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 ATTORNEYS FOR THE UNITED STATES (IRS)

**UNITED STATES BANKRUPTCY COURT
 NORTHERN DISTRICT OF TEXAS
 DALLAS DIVISION**

IN RE:	§	
	§	
SAMUEL E. WYLY,	§	Case No.: 14-35043
	§	Chapter 11
Debtor.	§	
	§	

**UNITED STATES’ (IRS) OBJECTIONS TO
 DEBTOR CAROLINE WYLY’S DISCLOSURE STATEMENT AND PLAN**

The United States of America, on behalf of its agency the Internal Revenue Service, objects to Debtor Caroline Wyly’s Disclosure Statement in Support of her First Amended Chapter 11 Plan of Reorganization (Dkt. # 1470) because it fails to comply with Bankruptcy Code section 1125, and it describes in part the Debtor’s Second Amended Chapter 11 Plan (Dkt. # 1517), which contains plan provisions that violate the Bankruptcy Code, the Internal Revenue Code and other applicable law. The United States understands that its objections to the Debtor’s disclosure statement may also include plan objections, but believes it is appropriate to raise these

objections now in order to avoid wasting time and judicial resources involved in solicitation of an unconfirmable plan.¹ To be clear, the United States does not support the Debtor's amended chapter 11 plan, and requests that the Debtor disclose the United States' opposition to her plan in the disclosure statement in order to inform all voting creditors. In support of this objection, the United States states as follows.

The United States' (IRS) Objections

1. The United States objects to the Debtor's disclosure statement because it solicits votes for the Debtor's chapter 11 plan of reorganization, which is patently unconfirmable. The Debtor's Second Amended plan cannot make the distributions proposed by the Debtor based on the amount of the Debtor's non-exempt assets available to fund her plan of reorganization. The Debtor's Second Amended Plan relies on the trustees of the Isle of Man (IOM) trusts to fund her plan by transferring assets to the Liquidating Trust, but only after confirmation of her plan. The IOM trusts are not property of the Debtor's bankruptcy estate, there is no guarantee the IOM trustees will transfer assets to fund the Debtor's plan, and the trustees are under no obligation to fund the Debtor's plan. Further, the IOM trustees are not under the Bankruptcy Court's jurisdiction to compel a transfer of assets.² Although the Debtor's plan proposes to pay creditors in full, it cannot do so without funding from the IOM trusts, and the Debtor cannot show that the IOM trustees will repatriate funds or assets to the Debtor for her plan.

Where a plan is facially unconfirmable, the bankruptcy court can deny approval of a debtor's disclosure statement. *See, e.g., In re American Capital Equip., LLC*, 688 F.3d 145 (3rd Cir. 2012); *In re U.S. Brass Corp.*, 194 B.R. 420, 422 (Bankr. E.D. Tex. 1996) ("Disapproval of

¹ The United States reserves its rights to specifically object to the Debtor's chapter 11 plan, if and when a plan is set for confirmation hearing.

² Indeed, Caroline Wyly filed a Notice of Abatement of IOM Proceedings (Dkt. # 1482), in which she adopts Sam Wyly's Notice of Lodging of Communication from the IOM Trustee's U.S. counsel (Dkt. # 1478). In that filing, counsel for the IOM trustees indicated that absent a global settlement, they would not repatriate assets in the IOM trusts and would continue the Manx Court proceedings.

the adequacy of a disclosure statement may sometimes be appropriate where it describes a plan of reorganization which is so fatally flawed that confirmation is impossible.”). The Debtor’s Second Amended Plan cannot make the plan payments as outlined therein based on the Debtor’s non-exempt assets in her bankruptcy estate. Accordingly, there is no reasonable prospect of success, the plan is not feasible, and is therefore unconfirmable. The Debtor’s disclosure statement is inadequate, misleading and inaccurate, and should not be approved.

2. The United States objects to the disclosure statement to the extent that Article VI fails to explain or acknowledge that Charles Wyly, Jr.’s death does not relieve his estate of the tax obligations he and the Debtor incurred prior to Charles Wyly, Jr.’s death. The Internal Revenue Service has assessed Charles Wyly, Jr. (Deceased) and the Estate of Charles Wyly, Jr. over \$249 million for international penalties. These assessments are currently due and owing and are not subject to any deficiency procedures. The IRS’s position is that the IOM assets with which the Debtor seeks to fund her plan are property of Charles Wyly, Jr.’s estate and thus are encumbered by the IRS international penalty assessments. The Debtor’s disclosure statement also fails to state that under Section 101.052 of the Texas Estate Code, “[t]he community property subject to the sole or joint management, control, and disposition of a spouse during marriage continues to be subject to the liabilities of that spouse on death.” Texas Estate Code § 101.052 (2014). Therefore, the Estate of Charles Wyly, Jr. remains liable, at a minimum, for the international penalties, and the Debtor’s interest in the Charles Wyly, Jr. estate is inferior to the claim the Internal Revenue Service has against Charles Wyly, Jr.’s estate. The disclosure statement fails to inform creditors of the IRS’s superior position over the Debtor vis-à-vis the Charles Wyly, Jr. estate.

3. The United States objects to the disclosure statement because it proposes terms that are unlawful or in violation of federal tax law and Texas state law. Specifically, under the

Debtor's chapter 11 plan, the holders of claims are enjoined from taking action against the Debtor or any of her Retained Assets, which includes the Debtor's "right and beneficial interests in the Charles [Wyly, Jr.] Probate Estate." Disclosure Statement, p. 33, n. 10. The Internal Revenue Service has filed a claim against the Charles Wyly, Jr. probate estate for over \$700 million. As stated above, under Texas law, the assets of the Charles Wyly, Jr. estate are presently liable for \$249 million in IRS penalties. The injunction in the disclosure statement and chapter 11 plan seek to enjoin the IRS from collecting tax liabilities from the Debtor's interest in the assets of the Charles Wyly, Jr. estate. The injunction set forth in the disclosure statement and chapter 11 plan are contrary to federal tax law and Texas state law that provide for the collection of tax debts against a decedent's estate before the distribution of assets to any beneficiaries. The disclosure statement therefore proposes terms that are contrary to law.

4. The United States objects to the disclosure statement and plan provisions that provide for the Debtor to retain certain assets and properties under Section 1115 of the Bankruptcy Code, along with a \$1.250 million Administrative Reserve. *See* Disclosure Statement, Article VI; Second Amended Plan, Article 6.3. Many of the assets the Debtor seeks to retain are non-exempt assets, and may not qualify as property that may be retained by the Debtor under Section 1115. The Fifth Circuit in *In re Lively*, 717 F.3d 406 (5th Cir. 2013) held that for purposes of the absolute priority rule and its interplay with Section 1115, a debtor may only retain their post-petition acquired property and earnings. The Debtor's retention of these prepetition assets is contrary to the provisions of the Bankruptcy Code.

5. The United States objects to the disclosure statement because it fails to include documents necessary for an informed creditor to make a decision. The disclosure statement fails to include the Liquidating Trust Agreement so that parties can ascertain the terms of the agreement, such as whether it is a creditor-grantor trust or a complex trust, which each have

attendant tax consequences. The disclosure statement and plan also fails to include any chapter 7 liquidation analysis, which is necessary since the plan is dependent on the transfer of assets from the IOM trusts. There is no explanation in the disclosure statement of what creditors can potentially receive if the IOM trustees refuse or fail to transfer assets to fund the Debtor's plan. As stated above, the IOM assets are property of Charles Wyly, Jr's estate and thus are encumbered by the IRS international penalty assessments and the proof of claim filed in the Charles Wyly, Jr. probate estate proceeding. The failure to include this information renders the disclosure statement inadequate.

6. The United States objects to the disclosure statement, and chapter 11 plan because they both fail to inform the creditor body that the IRS's claim against the Debtor is a non-dischargeable claim for over \$37 million, as set forth in the Order Determining Tax Liabilities of Caroline D. Wyly (Case No. 14-35074, ECF #102). The disclosure statement fails to inform creditors that the Debtor will remain liable to the IRS for her tax liabilities, until paid, and that the Debtor's exempt assets and assets received under the plan (*e.g.*, the Retained Assets) are subject to the IRS's non-dischargeable tax claim.

7. The United States objects to the disclosure statement and chapter 11 plan because it provides for the payment of other general unsecured creditors prior to payment of the IRS's general unsecured claim (and SEC general unsecured claim). The IRS's general unsecured claim is no different than other general unsecured allowed claims. To the extent the Debtor is able to fund her plan, the IRS's claim should be paid at the same time as other general unsecured claims. The Debtor's plan seeks to impermissibly gerrymander the claims of the IRS, SEC and other general unsecured creditors in different classes, not only for distribution purposes but also for plan voting purposes. Under Fifth Circuit law, the Debtor must demonstrate a business or economic justification for the separate classification of substantially similar claims, and the

Debtor has failed to do so. See *Phoenix Mut. Life Ins. Co. v. Greystone III Joint Venture (In re Greystone III Joint Venture)*, 995 F.2d 1274, 1278-79 (5th Cir. 1991). The Debtor's plan is not proposed in good faith.

8. The United States objects to the disclosure statement as inaccurate because it contains conflicting language regarding the right of the IRS to vote on the Debtor's chapter 11 plan. According to the Debtor's Second Amended Chapter 11 plan, she claims the IRS (a Class 5 claim) is unimpaired and therefore not entitled to vote on her chapter 11 plan, whereas the disclosure statement states that holders in Classes 1-5 are impaired and entitled to vote. The IRS is evaluating the Debtor's statement as it pertains to the Debtor's Second Amended plan and the IRS's right to vote on the plan, but at a minimum the disclosure statement currently contains conflicting statements regarding the IRS's rights under the plan.

9. The United States objects to the disclosure statement because it incorrectly states that the liquidating trust will be treated as a creditor-grantor trust and misstates the application of Rev. Proc. 94-45, 1994-2 C.B. 684, cited in the disclosure statement at page 45. Thus, the disclosure statement is misleading. First, because the Debtor is contributing assets to the liquidating trust, and has an interest in the liquidating trust (as do the creditors of the liquidating trust), the liquidating trust is considered a multi-owner grantor trust under the Internal Revenue Code, with both the Debtor and the creditors considered the owners and grantors. Second, Rev. Proc. 94-45 sets for the procedures for requesting an advance ruling classifying entities created pursuant to bankruptcy plans under chapter 11 as liquidating trust. Contrary to the Debtor's statement in Article XIII.C., Rev. Proc. 94-45 specifically states that "These operating rules do not define, as a matter of law, the circumstances under which an organization will be classified as a liquidating trust for federal income tax purposes." The Debtor's statements regarding Rev. Proc. 94-45 in her disclosure statement are incorrect and inaccurate.

10. The United States objects to the disclosure statement because it states that the Debtor has certain rights under her chapter 11 plan, which are not specifically set forth in her plan. For example, the disclosure statement states at Article 5.G (page 20) that pursuant to the plan, the Debtor or the liquidating trustee may object to claims. However, the Debtor's chapter 11 plan provides only that the liquidating trustee may object to claims.

CONCLUSION

The United States requests that the Court deny Debtor Caroline Wyly's disclosure statement, and for such further relief to which the United States is justly entitled.

Date: August 25, 2016.

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UNITED STATES ATTORNEY

/s/ David G. Adams

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CERTIFICATE OF SERVICE

I hereby certify that on August 25, 2016, I electronically filed the foregoing document with the Clerk of the Court using the ECF system, which will send notification of such filing to all counsel of record and those requesting notice.

/s/ David G. Adams
DAVID G. ADAMS