations exempt under section 501(a) of the Internal Revenue Code, including religious, charitable, and educational organizations. In order to fund this new office, the bill authorizes appropriations at the rate of $70 million per year for such administrative activities. [That is $70 million per year in 1974 dollars, which is somewhere in the neighborhood of $250 million to $350 million today.]

(Emphases added.)

Congress decreed that, although the trustee or custodian of an IRA account is usually a bank, a nonbank could also be a trustee or custodian if the nonbank provided "evidence," or "substantial evidence," that it met the necessary standards.

Under the governing instrument, the trustee of an individual retirement account generally is to be a bank (described in sec. 401(d)(1), [FN71]. In addition, a person who is not a bank may be a trustee if he demonstrates to the satisfaction of the Secretary of the Treasury that the way in which he will administer the trust will be consistent with the requirements of the rules governing individual retirement accounts. It is contemplated that under this provision the secretary of the Treasury generally will require evidence from applicants of their ability to act within accepted rules of fiduciary conduct with respect to the handling of other people's money; evidence of experience and competence with respect to accounting for the interests of a large number of participants, including calculating and allocating income earned and paying out distributions to participants and beneficiaries; and evidence of other activities normally associated with the handling of retirement funds.

* * * *

Although the bill generally requires that a trustee administer an individual retirement account trust, the bill also provides that a custodial account may be treated as a trust, and that a custodian may hold the account assets and administer the trust. Under the bill, a custodial account may be treated as a trust if the custodian is a bank (described in sec. 401(de)(1)) or other person, if he demonstrates to the satisfaction of the Secretary of the Treasury that the manner in which he will hold the assets will be consistent with the requirements governing individual retirement accounts. Again, it is contemplated that the Secretary will require substantial evidence (as described above) to determine if a person other than a bank may act as custodian. (Emphases added.)

Congress further required the trustee of an IRA to file annual reports:

The bill provides that the trustee of an individual retirement account (or issuer of a retirement annuity) is to report annually to the Secretary of the Treasury regarding contributions to the account or annuity and regarding other matters as prescribed by regulations. Your committee intends that the regulations will include a requirement that the trustee or issuer file annual information returns with the Internal Revenue Service (with copies to each individual for whose benefit a retirement account or a retirement annuity is maintained) on the amount of contributions to and distributions from the account or annuity.

So, it is clear beyond peradventure that Congress enacted the 1974 law in order to be certain that pensions, IRAs and similar kinds of arrangements are safeguarded - that "individuals who have spent their lives in useful and

socially productive work will have adequate incomes to meet their needs when they retire." Subsequently, the IRS established regulations - carrying out Congress' purposes - that had to be met for an institution to be approved as a nonbank custodian (NBC). Among the regulations are ones which ensure continuity of the NBC by providing "Sufficient diversity in the ownership of an incorporated applicant," diversity requiring that any person who owns more than 20 percent of the voting stock in [an NBC] cannot own more than 50 percent of it. An NBC applicant also has to "demonstrate in detail its experience and competence with respect to accounting for the interests of a large number of individuals," and must have a "separate trust division" in which "the investments of each account will not be commingled with any other property." Also, "Assets of accounts requiring safekeeping will be deposited in an adequate vault" with "A permanent record . . . of assets deposited in or withdrawn from the vault." As well, the NBC "must keep its fiduciary records separate and distinct from other records."

In addition, by an IRS General Counsel Memorandum that was "Date Numbered: April 13, 1984" (but that also bears the date October 11, 1983), the IRS insisted that, in carrying out the duties Congress gave it, "The legal authority for the inspections of books and records of . . . [an] approved nonbank trustee for individual retirement accounts . . . is inherent in the language of the [statutory section] which allows substantive discretion to the Commissioner in the setting of standards for nonbank trustees as well as the method of enforcement of those standards." Because the IRS had reason to believe that various nonbank trustees "may not be in compliance with the applicable requirements for nonbank trustees," the Internal Revenue Service "propose[d] to institute a program to verify compliance of specific nonbank trustees with the applicable requirements of the regulations."

Thus, to carry out Congress' desire for the safeguarding of pension plans and IRAs, the IRS established rules limiting percentages of ownership in NBCs, requiring NBCs to show expertise in relevant accounting, requiring a separate trust division, requiring a separate vault and separate records, and demanding access to an NBC's books and records.

All of this raises an overarching question with regard to Madoff, to wit, how in the hell did Madoff become an approved nonbank custodian for IRA accounts in 2004?

It has been widely believed, of course, that Madoff's firm refused to handle IRA accounts itself - that, if one desired an IRA account, one had to work through FISERV or its predecessors (like Retirement Accounts Incorporated). Lately, however, we are beginning to hear of people who say they had an IRA account directly with Madoff, not through FISERV. And, in any event, since FISERV and its predecessors never had in their custody any securities purchased by Madoff for customers (they couldn't have had them, since Madoff never bought securities), Madoff was what I have heard referred to as a subcustodian for FISERV (at least he would have been a subcustodian had he actually bought securities for the accounts). So, one way or another Madoff was a nonbank custodian - or at least would have been had he bought

securities instead of faking it.

Alright, so here is a guy who comes to the IRS and says he wants to become an approved nonbank custodian of securities, and who gets approved by the IRS in 2004. How did that happen? Did the IRS simply ignore its own regulations? For instance, did it ignore its own requirement that he not own more than fifty percent of the company? Did it not check to see whether he had a separate trust division. Did it not check to see whether securities were kept in an adequate vault and not commingled, and whether there was a permanent record of assets put into and taken out of the vault? Did it not check to see whether fiduciary records were kept separate from other records? Did the IRS not examine Madoff's books and records, as it had been claiming a right to do for two decades, since 1984?

Had the IRS done these things to determine compliance with its own regulations regarding becoming an approved nonbank custodian for IRAs, had it done these things which it seems that it must not have done, it almost surely would have discovered Madoff was a fraud. Madoff's game almost surely would have been up. The IRS would have found, for example, no vault with securities. It would not have found any securities. It would have found no separate trust division. It would have found no books and records of the kind needed to be a nonbank custodian of IRAs. It would have found that Bernie Madoff owned almost the whole damn business, not a "mere" 50 percent.

But since the IRS approved Madoff as a nonbank custodian in 2004, it must not have done these things. Its approval of Madoff, moreover, raises additional questions. Why did Madoff seek IRS approval in 2004? What did he gain from it, especially since he was telling people that he would not accept IRA accounts (except through FISERV). (Was he afraid of lawsuits for being a nonapproved nonbank subcustodian?) And knowing in advance, as he must have, what the IRS regulations required, how did Madoff even dare to apply for approval as a nonbank custodian? Was the fix in somehow?

Or did the impetus for seeking approval from the IRS not come from Madoff, but from the IRS itself? Did the IRS, for example, learn that Madoff was acting as an unapproved nonbank custodian of IRAs, tell him this is not permissible, and tell him to apply for approval? And if this is what occurred, how did the IRS not know for 20 years that Madoff was acting as an unapproved nonbank custodian and how did the IRS approve Madoff despite his failure to follow its regulations? Also, if the IRS learned he was acting as an unapproved nonbank custodian and told him to apply for approval, then the IRS had to have known or at least have suspected that he had been acting as an unapproved nonbank custodian for years, yet all it did, apparently, was to require him to submit a few pieces of paper whose veracity it did not check, and it then approved him without even looking at his books and records apparently? (Just as the SEC, after finding out in 2006-2007 that he had been acting as an unregistered investment adviser for years, did nothing except require him to register.)

One bottom line on all this is that there seems to be a plausible case – maybe even an overwhelming case - that the SEC is not the only government agency deeply at fault here. The IRS may also be deeply at fault. If so, the losses sustained by the thousands of small people, often in their 60s, 70s and 80s, who have been wiped out, who are having to sell their homes, who are trying to find even the most menial work in order to live, are due not just to the fault of one government agency (as well as to Madoff himself), but to the fault of two government agencies (as well as Madoff). This would make only the more compelling than it already is the case for extensive governmental restitution to compensate for the extensive governmental fault that wreaked disaster here.

Indeed, not only would the case for governmental restitution be even stronger than it already is, but the IRS' restitutionary action to date will look even less generous than some of us already recognize to be the unhappy fact. When the IRS came out with its new revenue ruling and its safe harbor procedure, there was widespread approbation, a widespread feeling that it had been generous. This was in significant part due to sheer relief that the IRS would do something, and in part due to the traditional American unwillingness and inability to look facts in the face and to recognize what is right in front of one's nose. For those of us of a certain age, this American unwillingness and inability have repeatedly been thrust in front of us since at least 1965 and the start of truly heavy American participation in the Viet Nam war. It was manifest in Viet Nam, in Nixon's and Kissinger's enlargements of that war, in Iraq, in the promotion of stock market and real estate bubbles (and in adjustable rate mortgages and their packaging, which fueled a bubble) that common sense and economics warned couldn't last, in the still continuing unwillingness to look torture and its perpetrators in the face, in the belief, starting with Reagan, that greed can serve as a philosophy of life, in the failure to recognize, as people like Andrew Bacevich and Robert Kaiser have now started to write in marvelous books, that our public life is thoroughly and almost uniformly corrupt at the federal level (and often below that too). Paul Krugman has often made clear the American unwillingness to recognize reality, the drastic failure of intelligence in a democracy whose health requires intelligence.

So it was with the general reaction to the IRS' action regarding Madoff. Largely lost in the handclapping for the IRS was recognition that its safe harbor procedure was the result of intense, immediate, behind the scenes lobbying by the superrich who were heavy donors to the Democratic party and who would benefit to the tune of deductions worth many score and even hundreds of millions of dollars, while small people (especially those who are older) who had had to take money out of Madoff every year to pay basic living expenses as well as to pay the tax on their very Madoff income itself would receive very little benefit and would instead continue to be subject to their "new- found inability" to afford food and shelter.

Largely lost was that the IRS' tax relief, designed to greatly benefit the superrich while the small man and woman got screwed, did not provide any restitution for people who invested through IRAs, through pension funds,

through feeder funds - these emphatically were not the private investment vehicles of the superrich Democratic donors who strongly pressed behind the scenes for the IRS' action.

Largely lost in the unconsidered gratitude and approbation was that, to take advantage of the IRS' safe harbor theft deduction provision, one had to agree to give up all claims to refunds of taxes paid on phantom income - on taxes that the government never had any right to - neither under the constitution nor the statutes - because there was no income, but which the government now was going to keep anyway.

Largely lost was that, if one were to use the safe harbor provisions - as many would out of sheer desperation to get something back quickly in order to be able to pay everyday living expenses, at least for awhile - one was required to give up the right to use legal doctrines that, if pressed in court, could conceivably result in refunds of taxes unconscionably being kept by the government: to give up the right to assert the claim of right doctrine, the equitable tolling doctrine, the equitable estoppel doctrine, the negative tax benefit doctrine.

All of this was lost in the cheers, cheers resulting from the typically American refusal to look facts in the face and possibly resulting here as well from an analog to what I believe is called the Stockholm syndrome.

And on top of all that, now it begins to look as if the IRS, which has done so little to help the small man and woman while kowtowing to the superrich who are heavy donors to the Democratic Party, may itself be one of the causes of the disaster, just like the SEC and Madoff himself. For it looks like the IRS, by ignoring Congress' desire that it safeguard those who had IRAs, and by ignoring its own regulations on the subject as well, approved of Madoff as a nonbank custodian of IRAs when, had it carried out Congress' desire and its own regulations, it would have discovered and thereby caused a stop to be put to the fraud which was occurring. And beyond this, for at least 20 years the IRS somehow ignored and/or did not learn that Madoff was acting as an unapproved nonbank custodian although, had it not ignored and/or failed to learn of this, and had it followed Congress' wishes and its own regulations, it would have rung the bell on Madoff in the 1980s or 1990s.

Does it not go without saying that the IRS' actions and inactions need to be extensively investigated by Congress, by the media, by Madoff investors, by litigants, by the FBI?

And there is one other point, too, one that might be called earth shaking in its implication. If the IRS acted with the extreme negligence and incompetence, if not complicity, that seems all too possible here with regard to Madoff, did it do the same with regard to other Ponzi schemes or frauds in which companies might have sought to elide suspicion by becoming an approved nonbank custodian? Almost daily, it seems, we hear of more frauds and more Ponzi schemes. Did the perpetrators of those frauds likewise seek and obtain IRS approval to shield themselves from suspicion? The thought is almost too

terrible to contemplate. But it cannot be ignored. Just how many Ponzi schemes and frauds, if any in addition to Madoff, may have hidden behind some form of negligent or complicitous IRS approval?

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