

**FENNEMORE CRAIG**

Dear Investors:

Enclosed are your Schedule K-1 forms relating to your interests in one or more of the MP Funds and/or Loan LLCs. Also, enclosed is a copy of a legal memorandum prepared for the ML Manager LLC Board by their legal advisors regarding potential theft loss issues. The memorandum is intended to provide you and your tax advisors with as much information as is currently available regarding the theft loss issues and discusses the possibility of a future amendment of the 2009 tax returns and a reissuance of the K-1 forms.

As you would imagine, the issues are complex and the ML Manager Board is retaining a national accounting firm to provide professional advice regarding the best potential tax strategies for the MP Funds and Loan LLCs.

The ML Manager Board, however, is not able to provide individual tax advice. The Board urges you to discuss the issues addressed in the enclosed memorandum and any other issues or questions you have with professional tax advisors.

Thank you,

Mark Winkleman  
Chief Operating Officer

# MEMORANDUM

**TO:** Board of Managers of ML Manager LLC  
**FROM:** Gregg Hanks and Steve Good  
**DATE:** March 24, 2010  
**RE:** 2009 Income Tax Returns for MP Fund LLCs and Loan LLCs

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**IRS CIRCULAR 230 DISCLOSURE: IN ACCORDANCE WITH 31 C.F.R. SECTION 10.35(b)(4), THIS MEMORANDUM HAS NOT BEEN PREPARED, AND MAY NOT BE RELIED UPON BY ANY PERSON, FOR PROTECTION AGAINST ANY FEDERAL TAX PENALTY.**

## **BACKGROUND**

We have prepared this memo at the request of the Board of Managers of ML Manager LLC (the “Board”) for distribution to investors (the “Investors”) holding direct and indirect interests in (i) the nine limited liability companies that were formed as pooled investment funds to acquire loan interests from Mortgages Ltd. (the “MP Funds”), and (ii) the forty-eight limited liability companies that were formed in connection with the Mortgages Ltd. bankruptcy to hold interests in specific loans previously acquired from Mortgages Ltd. (the “Loan LLCs”).

The Board is the client of Fennemore Craig, P.C. (“Fennemore Craig”). Neither the Board nor Fennemore Craig is advising the Investors with respect to their personal tax matters. Accordingly, Investors are strongly encouraged to consult with their own tax advisors regarding the various tax matters addressed in this memo.

## **STATUS OF TAX RETURNS**

The MP Funds and the Loan LLCs have filed 2009 Federal and Arizona State income tax returns (the “Income Tax Returns”) with the IRS and Arizona Department of Revenue. Investors are receiving Schedule K-1 forms (“K-1s”) from the MP Funds and the Loan LLCs, as applicable, concurrently with their receipt of this memo.

## **POTENTIAL DEDUCTIBILITY OF THEFT LOSSES**

The Board has been advised of the possibility that some or all of the MP Funds and/or the Loan LLCs might be able to claim “theft losses” on account of losses from loans originated by Mortgages Ltd.. A final determination regarding the availability and amount of potential theft loss deductions for the 2009 calendar year had not been made when the 2009 Income Tax Returns were filed for the MP Funds and the Loan LLCs.

The Board plans to continue its evaluation of the theft loss and associated issues for the MP Funds and the Loan LLCs, and, based on advice from Fennemore Craig, the Board plans to

engage a nationally-recognized accounting firm, with a significant presence and IRS contacts in Washington, D.C., to assist the Board in evaluating the theft loss issues. Preliminary interviews and discussions have occurred with three accounting firms, and each of the firms has provided an outline of how they would approach the representation. The Board will make a decision shortly on which, if any, of the firms to engage.

If the Board's advisors recommend that it is prudent to do so, based on the considerations discussed in greater detail below, the Board may cause amended 2009 Income Tax Returns to be filed for certain MP Funds and/or Loan LLCs, claiming theft losses, in which case, revised K-1s would be delivered to Investors reflecting their shares, if any, of theft losses reported on the amended Income Tax Returns. Fennemore Craig has advised the Board that it should proceed with amended 2009 Income Tax Returns claiming theft losses *only if* the Board has been advised by its tax advisors that doing so will not expose Investors to tax penalties.

### **PARTIES RESPONSIBLE FOR REPORTING THEFT LOSSES**

As noted above, both the MP Funds and the Loan LLCs have filed 2009 Income Tax Returns without claiming deductions for theft losses. **THE MP FUNDS' AND THE LOAN LLCs' DECISION NOT TO CLAIM THEFT LOSSES ON THEIR 2009 INCOME TAX RETURNS MAY EFFECTIVELY BAR INVESTORS' RIGHTS TO CLAIM THEFT LOSSES FOR 2009 WITH RESPECT TO THE MP FUNDS AND/OR THE LOAN LLCs UNLESS THE INVESTORS TAKE A POSITION (WITH PROPER DISCLOSURE) ON THEIR RESPECTIVE INDIVIDUAL INCOME TAX RETURNS THAT IS INCONSISTENT WITH THE POSITION TAKEN BY THE MP FUNDS AND THE LOAN LLCs, RESPECTIVELY. INVESTORS SHOULD CONSULT THEIR OWN ADVISORS REGARDING THE MANNER IN WHICH THEY MAY TAKE SUCH A POSITION AND WHETHER OR NOT IT IS ADVISABLE TO DO SO.**

### **YEAR FOR CLAIMING THEFT LOSSES**

Theft losses must be claimed, if at all, in the year in which they are first discovered and can be appropriately quantified. Under complex rulings and guidelines issued by the IRS, it is possible that the MP Funds and/or the Loan LLCs (i) may not claim theft losses on their 2009 Income Tax Returns (including amended returns, if applicable) because they have not yet been "discovered" within the meaning of applicable tax laws, but (ii) might be able to claim theft losses for the 2010 calendar year, based on events that have occurred or are yet to occur in 2010 that make the theft losses "discovered" in 2010 for tax purposes (e.g., a 2010 indictment of a key figure in Mortgages Ltd. on charges that amount to "theft" under federal income tax laws could lead the MP Funds and/or the Loan LLCs to claim theft losses in 2010).

### **DECISIONS FOR INVESTORS**

Investors should consult their own tax advisors to determine whether or not they are impacted at all by the availability or non-availability of theft losses (e.g., certain tax-exempt Investors might not be affected one way or another by theft losses). Investors should also consult their own tax advisors to determine whether or not they should do any or all of the following:

- file their own income tax returns based on the K-1s they receive from the MP Funds and/or the Loan LLCs, as applicable;
- extend the due dates of their own tax returns to await the decision of whether or not any of the MP Funds and/or the Loan LLCs will file amended Income Tax Returns with respect to theft losses;
- claim theft losses on their own income tax returns, irrespective of positions taken or not taken by the MP Funds and/or the Loan LLCs on their Income Tax Returns;
- take any steps to disclose that the positions taken by them on their own income tax returns are inconsistent with those taken by the MP Funds and/or the Loan LLCs (if that is in fact the case);
- take any other action to preserve their ability to claim theft losses independently from the MP Funds and/or the Loan LLCs;
- claim theft losses for the 2009 and/or 2010 calendar year; and/or
- file amended income tax returns for prior years, claiming theft losses on those returns.

### **POTENTIAL FOR INCONSISTENT POSITIONS**

It is possible for various reasons that the MP Funds, the Loan LLCs and the Investors may take inconsistent positions with respect to theft losses (e.g., the MP Funds and the Loan LLCs expect to claim theft losses on amended Income Tax Returns only if there is not a risk for imposition of penalties, while certain Investors may wish to take a more aggressive position, or Investors may simply disagree with positions taken by the MP Funds and/or the Loan LLCs). These inconsistencies may, unfortunately, be irreconcilable. Inconsistent positions by the MP Funds, the Loan LLCs and the Investors (in the event that the MP Funds and the Loan LLCs ultimately do not claim theft losses) are likely to increase the possibility of tax returns being audited by the IRS, and the decision by the MP Funds and/or the Loan LLCs to not claim theft losses may impair the Investors' ability to defend their election to do so, if the Investors have claimed theft losses.

### **DISCUSSIONS WITH IRS**

We have been advised that several Investors and/or their tax advisors have contacted various IRS personnel regarding the potential availability of theft losses from the Mortgages Ltd. transactions, including the possible application of the Revenue Procedure described in greater detail below. Such informal communications are not binding on the IRS.

It is likely that the tax advisors retained by the Board on behalf of the MP Funds and/or the Loan LLCs (i) will have further discussions with the IRS, and (ii) may request formal, binding rulings or other binding action by the IRS. Before the IRS will take any binding action,

the MP Funds and/or the Loan LLCs will be required either to demonstrate or represent the existence of facts that provide a compelling reason for why the MP Funds and/or the Loan LLCs should be permitted to claim theft losses. Because of the importance of these factual matters, the tax advisors retained by the Board will work diligently and carefully to present the most accurate and compelling set of facts to the IRS for its consideration.

While Investors are free to consult with the IRS as they deem advisable with respect to their own tax positions, there is a considerable risk that the MP Funds' and/or the Loan LLCs' efforts in dealing with the IRS could be adversely affected or impaired if the IRS receives information and assertions from Investors that conflict with those that will ultimately be presented by the tax advisors retained by the Board.

## **GENERAL DISCUSSION OF LAW REGARDING DEDUCTION OF THEFT LOSSES**

**1. Revenue Ruling 2009-9.** A revenue ruling is a formal, published communication from the IRS stating its interpretation of the law on a particular tax issue and the application of the law to a specific set of facts. Revenue rulings are issued by the IRS to provide guidance to similarly situated taxpayers. They are binding on the IRS and may be relied on by taxpayers.

In early 2009, the IRS issued Revenue Ruling 2009-9, setting forth the IRS's interpretation of law applicable to theft losses, and the IRS's application of that law to a specific set of facts described by the IRS as a Ponzi scheme. Revenue Ruling 2009-9, which is generally a good summary of the applicable law, sets forth a litany of factual matters, often difficult to prove, but that must be proven on a case-by-case basis by a taxpayer to qualify for a theft loss. The Board has not yet compiled sufficient factual information or data to determine whether or not any of the MP Funds or the Loan LLCs may be entitled to claim a theft loss under Revenue Ruling 2009-9.

**2. Revenue Procedure 2009-20.** A revenue procedure is also a formal, published communication from the IRS, often stating a safe harbor for pre-determined tax consequences applicable to a limited set of facts specified by the IRS in the revenue procedure (i.e., rather than stating the general law, as is the case in a revenue ruling, a revenue procedure generally specifies tax consequences applicable only to a limited, specified set of facts). Revenue procedures are generally applied in a relatively mechanical manner, so that taxpayers that are unable to demonstrate that their situation falls within the limited facts specified in a revenue procedure are not entitled to the safe-harbor tax consequences under that revenue procedure.

Revenue Procedure 2009-20 was issued in early 2009 as a companion to Revenue Ruling 2009-9. Revenue Procedure 2009-20 generally permits taxpayers to claim a specified percentage of their investment as a theft loss (without requiring specific proof of the amount of loss) and eliminates a taxpayer's obligation to prove that a theft occurred, if certain specified conditions are satisfied. One of those conditions is that a lead figure be indicted or charged under state or federal law with the commission of fraud, embezzlement or a similar crime that, if proven, would meet the definition of theft for purposes of tax law.

To date, no formal indictment or similar criminal charge has been filed with respect to any lead figure in Mortgages Ltd., possibly due in part to the suicide of Scott Coles. The United States Security and Exchange Commission ("SEC") commenced civil/administrative

proceedings that concluded with an order imposing civil penalties against, and revocation of the broker/dealer license of, Mortgages Limited Securities, LLC (an affiliate of Mortgages Ltd. that was owned indirectly by Scott Coles), and the Arizona Department of Financial Institutions (“ADFI”) commenced proceedings that concluded with a consent order by which Mortgages Ltd.’s mortgage banking license was surrendered. While the SEC and ADFI were civil proceedings involving entities, rather than Scott Coles individually, they contained factual allegations of acts purportedly committed or acquiesced in by Mr. Coles that could be criminal violations of Federal or Arizona law and that might constitute theft for purposes of Federal income tax laws. The MP Funds’ and the Loan LLCs’ tax advisors are evaluating whether or not these facts would be sufficient (or with appropriate action by the IRS would become sufficient) to meet the requirements of Revenue Procedure 2009-20.