

2014

Madoff Madness in the Estate of Kessel

Phyllis C. Taite

Florida A&M University College of Law, phyllis.taite@fam.u.edu

Follow this and additional works at: <http://commons.law.fam.u.edu/faculty-research>

 Part of the [Estates and Trusts Commons](#), [Taxation-Federal Commons](#), [Taxation-Federal Estate and Gift Commons](#), and the [Tax Law Commons](#)

Recommended Citation

Phyllis C. Taite, Madoff Madness in the Estate of Kessel, Tax Notes, Nov. 10, 2014 at 1.

This Note is brought to you for free and open access by the Faculty Works at Scholarly Commons @ FAMU Law. It has been accepted for inclusion in Journal Publications by an authorized administrator of Scholarly Commons @ FAMU Law. For more information, please contact linda.barrette@fam.u.edu.

Madoff Madness in the Estate of Kessel

By Phyllis C. Taite



Phyllis C. Taite

Phyllis C. Taite is a tenured associate professor of law at the Florida A&M University College of Law.

Taite discusses *Estate of Bernard Kessel*, in which the court addressed whether a decedent has a property interest in assets held in a Ponzi scheme. The Tax Court denied two motions

for summary judgment requested by the commissioner. As a result, the case will proceed and the estate will be permitted to argue there was no property interest in assets managed by Madoff Investments. As such, the gross estate should have zero value.

*Estate of Bernard Kessel*¹ involved property owned by Bernard Kessel in a qualified defined plan for which he was the sole participant. The plan invested \$610,000 with Madoff Investments. Kessel died testate on July 16, 2008. The executrix of the decedent's estate obtained an appraisal of the plan's Madoff account, and the date-of-death value was \$4,811,853.

The executrix requested an extension to file the estate tax return and paid \$1,570,509 at that time. She later filed the return within the time provided by the six-month extension, reporting that the estate owed \$1,881,256 in federal estate tax.

After Kessel died, the beneficiaries (the decedent's son and his fiancé/executrix) withdrew more than \$2.8 million from the Madoff account. On December 11, 2008, Bernard Madoff was arrested on charges of securities fraud for running a \$65 billion Ponzi scheme that had harmed thousands of investors over decades.² The SEC appointed a receiver

for Madoff Investments and froze its assets. Madoff was prosecuted by the U.S. attorney for effectuating a Ponzi scheme by failing to purchase securities as he had represented to his clients.³ Madoff confessed to the Ponzi scheme and was sentenced to 150 years in prison, the statutory maximum for the crimes to which he pleaded guilty.

The Kessel pension plan attempted to recover \$3,221,057 in securities reported in the Madoff account before the arrest, but the Madoff bankruptcy trustee denied the claim because (1) Madoff Investments never actually purchased securities for the Madoff account, and (2) the decedent and beneficiaries had withdrawn \$2,721,337 more than they had contributed. After the trustee's refusal to pay, the executrix submitted a claim for a refund of estate taxes in the amount of \$1,937,391, with a supplemental return reporting the date-of-death value of the Madoff account as zero rather than the original amount.

The commissioner denied the request for refund and filed a motion for summary judgment contending that (1) the Madoff account is the asset to be valued on the date of death (rather than the assets within the account), and (2) a hypothetical willing buyer and willing seller of the Madoff account would not reasonably foresee that Madoff was operating a Ponzi scheme when Kessel died. The Tax Court was asked to decide whether an estate should pay estate taxes for assets it purportedly owned but did not actually own.⁴

An estate tax is imposed on the gross estate of a decedent at death, and the gross estate is defined as property to which a decedent has a property interest at the time of death.⁵ When Kessel died, there was an interest akin to property rights in the Madoff account, and substantial withdrawals were made after the date of death. Still, it is questionable whether there was a property interest in the Madoff account based on the agreement between Madoff Investments and the pension plan.

³The charges against Madoff included fraud, money laundering, making false statements, perjury, and theft.

⁴In another case affected by the Madoff Ponzi scheme, the court held that the eventual discovery of the fraud did not dissolve a couple's Madoff investment account before the scheme began to unravel. *Simpkin v. Blank*, 968 N.E. 2d 459, 464 (N.Y. 2012).

⁵Section 2033.

¹T.C. Memo. 2014-97.

²Liz Moyer, "It Could Have Been Worse For Madoff," available at <http://www.forbes.com/2009/06/24/bernie-madoff-prison-sentence-business-beltway-madoff.html>.

Whatever property interest a decedent may have must be valued for estate tax purposes. State law determines the property interest, and federal law determines the taxation of those interests. The value attributed to any property in the gross estate is normally the fair market value at the time of the decedent's death.⁶ Later events that might affect the value are relevant only if they were reasonably foreseeable at the time.⁷ Conversely, subsequent events that do not affect value may be relevant to determining FMV regardless of whether they were foreseeable.⁸ The commissioner argued that a Ponzi scheme is not reasonably foreseeable until it is discovered or collapses. Therefore, a willing buyer would pay FMV for the Madoff account at the time of death. The court disagreed.

A court may grant summary judgment only when there are no genuine disputes regarding the material facts.⁹ In *Kessel*, the court determined that genuine disputes of material facts existed regarding whether (1) there was a property interest in the Madoff account at the time of the decedent's death, and (2) a willing buyer and willing seller would reasonably foresee that Madoff was operating a

Ponzi scheme. In denying the motions for summary judgment, the court indicated that there were questions about Madoff in the years preceding his arrest that may have given a hypothetical buyer reason to pause. The court also said there was insufficient evidence to determine the property interest in the Madoff account.

Analysis and Conclusion

Many of Madoff's clients lost millions investing in the Ponzi scheme. This brings to mind the timeless saying, "If it sounds too good to be true, it probably is." Even though Madoff is serving time that will amount to a life sentence in a federal prison, this case exemplifies collateral damage caused by financial crimes and raises important questions for investors, accountants, probate attorneys, and estate planners.

As a policy matter, should the gross estate include a property interest in property with a phantom existence? In *Kessel*, the decedent and beneficiaries were in the unique position of having withdrawn more funds than were contributed. Consequently, is Madoff Investments entitled to recover those excess distributions through a clawback action, or will the trustee be prohibited from doing so because the firm was the defrauding party? Should subsequent events that affect valuation of property for estate tax purposes factor into valuation at the date of death? Stay tuned as these and other policy questions will likely be answered in the continuing saga of the Madoff madness.

⁶Reg. section 20.2031-1(b). See also *Estate of Reichardt v. Commissioner*, 114 T.C. 144 (2000).

⁷*Kessel* at *4, citing *Estate of Gilford v. Commissioner*, 88 T.C. 38 (1987).

⁸*Kessel* at *4, citing *Estate of Jung v. Commissioner*, 101 T.C. 412, 431 (1993).

⁹Rule 121(b).