

## MEMORANDUM

**TO:** Board of Managers of ML Manager LLC  
**FROM:** Gregg Hanks  
**DATE:** February 13, 2013  
**RE:** Status Update and Recommendations Regarding Mortgages Ltd. Theft Losses

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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. WHILE FENNEMORE CRAIG, P.C. HAS CONSENTED TO COPIES OF THIS MEMO BEING GIVEN TO INVESTORS WHO ACQUIRED DIRECT OR INDIRECT INTERESTS IN LOANS ORIGINATED BY MORTGAGES LTD., THE BOARD OF ML MANAGER LLC IS THE CLIENT OF FENNEMORE CRAIG, P.C. NEITHER THE BOARD NOR FENNEMORE CRAIG, P.C., IS ADVISING INVESTORS WITH RESPECT TO THEIR PERSONAL TAX MATTERS. ACCORDINGLY, INVESTORS ARE STRONGLY ENCOURAGED TO CONSULT WITH THEIR OWN TAX ADVISORS REGARDING THE MATTERS ADDRESSED IN THIS MEMO.**

1. Purpose of Memo; Terminology. There has been a lack of clear guidance from the IRS on several important issues relating to the proper reporting of theft losses. Consequently, ML Manager LLC's board of managers requested that we update our prior analysis of theft loss issues relating to investments made in loans originated by Mortgages Ltd. The theft loss issues are complex and are not uniform for all investors. To avoid potential confusion, this memo uses the following defined terms, so investors and their tax advisors can readily ascertain how the analysis in this memo applies to them:

- "LLC". This term means an entity formed as a limited liability company under applicable state law. Each LLC referred to in this memo is treated as a "partnership" for federal income tax purposes, and each member of an LLC is treated as a "partner" in that LLC for federal income tax purposes. The terms "partnership" and "partner" are used throughout this memo for purposes of describing applicable tax laws governing theft losses.
- "Loan Interests". This term is used to describe fractional interests in loans that were originated by Mortgages Ltd. For example, a 1% interest in the \$32,000,000 loan made by Mortgages Ltd. to Portales Place Property, L.L.C. is a Loan Interest.

- "MP Funds". This term refers to LLCs that were formed for the purpose of acquiring Loan Interests in multiple loans originated by Mortgages Ltd. There are currently nine MP Funds:

MP122009 LLC  
Mortgages Ltd Opportunity Fund MP17 LLC  
Mortgages Ltd Opportunity Fund MP15 LLC  
Mortgages Ltd Opportunity Fund MP11 LLC  
MP062011 LLC  
Mortgages Ltd Opportunity Fund MP16 LLC  
Mortgages Ltd Opportunity Fund MP14 LLC  
Mortgages Ltd Opportunity Fund MP13 LLC  
Mortgages Ltd Opportunity Fund MP12 LLC

- "MP Fund Members". This term refers to investors who acquired interests as members of the MP Funds (as opposed to acquiring Loan Interests directly). There are approximately 1,400 MP Fund Members. Some MP Fund Members may hold interests in multiple MP Funds. ML Manager LLC coordinates the filing of tax returns for the MP Funds. Although neither ML Manager LLC nor Fennemore Craig, P.C. is advising MP Fund Members on tax issues, the tax positions taken by the MP Funds have implications for the MP Fund Members, some of which are discussed in this memo.
- "Pass-Through Investors". This term has historically been used to describe investors who acquired and held Loan Interests directly, as opposed to acquiring interests as members the MP Funds. For example, an investor who acquired a 5% fractional interest in the \$11,000,000 loan made by Mortgages Ltd. to Vanderbilt Farms, L.L.C. is a Pass-Through Investor with respect to that Loan Interest. There were originally approximately 535 Pass-Through Investors. Some Pass-Through Investors may also have acquired interests in the MP Funds, so they would be both Pass-Through Investors (with respect to the Loan Interests they acquired directly) and MP Fund Members (with respect to any interests they acquired in the MP Funds), and would thus be subject to multiple sets of tax rules described in this memo. As reflected in the definitions below, there are now two categories of Pass-Through Investors: Loan LLC Members and Non-Electing Pass-Through Investors.
- "Loan LLCs". This term refers to LLCs that were formed in accordance with the Mortgages Ltd. bankruptcy plan of reorganization for purposes of holding Loan Interests and exercising lenders' rights associated with such Loan Interests (such as foreclosing on the properties that secured the Loan Interests and thereafter selling such properties). A separate Loan LLC was formed to hold Loan Interests

with respect to each loan that was originated by Mortgages Ltd. and that remained outstanding at the time of the Mortgages Ltd. bankruptcy. For example, Centerpoint I Loan LLC was formed as a Loan LLC for the purpose of holding Loan Interests in a \$9,560,000 loan made to Tempe Land Company, L.L.C., and MWP Loan LLC was formed as a Loan LLC for the purpose of holding Loan Interests in a \$20,306,568 loan made to Maryland Way Partners, L.L.C. There are currently 48 Loan LLCs, each of which is readily identifiable as a Loan LLC because it has the clause "Loan LLC" in its name.

- "Loan LLC Members". This term refers to individuals or entities that hold interests as members of Loan LLCs. There are three categories of investors that became Loan LLC Members: (i) Pass-Through Investors who originally acquired and held a Loan Interest directly but subsequently transferred it to a Loan LLC as contemplated in the Mortgages Ltd. bankruptcy plan of reorganization; (ii) the MP Funds, all of which transferred their Loan Interests to the applicable Loan LLCs; and (iii) Radical Bunny, L.L.C., which acquired interests as a member of various Loan LLCs in accordance with the Mortgages Ltd. bankruptcy plan of reorganization<sup>1</sup>. The MP Fund Members did not become Loan LLC Members as a result of the transfer of the MP Funds Loan Interests to the Loan LLCs, and the MP Fund Members retained their status as MP Fund Members following such transfers. A majority of the Pass-Through Investors elected to become Loan LLC Members. ML Manager LLC coordinates filing of tax returns for the Loan LLCs. Although neither ML Manager LLC nor Fennemore Craig, P.C. is advising Loan LLC Members on tax issues, the tax positions taken by the Loan LLCs have implications for the Loan LLC Members, some of which are discussed in this memo.
- "Non-Electing Pass-Through Investors". This term refers to Pass-Through Investors who did not become Loan LLC Members. ML Manager LLC does not have direct responsibility for filing tax returns that affect Non-Electing Pass-Through Investors, and neither ML Manager LLC nor Fennemore Craig, P.C. is advising Non-Electing Pass-Through Investors on tax issues. Accordingly, all Non-Electing Pass-Through Investors have been encouraged to consult their own tax advisors regarding theft loss issues. While the matters discussed in this memo may provide useful information to Non-Electing Pass-Through Investors and their tax advisors, this memo does not discuss specifically any issues that may be unique to Non-Electing Pass-Through Investors, and that term is not used in the following discussion in this memo.
- "Amended MP Fund Tax Return". This term refers to an administrative adjustment request filed on IRS Form 8082 by an MP

Fund reporting theft losses for the 2009 tax year. Amended MP Fund Tax Returns were filed for all of the MP Funds, seeking to report theft losses and to amend certain items that were reported on the partnership tax returns previously filed by the MP Funds. A more detailed discussion of the Amended MP Fund Tax Returns and associated issues is set forth in the FC Theft Loss Memo (defined in paragraph 2 below).

2. Existing Materials Regarding Theft Losses. ML Manger LLC has posted on its www.mtgld.com website (under a link titled "IRS Theft Loss Tax Information") several documents, memos and other materials relating to theft losses. The chronology of matters relating to theft loss issues is included in portions of several newsletters posted on ML Manager LLC's website under a link titled "Newsletters". This memo does not attempt to summarize the materials that are available on ML Manager LLC's website or the analyses that are included in such materials. However, to understand fully the implications of this memo, investors and their tax advisors should review carefully and be familiar with all of the materials relating to theft losses that are available on the ML Manager LLC website. Some of the more important materials posted under the IRS Theft Loss Tax Information link are as follows:

- Revenue Procedure 2009-20. This revenue procedure was issued by the IRS to provide a safe harbor for reporting theft losses if certain conditions set forth in the revenue procedure are satisfied.
- Revenue Procedure 2011-58. This revenue procedure supplements Revenue Procedure 2009-20. It was issued, at least in part if not entirely, as a result of requests made by PricewaterhouseCoopers LLP ("PWC") on behalf of ML Manager LLC to extend the safe harbor under Revenue Procedure 2009-20 to losses incurred in connection with investments in Loan Interests. Revenue Procedure 2009-20 and Revenue Procedure 2011-58 are sometimes referred to in this memo as the "Theft-Loss Revenue Procedures"). The Theft-Loss Revenue Procedures form the basis for the theft losses discussed in this memo, and they include detailed information on the forms that must be filed and the processes that must be followed by taxpayers desiring to report theft losses in reliance thereon.
- PWC Opinion Letter dated February 15, 2012. This opinion letter (the "PWC Opinion Letter") sets forth various opinions from PWC regarding theft loss issues. It includes factual information relating to Mortgages Ltd., the Loan Interests, the MP Funds and the Loan LLCs, and it analyzes in detail the potential application of the Theft-Loss Revenue Procedures to investments in the MP Funds and Loan Interests. It is critical reading for investors and their tax advisors seeking to claim theft losses.

- Fennemore Craig Memorandum dated April 16, 2012. This memo (the "FC Theft Loss Memo") describes the process by which each MP Fund filed an Amended MP Fund Tax Return reporting theft losses for the 2009 tax year. It also includes a discussion of tax laws that require partners to file tax returns that are consistent with those filed by partnerships in which they are partners, unless inconsistent positions are properly disclosed. It is technical and complex in nature and is best suited for review by investors together with their professional tax advisors.
- Amended MP Fund Tax Return (exclusive of K-1s) filed for Mortgages Limited Opportunity Fund MP 12 LLC. This document was recently posted on the ML Manager LLC website, under the IRS Theft Loss Tax Information link. It illustrates how that particular MP Fund reported its theft losses for 2009 and the adjustments that were made with respect to that MP Fund's allocable share of foreclosure losses that were reported to it on K-1s it received from the Loan LLCs. The Amended MP Fund Tax Return for this particular MP Fund was selected because it is the subject of the CCA discussed in paragraph 3 below. The format used for the Amended MP Fund Tax Returns that were filed for the other MP Funds is comparable to the format used in the Amended MP Fund Tax Return that is posted on the website.

3. Recent Posting on ML Manager LLC Website; Chief Counsel Advice. The FC Theft Loss Memo is dated April 16, 2012, and it was the last technical work product from ML Manager LLC's tax advisors posted on ML Manager LLC's website. Since that date (specifically, on October 19, 2012), the Office of Chief Counsel of the IRS issued a memorandum, which identifies itself as a Chief Counsel Advice (the "CCA"), that provides guidance from the IRS's national office to an attorney in the IRS's Phoenix, Arizona office regarding the proper year of discovery of theft losses (for purposes of the Theft-Loss Revenue Procedures) with respect to Mortgages Limited Opportunity Fund MP 12 LLC, which is one of the nine MP Funds.<sup>2</sup> ML Manager LLC received an unsigned copy of the CCA on December 14, 2012, and a signed copy on January 3, 2013. A copy of the signed CCA has been posted on ML Manager LLC's website under the IRS Theft Loss Information link. The CCA raises the following specific question<sup>3</sup>:

Based on the facts described [in the CCA], whether [2009] or [2010] is the proper discovery year under Rev. Proc. 2009-20, as amended by Rev. Proc. 2011-58, for [Mortgages Limited Opportunity Fund MP 12 LLC's] theft loss claim.

After a detailed analysis of the requirements set forth in the Theft-Loss Revenue Procedures, the CCA answers the foregoing question as follows:

The [Arizona Department of Financial Institutions] notice<sup>4</sup>, the consent order<sup>5</sup>, and the SEC draft Order<sup>6</sup> filed in [2009] 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 [Scott Coles]. Since the [Arizona Department of Financial Institutions] notice, the consent order, and the SEC draft Order were filed by governmental entities in administrative agency enforcement proceedings in [2009], after the death of [Scott Coles] in [2008], the discovery year, as defined in Rev. Proc. 2011-58, is [2009].

The documents referred to in the portion of the CCA quoted above are described and discussed in the PWC Opinion Letter (and copies of those documents are available on the ML Manager LLC website, as described in footnotes 4, 5 and 6 below). These documents are a substantial part of the basis for the opinions in the PWC Opinion Letter. Although the CCA concluded that the year of discovery of the theft loss for Mortgages Limited Opportunity Fund MP 12 LLC was 2009, there are a number of important limitations, concerns and issues with respect to the CCA:

- The CCA is an internal IRS document, issued by its national office to provide guidance to the local office in Phoenix. Under applicable law, the CCA cannot be relied on by any taxpayer, including Mortgages Limited Opportunity Fund MP 12 LLC (even though it is the taxpayer identified in the CCA).
- The CCA is based in part on facts assumed by the IRS, as set forth in the text of the CCA. If the IRS were to conclude, after examination, that the actual facts vary from those assumed in the CCA, the IRS could change its conclusion on the year of discovery.
- The CCA addresses the year of discovery of the theft loss for purposes of the Theft-Loss Revenue Procedures, but does not specifically address who is the correct party to claim the theft losses (i.e., it does not resolve whether the MP Funds themselves or the MP Fund Members are the correct parties to report the theft losses).
- The CCA is applicable to only one of the MP Funds. While it is likely that the IRS would apply the CCA uniformly to all of the MP Funds, it is unclear whether the IRS would apply the CCA to the individual MP Fund Members (if they, rather than the MP Funds, were ultimately determined to be the correct parties to report the theft losses) or to the Loan LLC Members.

The IRS has already informed ML Manager LLC that the IRS intends to examine (i.e., audit) the Amended MP Fund Tax Returns that were filed by all of the MP Funds. Notwithstanding the conclusion in the CCA that 2009 was the year of discovery, the CCA does not guaranty that the IRS will ultimately accept 2009 as the year of discovery for any of the MP Funds, MP Fund Members or Loan LLC Members. Because the CCA indicates that 2009 is the proper year of discovery for reporting theft losses under the Theft-Loss Revenue Procedures, and because there are still unresolved issues relating to reporting of the theft losses, it is highly advisable for the

MP Fund Members and Loan LLC Members to take appropriate action to preserve their rights with respect to the reporting of theft losses for 2009, as discussed in greater detail below.

4. Status of Amended MP Fund Tax Returns. Towards the end of December, 2012, the accountants that prepared the Amended MP Fund Tax Returns received notice that most of the Amended MP Fund Tax Returns that were filed at the end of May and beginning of June of 2012 had been received by the IRS processing center in Ogden, Utah. Based on preliminary conversations with IRS personnel in Ogden, there was initial optimism that receipt of Amended MP Fund Tax Returns in the Ogden processing center meant that they would be accepted as filed. However, at the end of January of 2013, the IRS informed ML Manager LLC that all of the Amended MP Fund Tax Returns will be returned to the "field" for examination (i.e., the returns are going to be audited). There will be no limitations on the scope of the examination. At a minimum, the following issues could potentially be raised on examination:

- Whether theft losses should be allowed at all;
- Whether 2009, 2010 or some other year is the proper year of discovery for the theft losses under the Theft-Loss Revenue Procedures;
- Whether the MP Funds or the MP Fund Members are the correct parties to report the theft losses; and
- Whether the amounts of theft losses were correctly reported on the Amended MP Fund Tax Returns.

The examination of the Amended MP Fund Tax Returns is not expected to begin until the summer of 2013, long after the statute of limitations for filing theft loss claims for the 2009 tax year has expired (see discussion of statutes of limitation in paragraph 6 below).

5. Proactive Measures Previously Taken by ML Manager LLC; Lack of IRS Resolution. As reflected in newsletters posted on ML Manager LLC's website during 2012, shortly after the PWC Opinion Letter was issued, ML Manger LLC asked PWC to contact the IRS to seek guidance on the following issues (the "Key Procedural Issues"), among others:

(a) Is 2009 the proper year of discovery for reporting theft losses pursuant to the Theft-Loss Revenue Procedures for all parties that may potentially be entitled to report theft losses with respect to the Loan Interests? In other words, irrespective of whether theft losses are properly reportable by the MP Funds, the MP Fund Members, the Loan LLCs or the Loan LLC Members, is 2009 the proper year of discovery?

(b) Are the MP Funds, as opposed to the MP Fund Members, the proper parties to report theft losses under the Theft-Loss Revenue Procedures?

(c) Are the Loan LLCs, as opposed to the Loan LLC Members, the proper parties to report theft losses under the Theft-Loss Revenue Procedures?

PWC initiated contact with the IRS shortly after delivering the PWC Opinion Letter and well before the Amended MP Fund Tax Returns were filed. PWC's discussion of the Key Procedural Issues with IRS personnel in Phoenix most likely led to the issuance of the CCA discussed in paragraph 3 above. There have been continuing discussions of the Key Procedural Issues (as well as other associated technical issues) among ML Manager LLC's tax advisors and representatives from the IRS's Phoenix office, Ogden service center and national office. Although the IRS has devoted substantial resources to these discussions, ML Manager LLC was ultimately informed on January 29, 2013 that the IRS will not provide any guidance on the Key Procedural Issues before examination of the Amended MP Fund Tax Returns commenced, which, as noted above, will be long after applicable statutes of limitations have expired.

6. Statutes of Limitations. The IRS generally has three years after a tax return is due or filed, whichever is later, to examine the return and assess taxes with respect to that return. A taxpayer generally has three years from the original due date of a tax return within which the taxpayer may file amendments to that tax return. The foregoing periods are referred to as "statutes of limitations". Absent an extension (which may only be granted in the IRS's discretion), the statutes of limitations for reporting theft losses for the 2009 tax year (on amended or original tax returns) will generally expire on April 15, 2013 for the MP Funds, Loan LLCs, MP Fund Members and Loan LLC Members (although the statutes of limitations will terminate on an earlier date for any taxpayers whose tax returns are ordinarily due on a date earlier than April 15, such as corporations whose tax returns are due on March 15). **If original or amended tax returns properly reporting theft losses for the 2009 tax year are not filed by the correct parties prior to the expiration of the applicable statutes of limitations (which generally will be April 15, 2013), and if it is ultimately determined that 2009 is the proper year of discovery under the Theft-Loss Revenue Procedures, any refunds based on theft losses for 2009 will be forever barred.**

7. Actions by MP Funds, MP Fund Members, Loan LLCs and Loan LLC Members to Preserve Claims for Theft Loss for the 2009 Tax Year. There are four potential parties or groups of parties affected by tax returns for which ML Manager LLC has responsibilities who may be eligible to report theft losses under the Theft-Loss Revenue Procedures with respect to losses associated with the Loan Interests: the MP Funds, the MP Fund Members, the Loan LLCs and the Loan LLC Members. Because the applicable statutes of limitations for claiming 2009 theft losses are about to expire, protective measures should be taken with respect to each of these four groups to make sure that their potential theft losses for 2009 are not barred as a result of inaction. The protective measures that have already been taken (in the case of the MP Funds) or that should be carefully considered (in the case of the MP Fund Members, Loan LLCs and Loan LLC Members) are discussed below.

(a) MP Funds. The MP Funds have already filed the Amended MP Fund Tax Returns reporting theft losses under the Theft-Loss Revenue Procedures for the 2009 tax year as "partnership items"<sup>7</sup>. At the request of the IRS, the MP Funds have agreed to extend the statute of limitations for each of the MP Funds until April 15, 2014, so that issues relating to the MP Funds' theft losses can be resolved before the MP Funds' statutes of limitations expire. The extension of the MP Funds' statutes of limitations also extends the statutes of limitations with respect to the MP Fund Members, but solely with respect to their shares of "affected items"<sup>8</sup> that



arise from matters properly treated as partnership items by the MP Funds (which would include the theft losses that are allocable by the MP Funds to the MP Fund Members, if the theft losses are in fact properly treated as partnership items). The extension of the MP Funds' statutes of limitations will not extend any statutes of limitations with respect to the MP Fund Members or offer any protection to them if the theft losses are ultimately determined to be "nonpartnership items"<sup>9</sup>, because the MP Funds' extensions apply only to partnership items and affected items of the MP Funds.

(b) MP Fund Members. It is possible that the theft losses under the Theft-Loss Revenue Procedures (on account of Loan Interests acquired by the MP Funds) may ultimately be determined to be nonpartnership items with respect to the MP Fund Members, as opposed to partnership items with respect to the MP Funds. If the theft losses are in fact properly treated as nonpartnership items, then:

(i) they must be reported, if at all, by the MP Fund Members on original or amended tax returns filed on or before the expiration of their applicable statutes of limitations (which in no event should be later than April 15, 2013);

(ii) the prior filing of the Amended MP Fund Tax Returns is not sufficient to report the theft losses on behalf of the MP Fund Members; and

(iii) the extension of the MP Funds' statutes of limitations, as described in paragraph 7(a) above, does not extend the due date for filing of tax returns by the MP Fund Members to report theft losses for 2009.

**It is thus highly advisable for all MP Fund Members to consult with their tax advisors and file amended tax returns before the expiration of the applicable statutes of limitations (which generally will be April 15, 2013), reporting theft losses pursuant to the Theft-Loss Revenue Procedures for the 2009 tax year (if they have not already filed tax returns reporting theft losses for 2009 or prior years), and if returns claiming theft losses have previously been filed, it is also highly advisable for the MP Fund Members to review those returns with their tax advisors to make sure that there are no technical deficiencies in how theft losses were reported on those returns.**

(c) Loan LLCs. The Loan LLCs were formed long after the Loan Interests were acquired by the MP Funds and the other Loan LLC Members, so it is highly unlikely that the Loan LLCs would be the proper parties to report theft losses under the Theft-Loss Revenue Procedures with respect to the Loan Interests. Nevertheless, the remote possibility exists that the theft losses could properly be treated as partnership items with respect to the Loan LLCs. As a protective measure to address this remote possibility, it is advisable to do one of the following: (i) file "protective" administrative adjustment requests (amended tax returns) for each of the Loan LLCs reporting theft losses as a partnership item for 2009; or (ii) extend the statutes of limitations for the Loan LLCs, to preserve the Loan LLCs' ability to file administrative adjustment requests at a later date, after theft loss issues have been more fully resolved. In a January 29, 2013 telephone call, IRS representatives indicated that the IRS would probably be willing to grant such an extension.

(d) Loan LLC Members. On a number of occasions, ML Manager LLC has advised Loan LLC Members to consult with their tax advisors regarding reporting of theft losses under the Theft-Loss Revenue Procedures, because the Loan LLCs did not intend to report theft losses. **We reiterate that prior advice and encourage Loan LLC Members, upon consultation with their tax advisors, to file amended tax returns before the expiration of the applicable statutes of limitations (which generally will be April 15, 2013), reporting theft losses pursuant to the Theft-Loss Revenue Procedures for the 2009 tax year (if they have not already filed tax returns reporting theft losses for 2009 or prior years), and if returns claiming theft losses have previously been filed, to review those returns with their tax advisors to make sure that there are no technical deficiencies in how theft losses were reported on those returns.**

8. Technical Considerations for MP Fund Members, Loan LLC Members and their Tax Advisors. In connection with their decisions relating to reporting of theft losses, MP Fund Members, Loan LLC Members and their tax advisors should take into consideration the following (in addition to all other matters that they may deem relevant or applicable, taking into account the fact that neither ML Manager LLC nor Fennemore Craig, P.C. is advising MP Fund Members or Loan LLC Members on tax matters, and that the following items are a non-exclusive list of only a limited number of matters that need to be taken into consideration):

- The risks and issues addressed in the FC Theft Loss Memo.
- The form of the Amended MP Fund Tax Return that is posted on the ML Manager LLC website, and the presentation of theft losses and other adjustments thereon.
- The potential for carrying back to appropriate tax years preceding 2009 of any net operating losses arising from or increased by the theft losses as well as whether such net operating losses are properly characterized as affected items (and any statutes of limitations applicable to the foregoing).
- All of the technical requirements set forth in the Theft-Loss Revenue Procedures (including the forms required to be filed and the legends required to be set forth on such forms).
- The possibility that theft losses claimed by the MP Fund Members and Loan LLC Members may be disallowed if a Form 8082 is not filed with a current amended tax return claiming theft losses or if a Form 8082 was not included with a previously-filed original or amended tax return claiming theft losses.
- The IRS is aware that MP Fund Members may be filing "protective" amended tax returns reporting theft losses as nonpartnership items, which is inconsistent with theft losses having been reported on the Amended MP Fund Tax Returns. The IRS has indicated that MP Fund Members desiring to avoid confusion can add a legend at the top of their amended returns reading: "Protective Refund Claim – Mortgages Ltd. Theft Losses", to ensure that the amended return is processed in concert with the Amended MP Fund Tax Returns. Note that this

legend is not intended to supersede any other legend that may be required under the Theft Loss Revenue Procedures.

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<sup>1</sup> Any discussion of Radical Bunny, L.L.C. is beyond the scope of this memo.

<sup>2</sup> At ML Manager LLC's request, PWC contacted personnel in the IRS's Phoenix office to discuss the reasons why PWC believed that 2009 was the correct year of discovery for theft losses, and to seek the IRS's concurrence on the year of discovery issue. The IRS's Phoenix office requested guidance from the IRS's national office on the correct year of discovery and apparently submitted the Amended MP Fund Tax Return filed by Mortgages Limited Opportunity Fund MP 12 LLC as the basis for its request for guidance. To our knowledge, the Amended MP Fund Tax Returns for the other MP Funds were not submitted to the IRS's national office. At a minimum, the other MP Funds are not discussed in the CCA.

<sup>3</sup> The CCA includes a "legend" of defined terms at the beginning of that document, and then uses the defined terms in its body. For example, the legend defines "Year 2" as being 2009 and "Year 3" as being 2010. This structure is used in order to permit redaction of the taxpayer-specific information from the CCA, by removing the legend, before the CCA is made available to the public under the Freedom of Information Act. The bracketed language in the portion of the CCA that is quoted in the body of this memo substitutes information from the legend into the text of the CCA, to improve readability. For example, the actual text of the quoted portion of the CCA reads in part as follows: "Based on the facts described below, whether Year 2 or Year 3 is the proper discovery year . . ."

<sup>4</sup> A copy of the Arizona Department of Financial Institutions notice is posted on the ML Manager LLC website, under the IRS Theft Loss Information link, and is accessed through the sublink that reads "Notice of Dept. Financial Institution Proceedings.pdf".

<sup>5</sup> A copy of the consent order is posted on the ML Manager LLC website, under the IRS Theft Loss Information link, and is accessed through the sublink that reads "Dept. Financial Institutions Consent Order.pdf".

<sup>6</sup> A copy of the SEC draft Order is posted on ML Manager's website and is accessed through the following chain of links and sublinks: first, the link "Newsletters", then the sublink "2009.10.23 update to pass throughs", then the sublink "MLMTheft Loss & IRS Information", and finally the sublink "Order MLS 8-7-09 .pdf".

<sup>7</sup> In the case of partnerships and their partners, tax items are divided into two categories: "partnership items" and "nonpartnership items". The distinction between partnership items and nonpartnership items is not academic. Only partnerships can properly report partnership items and only partners can properly report nonpartnership items, creating an odd situation in which a partner may incur an economic loss in connection with a partnership-related matter, but the loss could be disallowed if it is reported on the wrong party's tax return. The terms "partnership item" and "nonpartnership item" are defined in Code Section 6231(a) and Regulation Section 301.6231(a)(3)-1, neither of which provides meaningful guidance on the issue of whether theft losses incurred with respect to Loan Interests acquired by the MP Funds are partnership or nonpartnership items. An entire body of law has developed to define what is and what is not a partnership item and to address the tax consequences incurred by any unfortunate taxpayers who fail to divine correctly into which category their losses fall. The PWC Opinion Letter concluded, with certain caveats, that theft losses with respect to Loan Interests acquired by the MP Funds are properly reported by the MP Funds (i.e., they are partnership items). We have been informed that certain MP Fund Members have taken the position that the theft losses are nonpartnership items that are properly reported by the MP Fund Members. Further discussion of the relative merits of these positions is beyond the scope of this memo, because the task at hand is not to resolve whether theft losses are or are not partnership items with respect to the MP Funds; rather it is to identify protective measures that should be taken by the MP Funds and the MP Fund Members to address both possible outcomes on the partnership versus nonpartnership item issue.

<sup>8</sup> "Affected items" are defined in Code Section 6231(a)(5) as items affected by partnership items, which sheds little light on the situation for the MP Funds and MP Fund Members, because the meaning of affected items is tied to the definition of partnership items. See discussion in footnote 7 above.

<sup>9</sup> See discussion in footnote 7 above.