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The following document is a signed copy of the IRS memorandum referred to as a "Chief Counsel Advice" or "CCA" in our Newsletter #27. As stated in that newsletter, the CCA was issued with respect to only one of the MP Funds (Mortgages Limited Opportunity Fund MP 12 LLC). Our accountants are still seeking clarification from the IRS on the matters referred to in Newsletter #27. We will provide updates as clarification is received. We recommend that you provide a copy of the CCA to your professional tax advisors and urge you to discuss this and all tax matters with them.

# FAX COVER SHEET

## INTERNAL REVENUE SERVICE



<b>Date Sent:</b> January 3, 2013	<b>Pages Sent:</b> 7 (Counting Cover)
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<b>Sent by:</b> jwd	<b>Time:</b> 12:15 pm

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**COMMENTS:** Dan, I am sending this to you at Mike Fleming's request, since I need to send it to someone on the 2848. Please let me know if there are any additional questions.

**Office of Chief Counsel  
Internal Revenue Service  
memorandum**

CC:ITA:B02:SVBoominathan  
POSTF-110330-12

Third Party Communication: None  
Date of Communication: Not Applicable

UILC: 165.00-00

**OCT 19 2012**

date: October 19, 2012

to: John W. Duncan  
General Attorney (Phoenix)  
(Large Business & International)

from: Norma C. Rotunno  
Senior Technician Reviewer, Branch 2  
(Income Tax & Accounting)

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subject: Timing of a Theft Loss Deduction under Revenue Procedure 2011-58

This Chief Counsel Advice responds to your request for assistance dated June 22, 2012. This advice may not be used or cited as precedent.

LEGEND

A	=	Mortgages Limited
B	=	Mortgages Limited Securities LLC
New A	=	ML Servicing Co., Inc.
New B	=	ML Manager LLC
taxpayer	=	Mortgages Limited Opportunity Fund MP12 LLC
State C	=	Arizona
State C	=	Arizona Department of Financial Institutions
Agency		
d	=	2,700
e	=	110
p	=	real estate development projects
q	=	pooled funds
LF	=	Scott M. Coles
Fact G	=	that A made a false promise or misrepresentation or concealed a material fact in the course of its business
Fact H	=	that A failed to disclose the loans it made to a related party that was also controlled by LF
Fact I	=	that B made misleading statements regarding loan performance and the overall financial stability of the company that generally led investors to think that their investments were safe
Fact J	=	that B used various means to mask nonperforming loans by making

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payments to investors that purported to be interest payments

Date R = June 2  
Date S = June 20  
Date T = May 20  
Date U = February 27  
Date V = July 28  
Month W = August  
Date X = January 19  
Date Y = April 7  
Year 1 = 2008  
Year 2 = 2009  
Year 3 = 2010  
Year 5 = 2012

### ISSUE

Based on the facts described below, whether Year 2 or Year 3 is the proper discovery year under Rev. Proc. 2009-20, as modified by Rev. Proc. 2011-58, for taxpayer's theft loss claim.

### CONCLUSION

Based on the facts described below, Year 2 is the proper discovery year for taxpayer's theft loss claim.

### FACTS

A was registered with State C Agency to lend money for p in State C. B was a broker-dealer registered with the Securities and Exchange Commission ("SEC"). A, through B, raised money from approximately d number of investors for the purpose of purchasing fractional interests in loans originated by A and secured by p. A gave investors the option of either investing directly in a specific p or investing in several q, each of which invested in multiple p.

LF, the lead figure, owned and controlled both A and B prior to Year 1. LF died on Date R of Year 1. There was speculation that LF fraudulently diverted investors' capital from A and B. An involuntary bankruptcy petition was filed on Date S of Year 1 against A, causing A's assets to become the property of the bankruptcy estate. The plan of reorganization, confirmed on Date T of Year 2, created a liquidating trust under the control of a liquidating trustee. The plan created New A and New B to act as the reorganized entity for A and B, respectively. The plan organized the property of the estate into separate entities containing loans related to the p ("Tier 1 entities"). Finally, the plan reorganized the q into separate entities which held various ownership interests in the Tier 1 Entities ("Tier 2 entities"). Pursuant to the plan, former investors with B were now creditors of either Tier 1 or Tier 2 entities, depending on individual investments made prior to bankruptcy. All the entities created pursuant to the plan of

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reorganization are treated for tax purposes as partnerships subject to the TEFRA assessment procedures of I.R.C. § 6221 *et seq.*, and New B is the Tax Matters Partner for each entity created under the plan of reorganization.

The Taxpayer is a Tier 2 entity that has ownership interests in several Tier 1 entities and has approximately e number of partners.

Sometime after LF's death in Year 1, State C Agency, which is responsible for regulating commercial concerns in A's line of business in State C, initiated an investigation as to whether A violated State C law. On Date U of Year 2, State C Agency issued a notice of hearing to revoke A's license to operate in State C ("notice"), alleging that A had violated State C law. State C Agency and New A, acting on behalf of A, settled the matter without administrative hearing. State C Agency filed a consent order on Date V of Year 2, finding that A violated numerous State C laws and revoking A's license to operate in State C. Relevant violations found by the State C Agency in the consent order include Fact G and Fact H.

Sometime after LF's death in Year 1, the SEC initiated an investigation concerning whether B violated federal securities law. An offer of settlement was submitted on behalf of B sometime in Month W of Year 2. The SEC at the same time issued to one of the reorganized entities a draft Order Instituting Administrative Proceedings ("draft Order") that alleged facts concerning actions by B and LF prior to the bankruptcy. The draft Order stated, among other things, Fact I. The draft Order further alleged Fact J. The draft Order found that B willfully violated several provisions of federal securities statutes and ordered the revocation of B's registration as a broker-dealer with the SEC. It is our understanding that the draft Order was posted on a website created to provide information to the investors with A and B, including information related to the bankruptcy proceeding, near the time of issuance by the SEC in Year 2.<sup>1</sup>

The SEC and New B agreed to the settlement as memorialized in the offer of settlement. On Date X of Year 3, the SEC publicly released the draft Order without significant changes to the facts alleged ("final Order").

On or about Date Y of Year 5, the taxpayer filed Form 8082, checking the box that such form constituted an Administrative Adjustment Request ("AAR"), as described in I.R.C. § 6227. The taxpayer filed the AAR with respect to its Form 1065, *U.S. Return of Partnership Income*, for its Year 2 tax return. This AAR contained three items. The first reflected a change from long-term capital loss, reflected on a Form K-1 passed-through from a Tier 1 entity, to a theft loss deduction. The second reflected a theft loss and reduction of basis on the ownership interest in a Tier 1 entity. The third reflected a decrease in partner transfers of capital based on taxpayer records.

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<sup>1</sup> Some of the facts in this paragraph are from statements made by the taxpayer's representatives. You may want to confirm these facts by further examination.

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You asked for advice regarding whether Year 2 or Year 3 is the proper discovery year under Revenue Procedure 2011-58 for the taxpayer's theft loss claim relating to investments made through A and B.

### LAW AND ANALYSIS

Section 165(a) of the Internal Revenue Code ("Code") allows a deduction for losses sustained during the taxable year and not compensated by insurance or otherwise. A loss from criminal fraud or embezzlement in a transaction entered into for profit is a theft loss under section 165(c)(2). See Rev. Rul. 2009-9, 2009-14 I.R.B. 735.

#### *Revenue Procedure 2009-20*

The Service and the Treasury Department issued Revenue Procedure 2009-20, 2009-14 I.R.B. 749, which provides an optional safe harbor for taxpayers who experience losses in certain criminally fraudulent investment arrangements, or so-called "Ponzi" schemes. The procedure provides investors with uniform and simplified procedures for determining the amount of a theft loss deduction.

Rev. Proc. 2009-20 allows a theft loss deduction to a "qualified investor" of a "qualified loss." See section 5 of Rev. Proc. 2009-20. The procedure defines a qualified loss as a loss resulting from a "specified fraudulent arrangement" in which, as a result of the conduct that caused the loss, the lead figure (or lead figures) of the scheme is criminally 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 section 165.<sup>2</sup> Section 4.02 of Rev. Proc. 2009-20. The procedure provides that a qualified investor may deduct the theft loss in the discovery year, defined as the year in which the criminal charge is filed. Sections 4.04 and 5.01(2) of Rev. Proc. 2009-20.

#### *Revenue Procedure 2011-58*

The Service recognized that the deaths of lead figures in certain Ponzi schemes prevented government authorities from charging them with criminal theft. In these cases, qualified investors would have been unable to meet the definition of a qualified loss in Rev. Proc. 2009-20 solely due to the death of the lead figure. Therefore, the Service and Treasury issued Rev. Proc. 2011-58, 2011-50 I.R.B. 849, to address those cases.

Rev. Proc. 2011-58 modified the definition of qualified loss in Rev. Proc. 2009-20 to add that the lead figure or an associated entity involved in the specified fraudulent arrangement was the subject of one or more civil complaints or similar documents (such as a notice or order instituting administrative proceedings or other document the Internal Revenue Service designates) filed by a state or federal governmental entity with a court

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<sup>2</sup> There are additional requirements in section 4 of the revenue procedure with respect to the type of criminal charge, whether an admission by the lead figure is alleged, and the appointment of a receiver or trustee with respect to the fraudulent arrangement or assets of the arrangement being frozen.

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or in an administrative agency enforcement proceeding, and all of the following requirements are satisfied:

(a) The civil complaint or similar documents together allege facts that comprise substantially all of the elements of a specified fraudulent arrangement conducted by the lead figure;

(b) The death of the lead figure precludes a criminal charge by indictment, information or criminal complaint against that lead figure; and

(c) A receiver or trustee was appointed with respect to the arrangement or assets of the arrangement were frozen. Section 4.01 of Rev. Proc. 2011-58.

In addition, the procedure modified the definition of discovery year in Rev. Proc. 2009-20 to include the later of either the year in which the civil complaint or similar document which alleges facts that comprise substantially all the elements of a specified fraudulent arrangement is filed, or the year in which the lead figure dies. Section 4.02 of Rev. Proc. 2011-58.

In the present case, the latter two requirements of Revenue Procedure 2011-58 described above are clearly satisfied. LF, the lead figure, died in Year 1 without being criminally charged for actions with respect to A and B. In addition, a trustee was appointed with respect to the arrangement.

With respect to the first requirement above, State C Agency filed a notice and a consent order in Year 2. The SEC issued a draft Order instituting administrative proceedings in Year 2, and publicly released a final Order in Year 3. None of these documents are civil complaints filed with a court. Therefore, in order to satisfy the first requirement above, these documents must constitute similar documents that together allege facts that comprise substantially all of the elements of a specified fraudulent arrangement conducted by the lead figure, and must be filed by a governmental entity in an administrative agency enforcement proceeding.

The notice and the consent order filed by State C agency, a state governmental entity, are similar documents filed in an administrative agency enforcement proceeding. You opined that the State C Agency notice and consent order from Year 2 do not allege facts that comprise substantially all of the elements of a specified fraudulent arrangement, and we agree.<sup>3</sup> Therefore, the filing of these documents does not, alone, control the proper year of discovery under the safe harbor procedures. These documents do, however, allege some facts relevant to the elements of a specified fraudulent arrangement, as discussed above.

Both the SEC draft Order and final Order are similar documents filed by a federal governmental entity in an administrative agency enforcement proceeding. The SEC draft Order and final Order allege facts that comprise substantially all of the elements of

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<sup>3</sup> It is our understanding that the taxpayer does not dispute this point.

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a specified fraudulent arrangement conducted by LF. The facts alleged in the Year 2 draft Order did not significantly change in the final Order publicly released in Year 3. In addition, in Year 2 the draft Order was posted on a website created to provide information to the investors, thereby putting all investors on notice regarding the facts of the specified fraudulent arrangement conducted by LF.

The State C Agency notice, the consent order, and the SEC draft Order filed in Year 2 are documents similar to a civil complaint and, together, allege facts that comprise substantially all of the elements of a specified fraudulent arrangement conducted by the lead figure. Since the State C Agency notice, the consent order, and the SEC draft Order were filed by governmental entities in administrative agency enforcement proceedings in Year 2, after the death of the lead figure in Year 1, the discovery year, as defined in Rev. Proc. 2011-58, is Year 2.

This writing may contain privileged information. Any unauthorized disclosure of this writing may undermine our ability to protect the privileged information. If disclosure is determined to be necessary, please contact this office for our views.

Please call (202) 622-7900 if you have any further questions.



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