

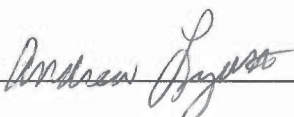
B104 (FORM 104) (08/07)

ADVERSARY PROCEEDING COVER SHEET (Instructions on Reverse)		ADVERSARY PROCEEDING NUMBER (Court Use Only)
PLAINTIFFS Stephen B. Darr as Trustee of the Estates of Telexfree, LLC, Telexfree, Inc. and Telexfree Financial, Inc.		DEFENDANTS United States of America, Department of the Treasury, Internal Revenue Service
ATTORNEYS (Firm Name, Address, and Telephone No.) Andrew G. Lizotte, Esq., Murphy & King, P.C., One Beacon Street, Boston, MA 02108 617-423-0400		ATTORNEYS (If Known)
PARTY (Check One Box Only) <input type="checkbox"/> Debtor <input type="checkbox"/> U.S. Trustee/Bankruptcy Admin <input type="checkbox"/> Creditor <input type="checkbox"/> Other <input checked="" type="checkbox"/> Trustee		PARTY (Check One Box Only) <input type="checkbox"/> Debtor <input type="checkbox"/> U.S. Trustee/Bankruptcy Admin <input type="checkbox"/> Creditor <input checked="" type="checkbox"/> Other <input type="checkbox"/> Trustee
CAUSE OF ACTION (WRITE A BRIEF STATEMENT OF CAUSE OF ACTION, INCLUDING ALL U.S. STATUTES INVOLVED) Declaratory judgment of tax liability, disallowance of claims, and payment of tax refund.		
NATURE OF SUIT (Number up to five (5) boxes starting with lead cause of action as 1, first alternative cause as 2, second alternative cause as 3, etc.)		
FRBP 7001(1) – Recovery of Money/Property <input type="checkbox"/> 11-Recovery of money/property - §542 turnover of property <input type="checkbox"/> 12-Recovery of money/property - §547 preference <input type="checkbox"/> 13-Recovery of money/property - §548 fraudulent transfer <input checked="" type="checkbox"/> 14-Recovery of money/property - other FRBP 7001(2) – Validity, Priority or Extent of Lien <input type="checkbox"/> 21-Validity, priority or extent of lien or other interest in property FRBP 7001(3) – Approval of Sale of Property <input type="checkbox"/> 31-Approval of sale of property of estate and of a co-owner - §363(h) FRBP 7001(4) – Objection/Revocation of Discharge <input type="checkbox"/> 41-Objection / revocation of discharge - §727(c),(d),(e) FRBP 7001(5) – Revocation of Confirmation <input type="checkbox"/> 51-Revocation of confirmation FRBP 7001(6) – Dischargeability <input type="checkbox"/> 66-Dischargeability - §523(a)(1),(14),(14A) priority tax claims <input type="checkbox"/> 62-Dischargeability - §523(a)(2), false pretenses, false representation, actual fraud <input type="checkbox"/> 67-Dischargeability - §523(a)(4), fraud as fiduciary, embezzlement, larceny (continued next column)		FRBP 7001(6) – Dischargeability (continued) <input type="checkbox"/> 61-Dischargeability - §523(a)(5), domestic support <input type="checkbox"/> 68-Dischargeability - §523(a)(6), willful and malicious injury <input type="checkbox"/> 63-Dischargeability - §523(a)(8), student loan <input type="checkbox"/> 64-Dischargeability - §523(a)(15), divorce or separation obligation (other than domestic support) <input type="checkbox"/> 65-Dischargeability - other FRBP 7001(7) – Injunctive Relief <input type="checkbox"/> 71-Injunctive relief – imposition of stay <input type="checkbox"/> 72-Injunctive relief – other FRBP 7001(8) Subordination of Claim or Interest <input type="checkbox"/> 81-Subordination of claim or interest FRBP 7001(9) Declaratory Judgment <input checked="" type="checkbox"/> 91-Declaratory judgment FRBP 7001(10) Determination of Removed Action <input type="checkbox"/> 01-Determination of removed claim or cause Other <input type="checkbox"/> SS-SIPA Case – 15 U.S.C. §§78aaa <i>et seq.</i> <input type="checkbox"/> 02-Other (e.g. other actions that would have been brought in state court if unrelated to bankruptcy case)
<input type="checkbox"/> Check if this case involves a substantive issue of state law		<input type="checkbox"/> Check if this is asserted to be a class action under FRCP 23
<input type="checkbox"/> Check if a jury trial is demanded in complaint		Demand \$
Other Relief Sought		



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B104 (FORM 104) (08/07), Page 2

BANKRUPTCY CASE IN WHICH THIS ADVERSARY PROCEEDING ARISES		
NAME OF DEBTOR Telexfree, LLC, Telexfree, Inc., Telexfree Financial, Inc.		BANKRUPTCY CASE NO. 14-40987-MSH, 14-40988-MSH, 14-40989-MSH
DISTRICT IN WHICH CASE IS PENDING Massachusetts	DIVISION OFFICE	NAME OF JUDGE Hoffman
RELATED ADVERSARY PROCEEDING (IF ANY)		
PLAINTIFF	DEFENDANT	ADVERSARY PROCEEDING NO.
DISTRICT IN WHICH ADVERSARY IS PENDING	DIVISION OFFICE	NAME OF JUDGE
SIGNATURE OF ATTORNEY (OR PLAINTIFF)		
/s/ 		PRINT NAME OF ATTORNEY (OR PLAINTIFF)
DATE July 30, 2018		Andrew G. Lizotte, Esq.

INSTRUCTIONS

The filing of a bankruptcy case creates an "estate" under the jurisdiction of the bankruptcy court which consists of all of the property of the debtor, wherever that property is located. Because the bankruptcy estate is so extensive and the jurisdiction of the court so broad, there may be lawsuits over the property or property rights of the estate. There also may be lawsuits concerning the debtor's discharge. If such a lawsuit is filed in a bankruptcy court, it is called an adversary proceeding.

A party filing an adversary proceeding must also must complete and file Form 104, the Adversary Proceeding Cover Sheet, unless the party files the adversary proceeding electronically through the court's Case Management/Electronic Case Filing system (CM/ECF). (CM/ECF captures the information on Form 104 as part of the filing process.) When completed, the cover sheet summarizes basic information on the adversary proceeding. The clerk of court needs the information to process the adversary proceeding and prepare required statistical reports on court activity.

The cover sheet and the information contained on it do not replace or supplement the filing and service of pleadings or other papers as required by law, the Bankruptcy Rules, or the local rules of court. The cover sheet, which is largely self-explanatory, must be completed by the plaintiff's attorney (or by the plaintiff if the plaintiff is not represented by an attorney). A separate cover sheet must be submitted to the clerk for each complaint filed.

Plaintiffs and Defendants. Give the names of the plaintiffs and defendants exactly as they appear on the complaint.

Attorneys. Give the names and addresses of the attorneys, if known.

Party. Check the most appropriate box in the first column for the plaintiffs and the second column for the defendants.

Demand. Enter the dollar amount being demanded in the complaint.

Signature. This cover sheet must be signed by the attorney of record in the box on the second page of the form. If the plaintiff is represented by a law firm, a member of the firm must sign. If the plaintiff is pro se, that is, not represented by an attorney, the plaintiff must sign.

UNITED STATES BANKRUPTCY COURT
DISTRICT OF MASSACHUSETTS

In re:

TELEXFREE, LLC,
TELEXFREE, INC. and
TELEXFREE FINANCIAL, INC.,

Debtors.

Chapter 11 Cases

14-40987-MSH

14-40988-MSH

14-40989-MSH

Jointly Administered

STEPHEN DARR, AS HE IS THE TRUSTEE
OF THE CHAPTER 11 ESTATES OF EACH
OF THE DEBTORS,

Plaintiff,

Adversary Proceeding

No. 18-

v.

UNITED STATES OF AMERICA,
DEPARTMENT OF THE TREASURY,
INTERNAL REVENUE SERVICE,

Defendant.

**COMPLAINT OF CHAPTER 11 TRUSTEE FOR DECLARATORY
JUDGMENT AND DISALLOWANCE OF CLAIM**

Stephen B. Darr, the Chapter 11 trustee (the "Chapter 11 Trustee") of the bankruptcy estates (the "Estates") of TelexFree LLC, TelexFree, Inc., and TelexFree Financial, Inc. (collectively, "TelexFree" or the "Debtors") brings this Complaint for declaratory judgment that the Debtors had no taxable income for the calendar years 2013 and 2014 and, although the Debtors earned current taxable income in calendar year 2012, the losses sustained by the Debtors in calendar years 2013 and 2014 offset any taxable income for calendar year 2012. As part of the declaration that TelexFree had no taxable income for the specified years, the Chapter 11 Trustee seeks a declaration that certain expenses incurred by TelexFree in operating the Ponzi

scheme, primarily ‘credits’ TelexFree owed to individuals who participated in TelexFree based upon those Participants’ advertising and recruiting activities, as well as other operating expenses and losses are appropriately deducted from income. The Chapter 11 Trustee is entitled to the declaratory judgment he seeks because the Internal Revenue Code (“IRC”) taxes income including income from illegal or criminal activity and correspondingly generally recognizes that expenses incurred by the enterprise in conducting such activity are deductible from gross income in determining taxable income. The IRC seeks to tax, not punish, illegal activities. The recognition of this rule is particularly appropriate in the present case, where the creditors of TelexFree are the millions of individuals (“Participants”) who were defrauded by TelexFree and whose recovery will be substantially diminished by the claim of the Internal Revenue Service (the “Service”) if it is allowed. Because TelexFree had no taxable income, the Chapter 11 Trustee seeks to retain the refund it received for the 2013 tax year and recover a refund of amounts paid for 2012.

The Chapter 11 Trustee further seeks a disallowance of the claims filed by the Service, including an administrative claim aggregating approximately \$69,000,000, a priority unsecured claim of approximately \$285,000,000, and a nonpriority unsecured claim of approximately \$75,000,000, on the basis that such claims are premised upon the improper disallowance of substantially all of the TelexFree expenses thereby resulting in taxable income, when, in fact, no taxable income existed for the years 2012, 2013, and 2014.

The Chapter 11 Trustee seeks a declaratory judgment that even if the Court were to determine a tax due for calendar year 2013 and that the Service erroneously issued a tax refund for that year, said claim for return of the erroneous tax refund should be accorded prepetition priority status rather than administrative status, because the 2013 tax year was a prepetition

period. The Chapter 11 Trustee further seeks declaratory judgment that even if the Court were to determine an income tax liability for 2014, said claim should be accorded prepetition priority status rather than administrative status because all of the income was generated prior to the bankruptcy filing.

Parties

1. The Plaintiff is Stephen B. Darr, the duly appointed Chapter 11 Trustee of TelexFree LLC, TelexFree Financial, Inc., both C corporations for federal income tax purposes, and TelexFree Inc., an S corporation for federal income tax purposes, with a place of business at c/o Huron Consulting Group, 100 High Street, Boston, MA 02110.

2. The Defendant Internal Revenue Service is an agency of the Department of the Treasury, United States of America, with a place of business at 1111 Constitution Ave., NW, Washington, DC 20224.

Jurisdiction and Venue

3. This Court has jurisdiction over the subject matter of this Complaint pursuant to 28 U.S.C. §§ 157 and 1334.

4. The relief sought herein constitutes a core matter within the meaning of 28 U.S.C. § 157(b)(2)(B), (C), and (E).

5. Venue is appropriate in this District under 28 U.S.C. §§ 1408 and 1409.

Procedural Background

6. On April 13, 2014 (the "Petition Date"), TelexFree LLC, TelexFree, Inc., and TelexFree Financial, Inc. filed voluntary petitions for relief under Chapter 11 of the United States Bankruptcy Code ("Bankruptcy Code") with the United States Bankruptcy Court for the District of Nevada (the "Nevada Bankruptcy Court").

7. The Debtors initially operated as debtors-in-possession pursuant to Sections 1107 and 1108 of the Bankruptcy Code.

8. On or about May 6, 2014, the Nevada Bankruptcy Court entered an order approving a motion filed by the Securities and Exchange Commission ("SEC") to change venue, and the cases were transferred to this Court on May 9, 2014

9. On May 30, 2014, the Court approved the motion of the Office of the United States Trustee to appoint a trustee, and the Chapter 11 Trustee was appointed on June 6, 2014.

Factual Statement

10. TelexFree purported to be in the business of selling long distance voice over internet protocol ("VoIP") phone packages in multiple countries. Customers registered their phone numbers with the Debtors and received software that enabled their computers to place phone calls through the Debtors' computer servers in Marlborough, Massachusetts.

11. The sale of VoIP service, however, constituted an insignificant portion of TelexFree's business. TelexFree's real business, and source of almost all of its revenue, was the recruitment from predominantly immigrant communities of members, or Participants, to sell membership plans and VoIP phone packages that were almost never used. Participants received financial incentives to recruit additional Participants, thereby creating an ever expanding pyramid.

12. The VoIP product was a mere pretext to create the appearance of a legitimate business.

Credits Issued by TelexFree Are Deductible Expenses

13. TelexFree sold to Participants membership plans and the right to sell the membership plans. TelexFree promised its members substantial returns for placing daily internet

advertisements. These advertisements lured individuals into the scheme and generated growing and widespread interest among Participants.

14. TelexFree maintained two membership plans, an AdCentral plan and an AdCentral Family plan ("Membership Plans"). Pursuant to the Membership Plans, a Participant could earn credits for posting ads on the internet ("Advertising Credits"). The amount of ads to be posted per week and the amount of credits to be earned depended upon the type of Membership Plan the Participants had purchased.

15. The Membership Plans were contracts which entitled Participants to earn Advertising Credits, which were redeemable for cash if Participants posted ads on the internet.

16. Participants' entitlement to Advertising Credits was determined by reference to the Membership Plans.

17. TelexFree issued Advertising Credits to Participants in exchange for the Participants' promotion of TelexFree.

18. The Advertising Credits and the terms of the Membership Plans increased TelexFree's customer base and encouraged current Participants to purchase additional plans and recruit additional Participants.

19. At the time they were issued, the Advertising Credits were the engine that drove the growth of TelexFree's business and created goodwill among TelexFree Participants and encouraged more and more people to join TelexFree.

20. TelexFree's operations were subject to the Federal Trade Commission Act.

21. TelexFree also awarded Participants credits in exchange for Participants recruiting new individuals into the scheme ("Recruiting Credits"), which is normal, usual, and customary for a pyramid scheme.

22. Like the Advertising Credits, a Participant's Recruiting Credits were redeemable for cash.

23. TelexFree's grant of Recruiting Credits in exchange for downline recruits was a substantial factor in recruiting new Participants.

24. A Participant could monetize the Advertising Credits and Recruiting Credits (collectively, "TelexFree Credits") earned by either redeeming the TelexFree Credits for a cash payment from TelexFree, receiving additional membership plans or utilizing the TelexFree Credits to consummate a Triangular Transaction. A Triangular Transaction is one in which a recruited Participant would pay cash to a recruiting Participant for the purchase of a Membership Plan, and the recruiting Participant then redeems his/her TelexFree Credits to satisfy the invoice for the Membership Plan purchased by the recruited Participant. A Participant's ability to earn credits through placing ads and to monetize the Advertising Credits for cash or through Triangular Transactions was a central component to the operation of the TelexFree scheme. The Triangular Transactions were the most common means by which Participants would monetize TelexFree Credits. When TelexFree attempted to change the method and amount of Advertising Credits that Participants could earn and redeem, Participants sought to accelerate their redemption of Advertising Credits, causing the scheme to collapse.

25. TelexFree recognizes income both when it received cash and when it allowed redemption of TelexFree Credits in a Triangular Transaction.

Ympactus Bad Debt

26. Over the course of 2012 and 2013, TelexFree recognized income totaling \$186,053,089 in the form of a net receivable from Ympactus Comercial, Ltda. ("Ympactus"), a related Brazilian entity.

27. In 2013, TelexFree determined that the Ympactus receivable was worthless, and TelexFree recorded a bad debt expense of \$186,344,898.

28. The IRS, in assessing taxes against TelexFree, included the Ympactus accrual as income, but inexplicably disallowed the subsequent bad debt write-off of the receivable from Ympactus as worthless.

SIG is a Reliable and Accurate Source of Financial Information

29. TelexFree tracked the activity for each Participant through “User Accounts” that were established each time a Participant purchased a Membership Plan. TelexFree recorded the TelexFree Credits and other credits earned along with redemptions in each User Account through a computerized system commonly referred to as SIG.

30. The Chapter 11 Trustee has been able to access the SIG system and has conducted various tests and sensitivity analyses in order to establish the reliability of the information contained on the SIG system. The Chapter 11 Trustee has further verified the reliability of the information on the SIG system by cross-checking the information in the SIG system against proofs of claim filed in the TelexFree case. More than eighty-five percent (85%) of those Participants who filed proofs of claim agreed with the claim amount as captured by the Chapter 11 Trustee from the SIG record. Further, both the SEC in the prosecution of civil actions against TelexFree and various individuals involved in the TelexFree scheme, and the United States Department of Justice in the prosecution of criminal indictments against the principals of TelexFree have relied upon the information contained in SIG and other information garnered by the Trustee from SIG.

31. Accordingly, the information obtained by the Chapter 11 Trustee from SIG is accurate and reliable. The Chapter 11 Trustee has been able to reliably confirm and aggregate all

of the Advertising Credits earned by Participants for placing ads and all of the credits which were redeemed by Participants either for cash or as part of Triangular Transactions, along with the other income, expenses, and losses, in determining TelexFree's taxable income.

Tax Returns

32. On September 9, 2016, the Chapter 11 Trustee filed an amended tax return for TelexFree LLC for the tax year 2012 (the "Amended 2012 Return") which reflected a taxable loss of \$1,239,944. The Chapter 11 Trustee requested a refund of \$886,700, consisting of tax paid of \$692,854 and interest and penalties of \$193,847.

33. On September 12, 2016, the Chapter 11 Trustee filed a tax return for TelexFree LLC for the tax year 2013 (the "Original 2013 Return") which reflected a taxable loss of \$2,101,985,935. The Chapter 11 Trustee sought a refund of \$15,792,982.

34. On December 27, 2016, the Service issued a refund to TelexFree LLC for the 2013 tax year in the amount of \$15,532,440 (the "2013 Refund"), consisting of taxes paid of \$15,477,122 and accrued interest of \$55,318. The Service withheld the balance of the refund request due to the assessment of a bad check penalty against TelexFree LLC in the amount of \$315,860. The Chapter 11 Trustee has filed for a penalty abatement request, which has not yet been ruled upon by the Service.

35. On April 25, 2017, notwithstanding that the Service had issued a refund to the TelexFree LLC Estate, the Service issued four (4) Notices of Proposed Adjustment ("NOPA") for the 2013 tax year, pursuant to which the Service:

- a) Disallowed the advertising expenses for 2013 in the amount of \$2,151,645,140;
- b) Disallowed commission expenses in the amount of \$622,588,034;

c) Disallowed the bad debt expense on account of the debt due from Ympactus of \$186,344,898; and

d) Imposed a failure to file penalty of \$75,126,857.

36. On June 8, 2017, the Service filed an administrative proof of claim against the Estate of TelexFree LLC [Claim No. 2987 filed with the Court] in the amount of \$15,532,440.39 on account of the 2013 Refund paid to the Chapter 11 Trustee.

37. On June 12, 2017, and based upon the 2013 NOPAs, the Service filed a prepetition proof of claim against the Estate of TelexFree LLC in the amount of \$356,898,861.36 on account of the Original 2013 Return, consisting of a prepetition priority unsecured claim in the amount of \$285,710,295 and a prepetition nonpriority unsecured claim in the amount of \$71,188,567 [Claim No. 3456 filed through the electronic claims portal established by the Chapter 11 Trustee, hereafter the "Prepetition Claim"].

38. On June 28, 2017, the Chapter 11 Trustee filed an original tax return for the Estate of TelexFree LLC for calendar year 2014 reflecting revenue of \$161,550,353, expenses of \$2,450,176,063, and a taxable loss of \$2,288,625,710.

39. On October 31, 2017, the Service issued a disallowance of the refund request for calendar tax year 2012 with respect to TelexFree LLC. In the notice of disallowance, the Service alleged that: (i) the advertising expenses were not ordinary and necessary business expenses; (ii) advertising and commission expenses were not deductible because the amounts were not paid or likely to be paid; (iii) the expenses represented nondeductible dividends; (iv) the expenses represented compensation that was not deductible for the 2013 tax year because some portion of the expenses was paid 3.5 months after the tax year-end and (v) the expenses were based upon estimated amounts.

40. On October 31, 2017, the Service issued a statutory notice of deficiency for tax year 2013, which proposed an increase in tax in the amount of \$300,507,248, and a late filing penalty of \$75,126,857.

41. On November 7, 2017, the Service issued three (3) NOPA's for the 2014 tax return:

- a) Disallowing advertising and other expenses for the calendar year 2014 in the amount of \$2,442,705,606;
- b) Imposing an addition to tax in the amount of \$13,481,991 for failure to file a timely return; and
- c) Disallowing the prior year net operating loss carryover on the 2014 return to \$0 based upon adjustments the Service proposed to the 2013 tax year.

42. On November 30, 2017, the Service filed an amended administrative proof of claim [Claim No. 2987-2 filed with the Court] against the TelexFree LLC Estate asserting an administrative claim in the aggregate amount of \$69,460,404 [as amended, the "Administrative Claim"] and, together with the Prepetition Claim, the "Claims"]. The Administrative Claim was amended to add a claim in the amount of \$53,927,964 for tax allegedly due for calendar year 2014 for the TelexFree LLC Estate.

43. On or about March 7, 2018, the Chapter 11 Trustee filed amended tax returns for 2012, 2013, and 2014 (the "Amended Tax Returns"). The Amended Tax Returns: (i) reported gross income based upon SIG and provided more comprehensive and detailed transactional information; (ii) for calendar years 2012 and 2013, reported deductions based upon Advertising Credits and other credits issued to Participants during the applicable tax year, rather than deducting credits based upon a trailing 12 month liability as presented in the earlier filed 2012

amended and 2013 original returns; and (iii) for calendar year 2014, included a deduction for casualty loss for assets seized by the federal government during that calendar year, and a deduction for the administrative expenses incurred by the bankruptcy Estates in that calendar year.

44. On or about March 7, 2018, the Chapter 11 Trustee filed a second amended tax return for 2012 (the "Second Amended 2012 Return") reflecting a net operating loss carryback of \$13,435,861, no net taxable income, and a total refund request of \$886,700.

45. On or about March 7, 2018, the Chapter 11 Trustee filed an amended tax return for 2013 (the "Amended 2013 Return") reflecting a taxable loss of \$3,143,851.

46. On or about March 7, 2018, the Chapter 11 Trustee filed an amended tax return for 2014 (the "Amended 2014 Return") reflecting a taxable loss of \$535,594,148.

47. The Chapter 11 Trustee disputes the proposed adjustments by the Service and the claims asserted by the Service.

48. After good faith negotiations, the Chapter 11 Trustee has been unable to resolve his dispute with the Service regarding the disallowance by the Service of ordinary and necessary business expenses incurred by TelexFree in the operation of its business, particularly, but not limited to, the deductibility of the Advertising Credits.

COUNT I
(Declaratory Judgment)

49. The Trustee realleges and repeats the allegations contained above and by reference incorporates them herein.

50. An actual controversy exists between the Chapter 11 Trustee and the Service within the meaning of 11 U.S.C. §505 with respect to whether the TelexFree Credits consisting of Advertising Credits, Recruiting Credits, and other credits awarded to Participants in 2012,

2013, and 2014 and reported on TelexFree's 2012, 2013, and 2014 tax returns were ordinary and necessary expenses of operating the TelexFree Ponzi scheme and are therefore deductible pursuant to 26 U.S.C. § 162.

51. The IRC generally taxes a taxpayer's net income regardless of the source, even if the source is from illegal activities. Further, the IRC recognizes that a taxpayer may claim deductions for costs related to the generation of its income, even if those costs are related to criminal or illegal activity.

52. Accordingly, the fact that TelexFree was engaged in a Ponzi scheme and that the Advertising Credits and other expenses were incurred in furtherance of this illegal activity does not, for the purposes of determining tax liability, render such costs and expenses nondeductible for the purposes of determining taxable income.

53. TelexFree used the accrual method of accounting for computing taxable income.

54. Under the accrual method, an item of income is included in gross income when all events fixing the taxpayer's right to receive the income have occurred and the amount of the income can be calculated with reasonable accuracy.

55. Correspondingly, under the accrual method, the taxpayer's deductions for expenses occurs when the liability is incurred in the taxable year in which:

- a) All events have occurred to establish the fact of liability;
- b) The amount of liability can be determined with reasonable accuracy; and
- c) Economic performance has occurred with respect to the liability.

56. TelexFree's deductions for TelexFree Credits, commissions, and bad debts satisfy all three elements for allowance of these items as deductible expenses in determining taxable income.

57. Accordingly, the Chapter 11 Trustee is entitled to a judgment determining that the TelexFree Credits are costs related to the TelexFree activity and were incurred for the purposes of carrying on the TelexFree activity and enterprise and, therefore, are deductible for income tax purposes.

58. The Chapter 11 Trustee is further entitled to judgment determining that the other expenses claimed in the Amended Tax Returns are properly deductible and that there is no tax due for TelexFree or its Estates for 2012, 2013, and 2014.

COUNT II
(Declaratory Judgment with Respect to the Claimed Refund)

59. The Trustee realleges and repeats the allegations contained above and by reference incorporates them herein.

60. Directly related to the dispute between the Chapter 11 Trustee and the Service regarding the deductibility of the TelexFree Credits is the Chapter 11 Trustee's entitlement to the refunds for 2012 and 2013.

61. Upon a determination of the deductibility of the TelexFree Credits, bad debts and other expenses and the corresponding finding of no taxable income, the Court should enter a judgment determining that the Chapter 11 Trustee is entitled to retain the 2013 Refund and to receive a refund for 2012 in the amount of \$886,700.

COUNT III
(Declaratory Judgment Disallowing the Claims of the Internal Revenue Service)

62. The Trustee realleges and repeats the allegations contained above and by reference incorporates them herein.

63. By reason of the foregoing, TelexFree Credits, bad debts and other expenses are allowable expense deductions resulting in no taxable income for the years 2012, 2013, and 2014.

64. The Administrative Claim and the Prepetition Claim are premised upon an erroneous assertion of taxable income and penalties and interest thereon. Accordingly, the Claims should be disallowed.

COUNT IV
(Declaratory Judgment as to Priority of Claim for 2013 Refund)

65. The Trustee realleges and repeats the allegations contained above and by reference incorporates them herein.

66. Pursuant to Section 507(c) of the Bankruptcy Code, “a claim of a governmental unit arising from an erroneous refund or credit of a tax has the same priority as a claim for the tax to which such refund or credit relates.”

67. TelexFree LLC has no income tax liability for calendar year 2013.

68. To the extent that TelexFree LLC has any income tax liability for calendar year 2013, any claim arising from the erroneous issuance of the 2013 Refund is entitled only to status as a prepetition priority unsecured claim pursuant to Section 507(a)(8) of the Bankruptcy Code, as calendar year 2013 was a prepetition tax year.

COUNT V
(Declaratory Judgment as to Priority of Claim for 2014)

69. The Trustee realleges and repeats the allegations contained above and by reference incorporates them herein.

70. The classification accorded a tax claim is determined based upon the time period in which the obligation accrues.

71. TelexFree was seized by federal authorities immediately after the Petition Date because it was operating a Ponzi and pyramid scheme.

72. To the extent that TelexFree LLC has any income tax liability for calendar year 2014, all of the income reported in the Amended 2014 Return was earned prior to the Petition Date and, therefore, any associated income tax liability accrued prior to the Petition Date.

73. Any tax liability owed by TelexFree LLC for 2014 is entitled only to status as a prepetition priority unsecured claim pursuant to Section 507(a)(8) of the Bankruptcy Code, as the period in which the tax liability accrued was a prepetition period.

WHEREFORE, Stephen Darr, as he is Trustee of the Chapter 11 Estates of TelexFree, LLC, TelexFree, Inc. and TelexFree Financial, Inc., respectfully prays that this Court:

1. Enter judgment for Stephen Darr as Trustee of the Chapter 11 Estates of TelexFree, LLC, TelexFree, Inc. and Telex Free Financial, Inc. declaring that the TelexFree Credits as claimed on the TelexFree, LLC Amended Tax Returns for the tax years 2012, 2013 and 2014 are ordinary and necessary expenses of the operation of TelexFree and are deductible, pursuant to 26 U.S.C. § 162, in determining TelexFree's taxable income for the tax years 2012, 2013, and 2014;

2. Enter judgment for Stephen Darr as Trustee of the Chapter 11 Estates of TelexFree, LLC, TelexFree, Inc. and Telex Free Financial, Inc. that TelexFree had no taxable income for the tax years 2012, 2013 and 2014 and is entitled to a tax refund of \$886,700 for the tax year 2012 and to retain the 2013 Refund;

3. Enter Judgment disallowing the Claims of the Service;

4. To the extent that the Service is entitled to a claim on account of the issuance of the 2013 Refund, enter judgment that such claim be accorded prepetition priority status pursuant to 11 U.S.C. §507(c);

5. To the extent that the Service is entitled to a claim on account of income tax liability for 2014, enter judgment that such claim be accorded prepetition priority status as the taxable income accrued prior to the Petition Date;

6. Grant such other relief as is just and proper.

STEPHEN B. DARR,
CHAPTER 11 TRUSTEE,

By his attorneys,

/s/ Andrew G. Lizotte
Harold B. Murphy (BBO #362610)
Charles R. Bennett, Jr. (BBO #037380)
Andrew G. Lizotte (BBO #559609)
Murphy & King, P. C.
One Beacon Street
Boston, MA 02108
Tel: (617) 423-0400
Fax: (617) 423-0498
hmurphy@murphyking.com
cbennett@murphyking.com
alizotte@murphyking.com

Dated: July 30, 2018

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