

POSSIBLE TAX RAMIFICATIONS OF 2006 EVENTS CONCERNING YOUR PURCHASE OF NOMINAL GENERAL PARTNERSHIP INTERESTS OR NOTES FROM PINNACLE DEVELOPMENT PARTNERS LLC AND RELATED PARTNERSHIPS

The following information concerning these transactions is not tax advice. Each individual should consult with a qualified tax adviser such as a Certified Public Accountant or Attorney to determine the appropriate tax treatment based on their specific set of facts and circumstances.

On October 11, 2006, the United States Securities and Exchange Commission (“the SEC”) filed a lawsuit against Pinnacle Development Partners, LLC (“Pinnacle”) and its principal, Gene A. O’Neal. In sum, the SEC alleges that Pinnacle’s investment offering and payments operated as a Ponzi scheme. The SEC alleges intentional wrongdoing by the defendants in operating this scheme, which is illegal under both federal and state laws. The Receiver has determined that Pinnacle’s payments to investors were made from purchase proceeds obtained from other investors. Pinnacle and the real estate partnerships did not generate revenue from any other sources that would be sufficient to support the monthly payments.

It appears that in excess of \$62 million was raised from approximately 2,000 investors in 48 different states plus the District of Columbia, Puerto Rico, Mexico, Columbia and, possibly, Australia. While the Receiver has frozen over \$14 million in cash as of the date of this memorandum, it is unclear how much will actually be available for distribution to investors.

THEFT LOSS

Section 165(a) of the Internal Revenue Code provides that there shall be allowed as a deduction any loss sustained during the taxable year and not compensated for by insurance or otherwise. Section 165(c) provides that in the case of an individual, losses are limited to losses incurred in a trade or business, losses incurred in a transaction entered in to for profit, and losses from fire, storm shipwreck, other casualty, or theft. Under Section 1.165-8(d) of the Income Tax Regulations, the term “theft” shall be deemed to include, but shall not be limited to, larceny, embezzlement, or robbery. The leading case in this area, Edwards v. Bromberg, states that for tax purposes, theft “is a word of general and broad connotation, intending to cover and covering, any criminal appropriation of another’s property to the use of the taker, particularly including theft by swindling, false pretenses, and any other form of guile.” Therefore, obtaining money under false pretenses may constitute fraud, which means that investors in a Ponzi scheme may be entitled to a theft loss deduction.

Theft losses must be deducted in the year the theft is discovered. The year of discovery is deemed to be the year a “reasonable person” would have discovered the loss. Because the SEC filed this civil action in 2006, it could be determined that a “reasonable person” would have discovered any theft loss in connection with these transactions in 2006.

The amount of the theft loss is the taxpayer's adjusted basis in the property. Like any loss, a theft loss is not deductible while there is a reasonable prospect of recovery or reimbursement. Such a prospect postpones the deduction until the prospect no longer exists, but only to the extent of any potential recovery. Any excess is deductible in the year of discovery. If a theft loss is claimed and a taxpayer subsequently receives a reimbursement, the taxpayer must recognize income in the year of recovery, subject to the limits of the tax benefit rules of Section 111 of the Internal Revenue Code.

An important point of clarification is that to qualify as a theft loss, the theft must be imposed directly on the taxpayer. Thus, for example, if a person's IRA or 401(k) plan purchased the investments, the IRA or the 401(k) plan is considered the "taxpayer" and not the individual who is the beneficiary of the IRA or 401(k) plan.

Because payments under these transactions may be taxable to you, you may receive K-1's from the partnership(s) in which you have invested or we may be required to issue you a Form 1099 for 2006. However, you and your tax adviser should consider whether, in light of the SEC actions, the 2006 payments you received might instead be considered as a recovery of part of your investment. In addition, you may have received one or more 2005 K-1's from these partnerships that may or may not be correct.

We hope the above information will be helpful to you and your tax adviser. Repeating, ***this information is not tax advice. Each individual should consult with a qualified tax adviser such as a Certified Public Accountant or Attorney to determine the appropriate tax treatment based on their specific set of facts and circumstances.***

The Receiver suggests that you print the Complaint filed by the SEC and the Receiver's First Interim Report and take them to your tax adviser. These documents can be found at <http://www.haysconsulting.net/pinnacle>.