Docket #0029 Date Filed: 11/29/2018

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, v. UNITED STATES OF AMERICA, DEPARTMENT OF THE TREASURY, INTERNAL REVENUE SERVICE, Defendant.	Adversary Proceeding No. 18-4091

CHAPTER 11 TRUSTEE'S RESPONSE TO UNITED STATES' STATEMENT OF ADDITIONAL UNDISPUTED MATERIAL FACTS IN SUPPORT OF ITS OPPOSITION AND CROSS-MOTION FOR PARTIAL SUMMARY JUDGMENT

Stephen B. Darr, the Chapter 11 trustee (the "Trustee") of the bankruptcy estates (the "Estates") of TelexFree LLC, TelexFree, Inc., and TelexFree Financial, Inc. (collectively, "TelexFree" or the "Debtors"), submits this response to the *United States' Statement of Additional Undisputed Material Facts In Support of its Opposition and Cross-Motion for Partial Summary Judgment* [docket no. 22] (the "United States' Statement of Facts"). Any admission by the Trustee to allegations contained in the United States' Statement of Facts constitute admissions solely for the purposes of the parties' motions for partial summary judgment in the

above-captioned adversary proceeding. The Trustee has reproduced below each numbered additional fact from the United States' Statement of Facts, and responds to each fact as follows.

TRUSTEE'S RESPONSES

35. On or about March 24, 2014, the IRS received a Form 7004, Application for Automatic Extension of Time to File Certain Business Income Tax, Information, and Other Returns, for TelexFree, LLC's 2013 income tax return, as well as a cashier's check dated March 24, 2014, in the amount of $15,792,982.00, to be applied towards TelexFree, LLC's 2013 income taxes. *See* Form 7004, Application for Automatic Extension of Time to File Certain Business Income Tax, Information, and Other Returns, and Cashier's Check dated March 24, 2014, collectively attached as **Exhibit C.**

Response: The Trustee admits the allegations contained in paragraph 35.

36. On April 13, 2014, TelexFree, LLC, filed a bankruptcy petition under Chapter 11 of the Bankruptcy Code.

Response: The Trustee admits the allegations contained in paragraph 36.

37. Between May 4, 2014, and May 10, 2014, the IRS was notified of TelexFree, LLC's bankruptcy petition.

Response: The Trustee has insufficient information to admit or deny the allegations contained in paragraph 37.

38. Between May 4, 2014, and May 10, 2014, the IRS placed a bankruptcy/litigation hold code on TelexFree, LLC's IRS accounts, including its account for the 2013 income tax year. This hold code should have stopped any tax refund from being generated. The bankruptcy/litigation hold code "freezes" the taxpayer's "Master File" and should prohibit any

offsets, refunds, or credit elects for automatically being processed. *See* Bankruptcy Specialist Decl., at ¶ 7.

Response: The Trustee has insufficient information to admit or deny the allegations contained in paragraph 38.

39. The Trustee filed a 2013 Form 1120, U.S. Corporation Income Tax Return, for TelexFree, LLC, which was received by the IRS on or about September 21, 2016. *See* 2013 Form 1120, U.S. Corporation Income Tax Return, for TelexFree, LLC, dated September 9, 2016, attached as **Exhibit D**; Bankruptcy Specialist Decl., at ¶ 10. On the 2013 income tax return, the Trustee claimed a loss of $2,101,985,935.00 and sought a refund in the amount of $15,858,111.00. *See* Exhibit D. The return is being offered to show what was reported by the Trustee, and not for the truth of anything set forth on the return.

Response: The Trustee admits the allegations contained in paragraph 39.

40. On or about December 9, 2016, the IRS selected the 2013 income tax return for examination. *See* Bankruptcy Specialist Decl., at ¶ 8.

Response: Upon information and belief, the Trustee admits the allegations contained in paragraph 40.

41. Despite the bankruptcy/litigation hold code that was put on TelexFree, LLC's IRS accounts, on or about December 26, 2016, the IRS issued a tax refund check to the Trustee in the amount of $15,532,440.39, related to TelexFree, LLC's 2013 income tax year. This was a computer-generated refund (as opposed to a manual refund), which should have been prevented by the bankruptcy/litigation hold code. *See* Bankruptcy Specialist Decl., at ¶ 9; Tax Refund Check dated December 27, 2016, attached as **Exhibit E**.

Response: The Trustee objects to the allegation that the "IRS issued a tax refund to the Trustee." The tax refund check, a copy of which was attached as Exhibit E to the United States' Statement of Facts, was issued to "TELEXFREE LLC . . . c/o S DARR BANKRUPTCY TTEE." While the Trustee admits to delivery of the refund, he has insufficient information to admit or deny the remaining allegations contained in paragraph 41.

42. On February 8, 2017, the IRS Revenue Agent examining TelexFree, LLC's income tax return spoke with the Trustee's representative at KPMG. The KPMG representative informed the IRS Revenue Agent that the Trustee had received a tax refund related to the 2013 income tax year, which surprised the IRS Revenue Agent because TelexFree, LLC's 2013 income tax return was still under examination. The KPMG representative informed the IRS Revenue Agent that, if the IRS wanted to recover the refund, the government would have to sue the Trustee in this Court. *See* IRS Revenue Agent Decl., at ¶ 8.

Response: In response to paragraph 42 of the United States Statement of Facts, the Trustee admits that he received a tax refund related to TelexFree's 2013 tax year and did not consent to return of the refund to the IRS. The Trustee denies the balance of the allegations and calls upon the movant to prove same.

43. On June 8, 2017, the IRS filed an administrative expense form—Form 6338, Request for Payment of Internal Revenue Taxes—for the erroneous refund related to the 2013 income tax year. On the form, the IRS identified the $15.5 million erroneous refund and specifically stated:

> The claim for tax period 12/31/2013 reflects that the Service mistakenly refunded the claimed amount to the Trustee in contravention of a control code input on the tax account that should have prevented a refund. The Service claims that it is entitled to recoup the mistakenly-refunded money with priority over all other claims, including other administrative-priority claims, whether based on the imposition of a constructive trust or other legal remedy.

See Claim No. 2987-1, Claims Registry.

Response: In response to the allegations contained in paragraph 43 of the United States Statement of Facts, the Trustee admits that the IRS filed an administrative claim on June 8, 2017 [denoted as claim 2987-1 by the Court] and further states that the claim speaks for itself.

44. On October 31, 2017, the IRS issued a statutory notice of deficiency related to TelexFree, LLC's income tax liabilities for 2013 that determined a deficiency in tax in the amount of $300,507,248.00, and a late-filing penalty in the amount of $75,126,857.00. *See* Compl., at ¶ 40; Answer, at ¶ 40; *also* Revenue Agent Decl., at ¶ 11.

Response: The Trustee admits the allegations contained in paragraph 44.

45. The Trustee agreed to segregate and hold the erroneous refund pending resolution of this dispute. *See, e.g.*, Case No. 14-40987, Doc. No. 961, at ¶ 3 ("Until the asserted administrative claim of the Service is determined by the Court or as otherwise ordered by the Court, the Trustee shall *segregate* and reserve the sum of $15,532,440 in order to adequately protect the request for payment filed by the Service.") (Emphasis added).

Response: In response to the allegations contained in paragraph 45 of the United States Statement of Facts, the Trustee states that the 2013 Refund was issued to TelexFree in December 2016 and deposited into the Trustee's general operating account. Nearly one year later and at the request of the Service, the Trustee admits that he agreed to set aside the amount of the 2013 Refund, and not the refund itself, pending resolution by the Court. In further responding, the Trustee states that the referenced order speaks for itself.

46. The United States has asserted a counterclaim against the Trustee in this adversary proceeding to recover the erroneous refund related to the 2013 income tax year. *See* Answer, at ¶¶ 74-84. In this counterclaim, the United States seeks a judgment against the Trustee

for the erroneous refund in the amount of $15,532,440.39, plus statutory additions from and after December 26, 2016.

Response: The Trustee admits the allegations contained in paragraph 46 and further states that the Counterclaim speaks for itself.

The Tax Claim for Income Tax Year 2014

47. On July 6, 2017, the IRS received an income tax return (Form 1120) for TelexFree, LLC, for the tax year 2014, that was filed by the Trustee, and in which he claimed total income of $161,550,353.00, claimed total deductions of $2,450,176.063.00, and claimed a loss of $2,288,625,710.00. *See* Compl., at ¶ 38; Answer, at ¶ 38.

Response: In response to the allegations contained in paragraph 47 of the United States Statement of Facts, the Trustee admits that he filed the referenced return on behalf of TelexFree.

48. On November 6, 2017, the IRS issued three Notices of Proposed Adjustment (NOPAs) related to TelexFree, LLC's 2014 income tax return, which proposed the following adjustments: (a) disallowing the claimed advertising credits expense claimed on the 2014 tax return in the amount of $2,442,705,606.00; (b) imposing a failure to file penalty in the amount of $13,481,991; and (c) disallowing the claimed net operating loss carry over deduction in the amount of $2,578,363,363.00. *See* Compl., at ¶ 41; Answer, at ¶ 41.

Response: The Trustee admits the allegations contained in paragraph 48.

49. On November 30, 2017, the IRS filed its amended request for payment against the Estate of TelexFree, LLC, to add an administrative expense in the amount of $53,927,964.00 for TelexFree, LLC's federal income tax liabilities for 2014. *See* Claim 2987-2, Claims Register.

Response: In response to the allegations contained in paragraph 49 of the United States Statement of Facts, the Trustee admits that the IRS filed an amended administrative claim on or

about November 30, 2017 [denoted by the Court as Claim 2987-2]. In further responding, the Trustee states that the amended claim speaks for itself.

50. The Trustee filed an amended Form 1120 for TelexFree, LLC, for the tax year 2014, claiming a $148,000,000 deduction for "165 Loss SEC Asset Seizure" in addition to $2,140,637 and $3,896,209 deductions for "Legal and Professional Fees" and "Consulting Expense," respectively, which were purportedly for expenses incurred *after* TelexFree, LLC, filed its bankruptcy petition. *See* Compl.,at ¶ 43;.Answer, at ¶ 43. The Trustee alleged that these expenses were for a "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…." Compl., at ¶ 43.

Response: In response to the allegations contained in paragraph 50 of the United States Statement of Facts, the Trustee admits that he filed an amended tax return for 2014. In further responding, the Trustee states that the tax return speaks for itself.

STEPHEN B. DARR,
CHAPTER 11 TRUSTEE,

By his attorneys,

/s/ Andrew G. Lizotte

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