Docket #0069 Date Filed: 11/4/2019

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

AFFIDAVIT OF THOMAS GREENAWAY IN SUPPORT OF THE OPPOSITION TO THE UNITED STATES OF AMERICA'S SECOND MOTION FOR PARTIAL SUMMARY JUDGMENT

I, Thomas Greenaway, being duly sworn, depose and state that:

1. I am a principal in the Business Tax Service practice at KPMG, LLP. Prior to joining KPMG, I served as a senior attorney in the Large and Midsize Business Division of the IRS Office of Chief Counsel in Boston. A more detailed resume is attached to my Expert Report, which is **Exhibit 1** to this affidavit.

2. On October 1, 2015, KPMG was retained by Stephen Darr as Trustee (the "Trustee") of the Chapter 11 Bankruptcy Estates of TelexFree, LLC, TelexFree, Inc and

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TelexFree Financial, Inc. ("TelexFree") to, among other things, provide tax advice and assistance to the Trustee and prepare tax returns for TelexFree.

3. On April 17, 2019, I was retained to provide an expert report on the deductibility of certain commission and advertising expenses incurred by TelexFree in promoting its business (the "Promotional Expenses"), the deductibility of a bad debt expense for a receivable due to TelexFree from Ympactus and the deductibility of a casualty loss suffered by TelexFree as a result of the seizure by the United States government of property of TelexFree [docket no. 1344].

4. I am making this affidavit based upon the files of KPMG, the documents identified in my report and the identified assumed facts underlying my expert report.

5. The Trustee and KPMG reported all TelexFree activity on the amended returns filed on behalf of TelexFree LLC as it was the primary operating entity and because it was impossible to separate the activity attributable to any individual entity. Tax returns reporting no activity were filed for TelexFree Inc. and TelexFree Financial, Inc.

6. TelexFree, LLC is a C corporation for U.S. federal income tax purposes.

7. TelexFree, LLC files federal income tax returns on a calendar-year basis.

8. TelexFree, LLC has never engaged in the trade or business of farming.

9. TelexFree, LLC has never performed services in the fields of health, law, engineering, architecture, accounting, actuarial science, performing arts, or consulting.

10. TelexFree, LLC used the accrual method of accounting for computing taxable income. Accordingly, TelexFree, LLC is required to include an item of income in gross income when all events fixing TelexFree, LLC's right to receive the income have occurred and the amount of the income can be calculated with reasonable accuracy.

11. Under the accrual method of accounting, TelexFree is entitled to claim deductions for a liability incurred in the taxable year in which: (i) all events have occurred to establish the fact of the liability; (ii) the amount of the liability can be determined with reasonable accuracy; and (iii) economic performance has occurred with respect to the liability.

12. In contrast to the accrual method, the cash method of accounting requires taxpayers to record revenue when cash is received and to record expenses when the expenses are paid.

13. The government did not provide any notice to TelexFree to change TelexFree's method of accounting from accrual to cash.

14. TelexFree maintained adequate and accurate books and records reflecting income and expenses arising from both direct transactions and triangular transactions involving the sale of membership plans.[1] Such income and expenses were reported on TelexFree's tax returns.

15. Economic performance as to the Promotional Expenses occurred when the Participants performed the promotional activities.

2012 Returns

16. On September 9, 2013, TelexFree, LLC filed an original federal income tax return, Form 1120, for the 2012 tax year, reporting tax of $686,121.

17. TelexFree, LLC made payments to the Service of $706,713.79 and $179,986.86 on October 16, 2013 and December 12, 2013, respectively, for the 2012 tax year, of which $686,211 is tax and $200,579 is penalties and interest.

[1] A direct transaction involved a payment directly between TelexFree and a Participant. A triangular transaction occurred when a recruited Participant purchased a membership plan from TelexFree, the recruited Participant paid the membership fee to the recruiting Participant, and the recruiting Participant used his/her accumulated credits to satisfy the invoice due from the recruited Participant to TelexFree.

18. On September 9, 2016, the Chapter 11 Trustee filed on behalf of TelexFree, LLC an amended federal income tax return, Form 1120X, for the 2012 tax year, reporting no tax liability and requesting a refund of amounts paid of $886,700 with respect to its 2012 tax year ("2012 Return").

19. On October 31, 2017, the Service disallowed TelexFree, LLC's 2012 refund claim based on its determination that the Promotional Expenses were not deductible under Section 162(a) of the Internal Revenue Code.

20. On March 9, 2018, the Chapter 11 Trustee filed on behalf of TelexFree, LLC a second amended federal income tax return, Form 1120X, for the 2012 tax year ("2012 Amended Return"). The 2012 Amended Return reported that TelexFree, LLC had no tax liability for the 2012 tax year. The 2012 Amended Return reported gross receipts of $18,220,915, including $11,869,444 in income from a Brazilian affiliate Ympactus Commercial Ltda ("Ympactus"), and a deduction for Promotional Expenses of $4,261,846, and a net loss carryback from 2014 in the amount of $13,435,861.

21. A true and accurate copy of the 2012 Amended Return is annexed as **Exhibit 2**.

2013 Returns

22. On September 9, 2016, the Chapter 11 Trustee filed on behalf of TelexFree, LLC an original federal income tax return, Form 1120, for the 2013 tax year, which reported no tax liability and requested a refund of the estimated prepetition payment made by TelexFree with respect to its 2013 tax year in the amount of $15,792,982 ("2013 Return").[2]

23. On December 26, 2016, after processing the 2013 Return, the Service issued a refund of $15,532,440 to the Chapter 11 Trustee related to TelexFree, LLC's 2013 tax year (the

[2] The 2013 Return erroneously reported estimated tax payments of $15,858,111. The actual estimated tax payments made for 2013 totaled $15,792,982.

"2013 Refund") based on the 2013 Return. The 2013 Refund was made up of three components: estimated taxes paid of $15,792,982, plus accrued interest of $55,318, less a $315,860 bad check penalty. The Chapter 11 Trustee filed a penalty abatement request for the bad check penalty, which has not yet been allowed by the Service.

24. On March 9, 2018, the Chapter 11 Trustee filed on behalf of TelexFree LLC an amended federal income tax return, Form 1120X, for the 2013 tax year ("2013 Amended Return"). The 2013 Amended Return reported that TelexFree, LLC had no tax liability for the 2013 tax year. The 2013 Amended Return reported gross receipts of $1,173,886,556, including $174,183,645 in income from Ympactus, and reported deductions for Promotional Expenses of $972,955,648 and for a bad debt deduction relating to Ympactus of $186,344,898.

25. A true and accurate copy of the 2013 Amended Return is annexed as **Exhibit 3**.

26. On April 25, 2017, the Service issued Notices of Proposed Adjustment ("NOPA") related to TelexFree, LLC's 2013 Return, proposing to disallow deductions for (i) TelexFree's advertising and commission credits of $2,161,645,140 and $622,588,034, respectively, and (ii) a bad debt of $186,344,898 related to amounts due from Ympactus, and proposing a late-filing penalty of $75,126,857.

27. On June 28, 2017, KPMG on behalf of the Trustee responded to the NOPA and provided the Service with substantiation for the deductions taken on behalf of TelexFree for the 2013 Return. ("KPMG 2013 Response").

28. A true and accurate copy of KPMG 2013 Response is annexed as **Exhibit 4**.

29. On October 31, 2017, the Service issued a statutory notice of deficiency for tax year 2013 related to the NOPAs issued on April 25, 2017. In the notice of deficiency, the Service

took the position that TelexFree's 2013 taxable income was $858,592,137 and proposed an increase in tax in the amount of $300,507,248, and a late-filing penalty of $75,126,857.

2014 Returns

30. On July 6, 2017, the Chapter 11 Trustee filed on behalf of TelexFree, LLC an original federal income tax return, Form 1120, for the 2014 tax year, which reported no tax liability ("2014 Return").

31. On November 7, 2017, the Service issued NOPAs related to TelexFree, LLC's 2014 tax year, proposing to disallow TelexFree's deduction for Promotional Expenses totaling $2,442,705,606 and the net operating loss, and proposing a late-filing penalty of $13,481,991.

32. On November 8, 2017, KPMG on behalf of the Trustee responded to the NOPA disputing the disallowances for the 2014 Return.

33. KPMG returned the 2014 NOPAs to the Service, noting that TelexFree disagreed with the findings. TelexFree's opposition was based upon substantially the same grounds as set forth in the KPMG 2013 Response.

34. On March 9, 2018, the Chapter 11 Trustee filed on behalf of TelexFree, LLC an amended federal income tax return, Form 1120X, for the 2014 tax year ("2014 Amended Return"). The 2014 Amended Return reported that TelexFree, LLC had no tax liability for the 2014 tax year. The 2014 Amended Return reported gross receipts of $2,067,416,945, and reported deductions for Promotional Expenses of $2,442,705,606 and a casualty loss of $148,000,000.

35. A true and accurate copy of the 2014 Amended Return is annexed as **Exhibit 5**.

36. On November 13, 2018, the Service issued an additional NOPA with respect to TelexFree, LLC's 2014 tax year, disallowing the casualty loss deduction of $148,000,000 claimed on the 2014 Amended Return.

37. KPMG submitted a detailed response to the additional NOPA on or about December 3, 2018, which is attached as **Exhibit 6**.

38. The Service's disallowance of the Promotional Expense deductions without any offsetting adjustment to the reported TelexFree income is fundamentally inconsistent with a fair presentation of TelexFree's taxable income or loss.

39. KPMG on behalf of the Trustee has responded to all of the government's requests for information both before and after the commencement of this litigation setting forth in detail the basis for each claimed deduction. The Service's request for production of documents and interrogatories have been answered. The Service has been provided with my Expert Report, and I was deposed by the Department of Justice regarding my Expert Report.

40. In the 2012 Return and the 2012 Amended Return, TelexFree LLC and the Trustee, respectively, reported income from Ympactus in the amount of $11,869,444 as a charge to Ympactus for accounting and administrative services provided by TelexFree to Ympactus.

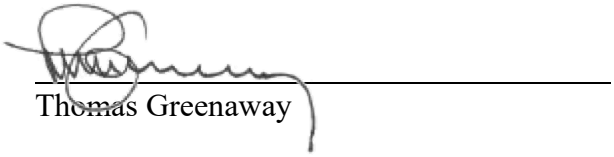
41. In the 2013 Return and 2013 Amended Return, the Trustee on behalf of TelexFree LLC reported income from Ympactus in the amount of $174,183,645 as a charge to Ympactus for accounting and administrative services provided by TelexFree to Ympactus.

42. In both the 2013 Return and 2013 Amended Return, the Chapter 11 Trustee on behalf of TelexFree LLC reported a write-off as uncollectible all of the amounts due from Ympactus in the amount of $186,344,898. The write-off of the Ympactus account receivable was because Ympactus had not paid the obligation, and the Brazilian authorities terminated Ympactus's operations and seized all its assets that year.

43. The Service's disallowance of the Ympactus bad debt deduction without any offsetting adjustment to the reported Ympactus income is fundamentally inconsistent with a fair presentation of TelexFree's taxable income or loss.

44. Many income-producing businesses that engage in illegal activity under federal and/or state law are permitted to take federal tax deductions for expenses incurred in pursuing the business.

Signed under the pains and penalties of perjury this 4th day of November, 2019.



Thomas Greenaway

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In re: TelexFree, LLC, *et al.*

Debtors

United States Bankruptcy Court

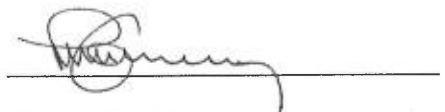
District of Massachusetts

Case No. 14-40987-MSH
Case No. 14-40988-MSH
Case No. 14-40989-MSH

REPORT OF THOMAS D. GREENAWAY

Submitted by:
Thomas D. Greenaway
KPMG LLP
60 South Street
Boston, MA 02111

I, Thomas D. Greenaway, submit the following report dated May 29, 2019. I reserve the right to refine or revise my conclusions if additional documents or information become available to me and to prepare summaries, graphical exhibits and/or charts. I may develop additional opinions based on such additional documents or information and/or clarifications to existing information made available to me.



Thomas D. Greenaway

Dated: May 29, 2019

Introduction

TelexFree's founders claimed that TelexFree was engaged in the business of selling voice over internet protocol service ("VoIP"), but that claim was never anything more than a cover for the actual business. The actual business of TelexFree was attracting people ("Participants") to join the TelexFree program by purchasing a membership plan. Participants paid TelexFree annual membership fees in order to earn back multiples of those fees in the form of TelexFree credits. The credits were worth their equivalent value in cash. Prospective Participants clamored to join the "get-rich-quick" scheme.

This case presents an unusual situation, but the tax principles and standards that apply here are basic and well-settled. TelexFree is subject to tax on its net taxable income. The tax analysis aligns with economic reality and the Ponzi findings of the Bankruptcy Court: over its life, TelexFree generated significant tax losses.

TelexFree incurred about $3.4 billion in commitments to pay Participants in the form of credits for advertising and sales commissions. These commitments—liabilities—generated tax deductions that overwhelmed the income generated by the scheme. TelexFree's credit liabilities, plus bad debts and casualty losses, generated large net operating losses for tax purposes.

The Internal Revenue Service ("Service" or "IRS") proposes to disallow almost all TelexFree's deductions, claiming that TelexFree generated over three billion dollars in taxable income over three years. In short, the IRS basically proposes to tax TelexFree on a gross—rather than a net—income basis. But this approach is inconsistent with basic tax accounting principles and well-settled federal tax rules and standards.

Scope

I was engaged by Stephen B. Darr, Chapter 11 Trustee ("Trustee") of TelexFree to provide a report to submit to the Bankruptcy Court regarding positions taken on federal income tax returns filed by the Trustee on behalf of TelexFree for the 2012, 2013, and 2014 tax years ("Applicable Tax Years")—some of which have been challenged by the Service. These returns were prepared by KPMG LLP ("KPMG") on behalf of the Trustee. All capitalized terms used throughout this document refer to terms defined either in the Statement of Assumed Facts or in this Report.

The opinions contained in this report are based on the facts as set forth in the Statement of Assumed Facts, as well as the List of Documents Considered at the end of this report. Any change in Fact or Representation could cause me to change my opinions. In rendering my opinions, I relied upon the relevant provisions of federal law, including the Internal Revenue Code,[1] Treasury regulations, and settled interpretations of these laws and standards – all as in effect during the Applicable Tax Years.

Qualifications

I am a Principal in the Business Tax Services Practice at KPMG, a professional services firm that provides Audit, Tax, and Advisory services. I assist firm clients on federal tax consulting matters, including representing clients before the IRS. Before joining KPMG, I served as a senior attorney in the Large & Midsize Business division of the IRS Office of Chief Counsel in Boston. I currently serve as the American Bar Association Tax Section's liaison to the American Institute of Certified Public Accountants. I am a

[1] All references to "I.R.C.," "section," "§," or "Code" refer to the Internal Revenue Code of 1986, as amended to 2014, unless otherwise noted.

former officer and former Council Director of the ABA Tax Section, and a former chair of the Boston Bar Association Tax Section. I am a member of the Boston Tax Forum. I write on tax topics and have contributed articles to Tax Executive, Tax Notes, and The Tax Lawyer, among other publications. I speak regularly before professional organizations such as Tax Executives Institute. In addition, I served as a member of the faculty for the American Law Institute's annual Tax Controversy Conference for several years. I am an attorney licensed in Connecticut. I earned a Bachelor of Arts degree, *cum laude*, from Columbia College and a Juris Doctor degree, with honors, from the University of Connecticut School of Law. My Curriculum Vitae is provided as **Exhibit A** to this report.

General Discussion

The IRS proposed adjustments to tax returns for the years ended December 31, 2012, 2013 and 2014 filed by the Trustee. Table 1 presents a summary of my understanding of the differences between the parties:

Table 1: TelexFree Taxable Income ($)

Year	Per Trustee	Per IRS
2012	0	17,697,707
2013	(3,143,852)	1,156,156,694
2014	(535,594,148)	2,055,111,458
Totals	(538,738,000)	3,228,965,859

The IRS accepted all of TelexFree's reported income, but disallowed almost all of TelexFree's deductions.

The adjustments proposed by the IRS address:

- Deductibility of approximately $3.4 billion owed to Participants for commissions and advertising expenses.
- Deducibility of approximately $180 million bad debt expense for an uncollectible account receivable.
- Deductibility of approximately $150 million casualty loss resulting from the seizure of TelexFree's assets.

Opinions

In my opinion, based on the documents made available to me as well as the controlling federal income tax principles, for federal income tax purposes:

> **Opinion 1:** TelexFree must include both cash, accounts receivable, and other accrual income items in gross receipts; and
>
> **Opinion 2:** TelexFree is entitled to deductions for:
>
> (a) commission and advertising expenses accrued by TelexFree in 2012, 2013, and 2014;
> (b) a worthless debt that arose in 2013 arising from receivables TelexFree included in income for the 2012 and 2013 tax years; and
> (c) a casualty loss TelexFree suffered in 2014 when its assets were seized by order of the U.S. District Court.

These opinions are supported by the information contained in **Exhibit B**, which summarizes TelexFree's books and records reconstructed by the Trustee.

Background

On October 1, 2015, the Bankruptcy Court authorized the Trustee to retain KPMG as tax accountants and tax advisors to prepare and file original and amended tax returns as necessary for TelexFree, to conclude on any technical tax issues arising in the preparation or amendment of such income tax returns, and to represent TelexFree before the IRS. The court order authorizing this engagement, including the KPMG engagement letters executed by the Trustee, is attached as **Exhibit C**.

I took primary responsibility for evaluating TelexFree's material technical federal income tax positions. The tax returns KPMG prepared on behalf of TelexFree were reviewed and signed by Joseph Middleton, a certified public accountant and partner at KPMG. Mr. Middleton reviewed and concurred with my views on the material tax positions presented on the returns. Furthermore, both the KPMG team that prepared the returns and I consulted with Carol Conjura, a partner in KPMG's Washington National Tax practice, with respect to certain significant positions taken on the returns.

A. Return Filing History

After reviewing all of the available records, the Trustee and KPMG reported all TelexFree operating activity on the returns prepared for TelexFree, the primary operating entity in the scheme. Tax returns were filed for TelexFree, Inc. and TelexFree Financial, Inc. reporting no activity. As the current controversy relates only to the returns of TelexFree, I do not provide the filing history for returns KPMG prepared on behalf of TelexFree, Inc. and TelexFree Financial, Inc. in this report.

1. 2012 Tax Year

On September 9, 2013, TelexFree filed its original 2012 Form 1120, *U.S. Corporation Income Tax Return*. I understand that this return was prepared at the direction of Joseph Craft, TelexFree's former Chief Financial Officer. This return was materially incorrect.

On September 9, 2016, KPMG prepared and TelexFree filed Form 1120-X, *Amended U.S. Corporation Income Tax Return*, for the 2012 tax year, reporting no tax liability and claiming a refund of amounts paid with respect to its 2012 tax year ("2012 Return") in the amount of $692,954. This return was based on the best available information at the time.

The 2012 Return was filed consistent with Revenue Procedure 2010-27, which explains how bankruptcy trustees may request a tax refund from the IRS under 11 U.S.C. § 505(a)(2)(B) (a "505(a) request"). In addition, in an overabundance of caution, a duplicate copy of the return was filed under Revenue Procedure 2006-24, which explains how bankruptcy trustees may request a prompt determination of any unpaid tax liability from the IRS under 11 U.S.C. § 505(b)(2) (a "505(b) request").

On March 9, 2018, KPMG prepared and TelexFree provided the IRS with a revised Form 1120-X in support of its 2012 refund claim to report items of income and deductions based on reconstructed transaction data in TelexFree's electronic records system (the "SIG System"), and to capture activity for all TelexFree entities on TelexFree's return ("2012 Amended Return"). Similar to the 2012 Return, the revised 2012 Form 1120-X reported that TelexFree had no tax liability for the 2012 tax year.

2. 2013 Tax Year

On September 12, 2016, KPMG prepared and TelexFree filed its original 2013 Form 1120, which reported no tax liability and requested a refund of $15,792,982 in estimated tax TelexFree paid with respect to its 2013 tax year ("2013 Return"). The 2013 Return was filed under the procedures provided for a 505(a) request, and a duplicate copy of the return was filed under the procedures provided for a 505(b) request.

On or around March 7, 2018, KPMG prepared and TelexFree filed Form 1120-X for the 2013 tax year ("2013 Amended Return") to report items of income and deductions based on reconstructed transaction data in the SIG System, and to capture activity for all TelexFree entities on TelexFree's return. Similar to the 2013 Return, the 2013 Amended Return reported that TelexFree had no tax liability for the 2013 tax year.

3. 2014 Tax Year

On July 6, 2017, KPMG prepared and TelexFree filed its original 2014 Form 1120 ("2014 Return"), which reported no tax liability for the 2014 tax year. The 2014 Return was filed under the procedures applicable to a 505(b) request.

On March 9, 2018, KPMG prepared and TelexFree filed Form 1120-X for the 2014 tax year ("2014 Amended Return") to reconcile the SIG System and the general ledgers used to prepare the 2014 Return, and to claim deductions for bankruptcy estate administrative expenses and for assets frozen or seized by the government. Similar to the 2014 Return, the 2014 Amended Return reported that TelexFree had no tax liability for the 2014 tax year.

B. IRS Audit Activity

1. 2012 Tax Year

On October 31, 2017, the IRS disallowed TelexFree's 2012 Refund Claim.

2. 2013 Tax Year

The IRS processed the 2013 Return and issued a refund check to the Trustee in December 2016. On April 25, 2017, the IRS issued Notices of Proposed Adjustment ("NOPAs") disallowing deductions for (i) TelexFree's advertising and commission costs of $2,161,645,140 and $622,588,034, respectively, and (ii) a bad debt of $186,344,898 related to amounts due from a Brazilian affiliate, Ympactus Commercial Ltda. ("Ympactus"), and imposing a late-filing penalty of $75,126,857. On October 31, 2017, the IRS issued a statutory notice of deficiency for 2013. In the notice of deficiency, the IRS took the position that TelexFree's 2013 taxable income was $858,592,137, proposing a $300,507,248 tax deficiency and a late filing penalty of $75,126,857. After taking into account the additional $297,564,557 in gross income reported on the 2013 Amended Return, I conclude that the updated IRS position is that TelexFree had $1,156,156,694 in taxable income in 2013, and TelexFree has a $404,654,843 tax deficiency for 2013.

3. 2014 Tax Year

On November 7, 2017, the IRS issued NOPAs proposing to disallow TelexFree's deduction for advertising and commission costs in the amount of $2,442,705,606, and proposing a late-filing penalty of $13,481,991. On November 13, 2018, the IRS issued an additional NOPA disallowing the casualty loss deduction claimed on TelexFree's Amended 2014 Return in the amount of $148,000,000. Based on the NOPAs, I conclude that the IRS has taken the position that TelexFree generated $2,055,111,458 in taxable income in 2014 and a $719,289,010 tax deficiency.

Discussion

Participants paid TelexFree for membership plans which entitled Participants to post advertisements on the internet to earn credits under either an AdCentral plan or an AdCentral Family plan. Both plans were annual plans. For the AdCentral Plan, Participants paid TelexFree $289 for a one-year AdCentral plan, plus a $50 membership fee. Both plans gave the holder the right to sell VoIP packages, for which a Participant could receive a commission if the packages were sold, or the VoIP packages could be redeemed for cash. Participants purchasing an AdCentral Plan were required to place one internet ad per day and, for each week in which the Participant placed the required ads, the Participant was entitled to one additional VoIP package, which could be sold or exchanged for additional credits. Thus, Participants who posted the required ads were eligible to receive $20 per week for 52 weeks, for a total annual return of $1,040. AdCentral Family plans cost $1,375 (plus the $50 membership fee), but they allowed Participants to earn $100 in weekly credits per plan, for a total annual return of $5,200. Participants also earned direct and indirect credit commissions for recruiting new Participants into their "downline."

At its essence, then, the sale of each plan generated up-front revenue for TelexFree, but it also gave rise to liabilities to each Participant as advertising services were performed by the Participant. Participants performed advertising services which were paid on a weekly basis in the form of credits. As noted above, at the end of each membership plan period, TelexFree's liability to each Participant who performed advertising services or earned commissions was a multiple of the revenue recognized on the sale of the membership plan.

Among other things, the tax returns KPMG prepared for the Trustee on behalf of TelexFree:

- Included in gross income, among other things, cash received from the sale of membership plans, credits exchanged for new memberships through Triangular Transactions (defined below), and services rendered to Ympactus.
- Deducted the credits issued to Participants for as commissions earned and advertising expenses incurred in the promotion of the pyramid/Ponzi scheme, as well as other ordinary and necessary business expenses.
- Claimed a bad debt deduction for receivables from Ympactus recognized as income, which became unrecoverable as a result of the Brazilian authorities' seizure of Ympactus.
- Claimed a casualty loss deduction for assets seized and ordered by the District Court to be paid to Participants in restitution of their losses under the Net Equity formula approved by the Court.

A. TelexFree's Gross Receipts Include Cash Income & Credits Exchanged for New Memberships

As discussed above, the sale of membership plans were the key mechanism for growing TelexFree's business. Participants could purchase membership plans from TelexFree in one of two ways – either by direct payment to TelexFree (a "Direct Transaction") or by payment of the membership fees to the Participant who recruited them, in which case the recruiting Participant retained the membership fee and used his/her earned credits to satisfy the membership plan invoice of the recruited participant (a "Triangular Transaction"). Triangular Transactions were the predominant method by which Participants purchased membership plans and joined the TelexFree program. I refer to TelexFree's income generated by Triangular Transactions as "Triangular Income."

TelexFree's books and records reflect income derived from:

i. the sale of membership plans through Direct and Triangular Transactions;
ii. revenue for amounts due from Ympactus;
iii. the sale of VoIP products; and
iv. other immaterial items, such as interest.

Table 2, below, identifies the three material components of gross receipts reported on the returns filed by TelexFree for the Applicable Tax Years: Cash, Triangular Income, and revenue for services rendered to Ympactus.[2]

Table 2: TelexFree Gross Receipts ($)

Year	Cash Receipts	Triangular Income	Revenue from Ympactus	Gross Receipts
2012	2,943,517	3,407,954	11,869,444	18,220,915
2013	156,227,156	843,475,755	174,183,645	1,173,886,556
2014	200,621,569	1,866,795,376	--	2,067,416,945

[2] The Trustee reconstructed copies of TelexFree electronic records in the SIG System, and, based upon that information, financial records obtained through Rule 2004 examinations and other documents obtained and reviewed by the Trustee, the Trustee was able to accurately determine the amount of income derived by TelexFree. *See* **Exhibit B.**

For federal tax purposes, TelexFree must include in gross income any income generated in the operation of its business, including income from the sale of membership plans. A taxpayer's gross income includes all realized accessions to wealth over which the taxpayer has dominion.[3] It is well-established that this broad definition of gross income includes income generated by illegal activities. The Triangular Transactions relieved TelexFree of the obligation to settle credit liabilities for cash. The offset of a receivable with a payable is a well-accepted form of payment for federal income tax purposes, so Triangular Income also belongs in TelexFree's gross receipts. These conclusions are based upon the accrual method of tax accounting, which I discuss in more detail below.

TelexFree computed its taxable income using the accrual method of accounting. Generally, a taxpayer must compute its taxable income under the method the taxpayer regularly uses to compute its income for book purposes unless that method does not clearly reflect income.[4] There are two basic tax accounting methods: the cash method and the accrual method. Cash method taxpayers generally account for items of income and deduction when they actually receive or make cash payments, respectively. Accrual method taxpayers, in contrast, generally account for items of income and deduction when those items meet the all-events test, discussed in more detail below. "C" corporations[5] generally must use the accrual method of accounting.[6]

TelexFree was required to compute taxable income under the accrual method of accounting for three reasons: (1) the accrual method clearly reflects the overall economic loss of TelexFree's operations, the hallmark of a Ponzi scheme, (2) TelexFree kept its books and records on the accrual method of accounting, and (3) "C" corporations like TelexFree are prohibited from using the cash method of accounting. In any event, neither the IRS nor the Department of Justice has proposed to change TelexFree's method of accounting.

Under the accrual method of accounting, 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.[7] Tax practitioners consider the right to receive income as fixed at the earliest of the following three dates: (1) the date of performance; (2) the date payment is due; or (3) the date payment is received. For that reason, accrual method taxpayers must include accounts receivable in income. As applied here, cash, Triangular Income, and Ympactus accounts receivable all belong in TelexFree's gross income.

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[3] *See* I.R.C. § 61(a).

[4] *See* I.R.C. § 446(a).

[5] Subchapter C of the Code applies to all corporations. Subchapter S of the Code applies to a subset of corporations that elect to be treated as pass-through entities for federal income tax purposes. Tax practitioners refer to those sorts of corporations as S corporations, and all other corporations as C corporations.

[6] Under section 448, a C corporation may not use the cash method of accounting unless one of the following exceptions applies:

(i) The C corporation is in the trade or business of farming, as described in section 263A(e)(4);

(ii) The C corporation constitutes a qualified personal service corporation; or

(iii) The average annual gross receipts of the C corporation for the three prior tax years (or, if shorter, the period during which the entity was in existence) does not exceed $5 million.

[7] Treas. Reg. § 1.451-1(a).

B. TelexFree's Commission and Advertising Expenses Are Deductible

1. Whether TelexFree May Take Deductions

Advertising and promotional expenses are deductible for tax purposes.[8] Similarly, expenses that promote a taxpayer's goodwill (i.e., goodwill advertising), either to current or future customers, are also currently deductible.[9] As noted above, TelexFree was in the trade or business of promoting an illegal pyramid and Ponzi scheme. For this business to grow, TelexFree had to compensate Participants for promoting, recruiting, and signing up other new members. Additionally, Participants were incentivized to post advertisements on the internet. In exchange for these services, TelexFree paid compensation in credits to the Participants' User Accounts. These credits could be redeemed for cash from TelexFree directly or from a third party in a Triangular Transaction. The credits provided a strong incentive for the Participants to renew their membership plans, purchase additional plans, and to encourage other individuals to purchase plans.

These payments and promises to pay were core to the business model that made TelexFree one of the largest Ponzi schemes of all time. The magnitude of TelexFree's advertising expenses led directly to the billions of transactions that ran through the business: the TelexFree business model was wildly successful in recruiting new Participants.

Advertising was the core service Participants provided under the terms of their contractual arrangement with TelexFree. Participants placed between one and five internet advertisements per day. When doing so, the Participants logged onto TelexFree's website to download marketing materials, posted advertisements on the chosen websites, and then returned to TelexFree's website to validate their posting of the advertisements. In other words, Participants received credits largely in exchange for their promotion of TelexFree's membership plans (and to a lesser extent, their promotion of TelexFree's products).

Considering that TelexFree was a Ponzi or pyramid scheme, the expenses at issue must be viewed as normal, usual, or customary: they drove the growth of the business. Because the expenses at issue were integral to TelexFree's operation and are customary for a Ponzi or pyramid scheme, these expenses fall within the scope of the Treasury regulations discussed above that allow deductions for advertising and promotional expenses.

Nothing in the Code or the regulations overrides the application of these straightforward principles to this case. The Code bars traffickers in controlled substances from taking any deductions,[10] but all other illegal businesses are taxed on their net taxable income, not on a gross income basis. The Code bars deductions for illegal payments.[11] Tax standards interpret this exception to deductibility narrowly, however, requiring that the payment itself be illegal, rather than considering whether the overall business is illegal. Advertising and commission expense accruals are not illegal.

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[8] Treas. Reg. § 1.162-1(a); Rev. Rul. 92-80.

[9] Treas. Reg. § 1.162-20(a)(2).

[10] I.R.C. § 280E.

[11] I.R.C. § 162(c)(2).

2. When TelexFree May Take Deductions

Once a tax practitioner determines *whether* an expense is deductible, the next important question to consider is *when* the expense may be deducted. A liability may be deducted under the accrual method of accounting in the taxable year in which the all-events test is satisfied. The all-events test for liabilities has three prongs:

i. The fact of the liability is established;
ii. The amount of the liability can be determined with reasonable accuracy; and
iii. Economic performance has occurred with respect to the liability.[12]

The term "liability" includes any item allowable as a deduction, cost, or expense for federal income tax purposes. [13]

To satisfy the first prong of the all-events test, a liability must be fixed, absolute, and unconditional. The all-events test does not require absolute certainty that an item of income or liability will actually be paid. Tax practitioners understand that the existence of an absolute liability is necessary for a good tax expense accrual, but absolute certainty that the liability will be discharged by payment is not. Put differently, the same tax accounting rules apply to solvent and insolvent taxpayers.

There is a well-recognized, taxpayer-favorable rule in accrual-method deduction cases where cash payment is uncertain. Deductions are proper unless it can be categorically said at the time the deductions were taken that the expense accrual would not be paid. This rule holds true even if the facts show that the likelihood of payment of any part of the disallowed portion was extremely doubtful. In contrast, if there is absolutely *no* possibility of payment or payment will not occur for an inordinate amount of time, a liability will not satisfy the all-events test because it is not considered fixed.

The second-prong of the all-events test is likewise satisfied because the liabilities can be calculated under the terms of the membership plans. The SIG System tracked the earning of credits by User Account. Furthermore, the restoration and reconciliation work the Trustee and his team performed with respect to the SIG System shows that the amounts of the liabilities at issue can be determined with reasonable accuracy. At KPMG, we took comfort in the fact that several federal agencies and the U.S. Attorney's office relied on the Trustee's books and records for various purposes, including in criminal sentencing calculations.

With respect to the third prong of the all-events test, a taxpayer may not claim a deduction any earlier than the taxable year in which economic performance occurs with respect to the liability.[14] The economic performance rules provide different timing rules for different types of liabilities. When a taxpayer's liability arises because of another person providing services to the taxpayer, economic performance generally occurs upon the provision of the services.[15]

For advertising and commission expenses accrued by TelexFree, the all-events test is satisfied in the tax year credits were earned by Participants for advertising and commission-based services. Participants earned a fixed amount of credits for advertising and other services provided to TelexFree, including the direct or indirect recruitment of new Participants or the sale of VoIP packages ("commission-based services"). When

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[12] Treas. Reg. § 1.461-1(a)(2)(i).

[13] Treas. Reg. § 1.446-1(c)(1)(ii)(B).

[14] Treas. Reg. § 1.446-1(c)(1)(ii).

[15] Treas. Reg. § 1.461-4(d)(2)(i).

a Participant provided these services and further demonstrated that the ads were placed in the case of advertising services, credits were deposited on a weekly basis in an account that the Participants established with TelexFree ("User Account").

The credits earned by a Participant were redeemable for cash on a dollar-per-credit basis or could be used to purchase additional membership plans for that Participant or for a newly-recruited Participant through a Triangular Transaction. (A Participant was able to monetize credits in a Triangular Transaction by using the Participant's accumulated credits to satisfy the invoice for a recruited Participant's membership plan in exchange for payment of the membership fee from the recruited Participant directly to the recruiting Participant.)

At all times during TelexFree's operations and up to the bankruptcy filing, Participants were able to, and in fact did, redeem the credits earned for cash and/or for the purchase of additional membership plans.[16] The use of Triangular Transactions to monetize credits earned by Participants remained strong up until the month before the bankruptcy filing.[17] Triangular Transactions resulted in a Participant receiving cash from a third party in exchange for Participants redemption of TelexFree credits to satisfy a newly-issued invoice.

The first two prongs of the all-event test—the fact and the amount of the liability—are satisfied at the time TelexFree was required, by the terms of the membership plans, to deposit a specified, fixed amount of credits into a Participant's User Account. This obligation arose upon Participants' performance of the advertising and commission-based services and, in the case of advertising, demonstration that ads had been placed. TelexFree did, in fact, pay specified and fixed amounts of credits into Participants' User Accounts as earned on a weekly basis.

The amount of credits redeemed by Participants was equal to or nearly equal to the amount of credits issued in each year, as shown in Table 3, below.

Table 3: Credits Issued and Redeemed ($)

Year	Issued	Redeemed
2012	4,261,846	4,261,846
2013	972,955,648	911,620,550
2014	2,442,705,606	1,950,007,485

The first two prongs of the all-events test are satisfied even though there was a possibility TelexFree would not be able to redeem credits earned by Participants for advertising or commission-based services. Throughout TelexFree's operations, Participants exchanged their credits for cash payments from TelexFree. This is not an instance in which the liabilities would never be paid, or not be paid for an inordinate amount of time. To the contrary, TelexFree redeemed its credit obligations right up until shortly before its bankruptcy filing.[18]

With respect to the third prong of the all-events test, economic performance occurred on a weekly basis, when the Participants provided the advertising or commission-based services.[19] The regulations provide an

[16] *See* **Exhibit D**, Chart Showing 2014 Credit Redemptions for Cash.

[17] *See* **Exhibit E**, Chart Showing Triangular Transaction Volume, 2013-2014.

[18] *See* **Exhibit D**, Chart Showing 2014 Credit Redemptions for Cash.

[19] Treas. Reg. §§ 1.446-1(c)(1)(ii), 1.461-4(d)(2)(i).

example involving X, a corporate automobile dealer, an accrual method taxpayer.[20] In the example, Y agrees to provide advertising and promotional activities to X in 1990. X pays Y $10,000 in 1990. Y provides the advertising and promotional activities to X in 1992. The example concludes that X incurs the $10,000 in 1992, the year the services are performed, under the economic performance rule.

In conclusion, TelexFree is entitled to claim deductions for commission and advertising expenses incurred in the operation of its business, whether the credits are viewed as product advertising or as goodwill advertising. The all-events test is satisfied in the same year credits were paid into User Accounts after Participants' performed their required advertising and commission-based services.

IRS Position – Deductibility of Advertising and Commission Expenses

The IRS claims that TelexFree's liabilities for advertising, product sales, and recruiting are not ordinary and necessary business expenses of a VoIP business. The Service's characterization of TelexFree's business is not just wrong; it is contrary to the Ponzi ruling of this court. As this Court has already found, TelexFree was in the trade or business of promoting a Ponzi scheme, not a VoIP business.

The IRS further asserts that TelexFree's entire advertising and commission expense should be disallowed because it constitutes unreasonable compensation. However, reasonable compensation plays no role in analyzing the deductibility of advertising expenses. The IRS did not provide any authority to support its argument that substantiated advertising expenses may be disallowed if IRS considers the expense unreasonable. In any event, the credits and payments made to individual Participants were reasonable. There were millions of Participants. The advertising was effective as evidenced by the strong growth of the business.

The IRS also argues that TelexFree's advertising and commission expense should be classified as non-deductible payments on equity interests (i.e., a "dividend").

Participants did not hold equity interests in TelexFree for tax or any other purpose. It is well-settled that an equity interest for tax purposes is an instrument that provides the holder with the right to share in the profits of the venture, subject to the associated risks of loss. In this case, the membership plans entitled Participants to earn credits for posting advertisements or recruiting other Participants. The membership plans did not provide Participants with a right to share in profits or surplus of TelexFree, nor did they force Participants to share in any losses incurred by TelexFree.

IRS Position – All-Events Test on Advertising and Commission Expenses

The IRS claims that the all-events test was not satisfied with respect to amounts owed for advertising on two different theories-that the expense should be treated as deferred compensation or that it should be disallowed because it was not likely to be paid. In fact, the expense accruals were not deferred compensation, and billions of dollars in credits were redeemed.

Under its first theory, the IRS mischaracterizes the payments owed to Participants as compensation, concluding that the economic performance requirement was not satisfied because payment was not made within 2 ½ months of the relevant year-end under section 404 and Temporary Treasury regulations section

[20] Treas. Reg. § 1.461-4(d)(7)(Ex. 5).

1.404(b)-1T, Q&A 2. Where a compensation plan defers payment to an independent contractor, section 404 generally provides that the payor may not claim a deduction until the compensation is includible in the gross income of the independent contractor—even if the all-events test is satisfied and economic performance occurred.

But this is not a deferred compensation case. Credit income was received by the Participants when the credits were deposited into their User Accounts, because Participants could redeem credits for cash—as many did.[21] Moreover, freely assignable promises to pay like the credits at issue here are treated as cash equivalents for federal tax purposes. They are therefore currently taxable to the Participants, since cash constitutes payment. In the Participants' hands, TelexFree's credits were both unconditional and assignable, and not subject to set-off. As shown by the more than 11 million User Accounts, and the active Triangular Transaction market, at the time Participants invested cash in the operation and during their recruitment and online advertising pursuits, Participants considered the credits they received to have a cash value equivalent to their face value.

Under its second theory, the IRS contends that the all-events test was not satisfied because the amount was not likely to be paid. Until its assets were frozen, TelexFree never showed a clear inability to pay obligations. To the contrary, TelexFree paid on its credit obligations right up to its bankruptcy filing.[22] As indicated in Table 3, TelexFree redeemed credits in 2012, 2013, and 2014 consistently in amounts equal to or nearly equal to the sum of credits issued in each respective year.

C. The Ympactus Bad Debt is Deductible

Under section 166, a taxpayer may deduct debts that become worthless within the taxable year. To qualify for a section 166 deduction, the debt must be a bona fide debt.[23] Treasury regulations provide that a debt arising from the receivables of an accrual method taxpayer constitutes a bona fide debt to the extent that income representing the debt was included in income for the year in which the bad debt deduction is claimed or for a prior year.[24]

The debt owed by Ympactus is a bona fide debt for purposes of section 166 because TelexFree, an accrual method taxpayer, included revenue arising from TelexFree's provision of accounting and administrative services to Ympactus in gross income for the 2012 and 2013 tax years. Ympactus did not pay or otherwise settle this receiveable.[25] Accordingly, TelexFree is entitled to a bad debt deduction of at least the same amount in 2013, when the Ympactus trade receivable became worthless due to the seizure of Ympactus's assets and the cessation of its operations by the Brazilian authorities. Another way to come to the same conclusion would be to apply the "claim-of-right" doctrine to this situation. The claim of right doctrine

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[21] *See* Treas. Reg. § 1.451-2(a).

[22] *See* **Exhibit D**, Chart Showing 2014 Credit Redemptions for Cash.

[23] *See* Treas. Reg. § 1.166-1(c).

[24] *Id.*

[25] On the 2012 Refund Claim and the 2013 Return, KPMG included $186,344,898 in income attributable to the Ympactus receivable. With better information, KPMG reported a total of $186,053,089 in income attributable to the Ympactus receivable on the 2012 Amended Refund Claim and the 2013 Amended Return. The bad debt deduction should be limited to the smaller amount, which is based on better information.

allows taxpayers to deduct prior years' income inclusions when and if those inclusions turn out not to have been income to the taxpayer after all.[26]

IRS Position – Ympactus Bad Debt

IRS claims the Ympactus receivable should not be treated as indebtedness because interest was not charged, the parties did not agree to a fixed repayment schedule, and there was no fixed maturity date. This position is inconsistent with the controlling Treasury regulation, as explained above. The Code and regulations allow taxpayers to take a bad debt deduction that offsets the prior income inclusion. As noted above, an account receivable constitutes a bona fide debt under section 166 if the taxpayer is an accrual-method taxpayer and reported the receivable as income in the year the taxpayer claims a bad debt deduction or a prior year.[27] Applying this regulation here also makes sense as a matter of basic tax accounting. Income accruals that become uncollectible should generate a bad debt deduction. The one offsets the other, since over time, the taxpayer had no cumulative accession to wealth.

D. TelexFree's Casualty Loss Deduction for the Frozen Assets

Section 165(a) allows a deduction for any loss not compensated for by insurance or otherwise. Section 162(f) disallows a deduction for any fine or similar penalty paid to the government for the violation of any law or the investigation or inquiry into the potential violation of any law. Since the enactment of section 162(f), tax professionals generally look to the public policy standards set by the precise terms of section 162(f) and its regulations when interpreting the scope of permissible loss deductions under section 165.

Section 1.162-21(b) of the Treasury regulations provides that compensatory damages paid to a government do not constitute a fine or penalty and, therefore, compensatory damages are deductible. When deciding whether losses in this context should be deductible, tax practitioners look to whether the losses are primarily compensatory or punitive.

TelexFree has not been indicted or found guilty of any crime nor has it been assessed any fine or penalty other than the tax penalties proposed by the Service. TelexFree is entitled to a section 165 deduction with respect to its frozen trade or business assets because the U.S. district court ordered the assets to be turned over to the Trustee to be distributed to victims as a remedial measure designed to compensate victims of the Ponzi scheme. The U.S. District Court ordered that the seized assets to be turned over to the Trustee for payment as restitution to Participants, and not to the government. Until 2017, 162(f) only disallowed deductions for penalties and fines paid *to the government*.[28] Because the Frozen Assets were intended to be paid over to the Trustee (and not the government), the all-inclusive public policy exception established by section 162(f) does not affect the deductibility of the loss.

Furthermore, section 1.162-21(b) of the Treasury regulations provides that compensatory losses and payments do not constitute a fine or penalty. In this case, the Trustee worked closely with the United States in connection with the recovery of funds for victims. The Trustee did not challenge the order of forfeiture with respect to the funds and property as part of an agreement with the United States that the funds and property would be turned over to the Trustee for payment as compensation to victims. The Sentencing Memorandum, the Restitution Order, the Order to Apply Certain Assets to Restitution, and the Forfeiture

[26] I.R.C. § 1341.

[27] Treas. Reg. § 1.166-1(c).

[28] *See Conference Report,* H.R. Rep. No. 115-466, at 430 (2017).

Order implement the carefully coordinated plan to distribute the seized assets as restitution to compensate victims of the fraud. In form and in substance, the frozen assets will be distributed to compensate victims, so the loss is deductible under well-settled tax principles.

IRS Position – Casualty Loss

The IRS contends that allowing a deduction for the casualty loss noted above would undermine public policy and encourage others to engage in illegal Ponzi schemes. IRS likens the asset freeze to a fine or a penalty.

But this policy argument is wrong as a matter of fact and unsupported by the Code and regulations, as discussed above. The federal income tax is a tax on net income, not a sanction against wrongdoing. All the other federal agencies in this case carefully worked to ensure that the maximum amount of available funds be distributed to victims in compensation for their losses—which is restitution, not a fine or penalty. The anomalous IRS position, if adopted, would strip funds away from victims in favor of the U.S. Treasury. Public policy supports the Trustee's position, not the IRS. One of TelexFree's principals has been convicted, and a second has been indicted and fled the country. The Trustee has displaced the Debtors' management and operations have been shut down. The Trustee was appointed to liquidate the Debtors' assets and to pursue recoveries. No public policy would be frustrated by allowing a casualty loss deduction under these circumstances.

Appendix List

Exhibit A	Thomas Greenaway, Esq. CV
Exhibit B	Workpaper Bridging TelexFree Returns to IRS's Position
Exhibit C	Order Authorizing the Chapter 11 Trustee to Retain and Employ KPMG LLP as Tax Compliance Accountant and Tax Consultant
Exhibit D	Chart Showing 2014 Credit Redemptions for Cash
Exhibit E	Chart Showing Daily Triangular Transaction Volume 2012-2014

List of Documents Considered

- Statement of Assumed Facts.
- Tax workpapers prepared by and at the direction of the Trustee
- TelexFree's 2012 Return, 2012 Refund Claim, and 2012 Amended Return filed on September 9, 2013, September 9, 2016, and March 9, 2018, respectively.
- TelexFree's 2013 Return and 2013 Amended Return filed September 12, 2016 and March 9, 2018, respectively.
- TelexFree's 2014 Return and 2014 Amended Return filed on July 6, 2017 and March 9, 2018, respectively.
- NOPAs 001 & 002 issued by the IRS on April 25, 2017 with respect to TelexFree's 2013 tax year.
- Notice of Disallowance issued by the IRS on October 31, 2017 with respect to TelexFree's 2012 Refund Claim.
- Statutory Notice of Deficiency issued by the IRS on October 31, 2017 with respect to TelexFree's 2013 tax year.
- NOPA 003 issued by the IRS on November 7, 2017 with respect to TelexFree's 2014 tax year.
- NOPA 004 issued by the IRS dated November 13, 2018 with respect to TelexFree's 2014 tax year.
- Various papers and Orders entered in this case, the case of *United States of America v. James Merrill*, 4:14-CR-40028-TSH, and *Securities & Exchange Commission v. Telexfree, Inc. et al*, 1.14-CV-11858-DJC.

Exhibit A

KPMG



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Function and Specialization
Tom specializes in representing clients before the IRS, with a focus on international matters.

Civic & Professional Associations

- Liaison to AICPA, American Bar Association Section of Taxation
- Member, Boston Tax Forum
- Past-chair, Boston Bar Association Tax Section

Education, Licenses & Certifications

- B.A., Columbia College
- J.D., University of Connecticut

Background

Tom leads KPMG's Tax Controversy Services practice in New England and serves as a lead tax partner for firm clients.

Professional and Industry Experience

Tom and his team cover all areas of tax controversy representation, with an emphasis on international tax matters. Tom also works with firm clients on a wide variety of other sensitive tax matters. Before joining KPMG in 2008, Tom served as an attorney at the IRS Office of Chief Counsel.

Tom is an active member of his professional and local community. He serves as the liaison to the AICPA for the American Bar Association Tax Section, and is a past Council director for the ABA Tax Section. He served two terms as a member of the Wayland Finance Committee, and as a Chair for two years. Tom was also elected to two terms on the Board of Finance in Chester, Connecticut. He is a member of the Boston Tax Forum and a past chair of the Boston Bar Association Tax Section.

Tom writes frequently on tax topics, contributing articles to Tax Notes, The Tax Lawyer, and Taxes. He speaks regularly before professional organizations such as Tax Executives Institute and the ABA Tax Section.

Tom earned a BA degree, cum laude, from Columbia College, and a JD degree, with honors, from the University of Connecticut School of Law.

Selected Publications and Speaking Engagements

- *Taking Positions Contrary to Proposed Regulations*, 162 Tax Notes 71 (January 7, 2019)
- *Creative Approaches to Large-Case Tax Administration*, Tax Executive (April-May 2015)
- *Examinations (The Audit Process), in* EFFECTIVELY REPRESENTING YOUR CLIENT BEFORE THE IRS, 6TH ED. (2015)
- *Mark-to-Market Tax Accounting: Why Wait for the Government?* 145 Tax Notes 1287 (Dec. 15, 2014)
- *A Simpler Debt-Equity Test*, 66 Tax Lawyer 73 (2012)
- Mayo Foundation *Cures Tax Myopia*, TAXES (April 2011)
- *The Ethereal Angel List*, 29 ABA Tax Section NewsQuarterly I (2010)
- *International Tax Arbitrage: A Frozen Debate Thaws*, 57 Tax Notes International 4 (Jan. 25, 2010)
- *Choice of Forum in Civil Tax Litigation*, 62 TAX LAWYER 311 (2009)
- *Worldwide Taxation, Worldwide Enforcement*, 123 Tax Notes 561 (May 4, 2009)
- Tom speaks regularly before professional organizations such as Tax Executives Institute and the ABA Tax Section.

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Exhibit B

KPMG

TelexFree, LLC ("TelexFree") - Expert Report Exhibit B

	Original Return	Amended Return	Per IRS
2012			
Taxable Income	2,018,002	0	17,697,707
Tax Deficiency (Overpayment)	692,854	(692,854)	5,501,344
2013			
Taxable Income	(2,101,985,935)	(3,143,852)	1,156,156,694
Tax Deficiency (Overpayment)	(15,858,111)	(15,792,982)	404,654,843
2014			
Taxable Income	(2,288,625,710)	(535,594,148)	2,055,111,458
Tax Deficiency (Overpayment)	0	0	719,289,010
Total			
Taxable Income	(4,388,593,643)	(538,738,000)	3,228,965,859
Tax	(15,165,257)	(16,485,836)	1,129,445,197

**The summary above does not consider penalties, interest, or any net operating losses that may be available from subsequent years.*

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TelexFree - Expert Report Exhibit B

2012					
	Form 1120 Relevant Lines and Description		Original Return (1)	Amended Return (2)	Per IRS (3)
Income	1a	Gross Receipts	2,193,079	18,220,915	18,220,915
		Direct Receipts	-	*2,943,517*	*2,943,517*
		Indirect Credit Redemptions	-	*3,407,954*	*3,407,954*
		Ympactus Service Income	-	*11,869,444*	*11,869,444*
	1b	Returns and Allowances	113,012	248,692	248,692
	2	Cost of Goods Sold	-	105,363	105,363
	3	Gross Profit (line 1a less 1b less 2)	2,080,067	17,866,860	17,866,860
	5	Interest	-	-	-
	11	**Total Income**	2,080,067	17,866,860	17,866,860
Deductions	13	Salaries and Wages	-	400	400
	16	Rents	-	8,028	8,028
	17	Taxes and Licenses	-	-	-
	20	Depreciation	-	15,121	15,121
	22	Advertising	-	1,550	1,550
	26	Other Deductions	62,065	4,405,900	144,054
		Gross Credit Liability Accrual[4]	-	*4,261,846*	-
		Travel, Meals and Entertainment	*221*	*726*	*726*
		Bank Charges	*20*	*17,586*	*17,586*
		Merchant Fees	*61,824*	*84,712*	*84,712*
		Filing Fees	-	*1,104*	*1,104*
		Miscellaneous	-	*512*	*512*
		Office Expenses	-	*466*	*466*
		Office Supplies	-	*2,441*	*2,441*
		Professional Fees	-	*23,933*	*23,933*

2012					
	Form 1120 Relevant Lines and Description		Original Return (1)	Amended Return (2)	Per IRS (3)
		Product Development	-	*6,320*	*6,320*
		Refund/Chargebacks, Charged Twice, Fraud, No Docs	-	-	-
		Small Items Not Capitalized	-	*6,254*	*6,254*
	27	**Total Deductions**	62,065	4,430,999	169,153
	28	**Taxable Income before NOL (line 11 less 27)**	2,018,002	13,435,861	17,697,707
	29a	Net Operating Loss Deduction	-	13,435,861	-
	30	**Taxable Income (line 28 less 29a)**	2,018,002	-	17,697,707
	31	**Total Tax**	692,854	-	6,194,198
Payments	32	Total Payments	-	692,854	692,854
	34	Amount Owed	692,854	-	5,501,344
	35	Overpayments	-	692,854	-

Note 1: It is our understanding that the original return was filed by Joe Craft, TelexFree's former Chief Financial Officer, who was complicit in the Ponzi/Pyramid scheme.

Note 2: In September 2016, an amended return was prepared by KPMG and filed by TelexFree, reporting no tax liability and claiming a refund of amounts paid with respect to the 2012 tax year ("Refund Claim"). The Refund Claim was based on the best available information at the time. In March 2018, KPMG prepared and TelexFree provided the IRS with a revised amended return in support of its Refund Claim to report items of income and deductions based on reconstructed transaction data in SIG, and to capture activity for all TelexFree entities on TelexFree's return ("Amended Return"). Similar to the Refund Claim, the Amended Return reported that TelexFree had no tax liability for the 2012 tax year. We show the items reported on the Amended Return here.

Note 3: The IRS is barred by the statute of limitations from assessing additional tax with respect to the Taxpayer's 2012 tax year. If the IRS had processed the Amended Return filed in March 2018, however, presumably the IRS would have taken the position that TelexFree had taxable income of $17,697,707, consistent with the position the IRS has taken with respect to returns filed for the 2013 and 2014 tax years.

Note 4: TelexFree claimed a $4,261,846 deduction on its Amended Return for credits issued to members of the Ponzi/pyramid scheme for advertising, VoIP package sales, and recruiting conducted by the participants.

KPMG

TelexFree - Expert Report Exhibit B

			2013		
	Form 1120 Relevant Lines and Description		Original Return (1)	Amended Return (2)	Per IRS (3)
Income	1a	Gross Receipts	865,893,525	1,173,886,556	1,173,886,556
		Direct Receipts	*119,468,920*	*156,227,156*	*156,227,156*
		Indirect Credit Redemptions	*572,240,960*	*843,475,755*	*843,475,755*
		Ympactus Service Income	*174,183,645*	*174,183,645*	*174,183,645*
	1b	Returns and Allowances	2,092,676	3,273,922	3,273,922
	2	Cost of Goods Sold	2,263,477	2,661,213	2,661,213
	3	Gross Profit (line 1a less 1b less 2)	861,537,372	1,167,951,421	1,167,951,421
	5	Interest	2,732	2,732	2,732
	11	**Total Income**	861,540,104	1,167,954,153	1,167,954,153
Deductions	13	Salaries and Wages	3,507	119,285	119,285
	15	Bad Debts [4]	186,344,898	186,344,898	-
	16	Rents	10,604	42,806	42,806
	17	Taxes and Licenses	26,356	40,366	40,366
	18	Interest	14,127	15,362	15,362
	20	Depreciation	86,543	243,373	243,373
	22	Advertising	16,569	25,547	25,547
	26	Other Deductions	2,777,023,435	984,266,367	11,310,719
		Gross Credit Liability Accrual [5]	*2,774,233,174*	*972,955,648*	-
		Travel, Meals and Entertainment	*137,011*	*194,012*	*194,012*
		Bank Charges	*255,369*	*299,799*	*299,799*
		Credit Card Fees	*16*	*284*	*284*
		Events	*109,455*	*114,038*	*114,038*
		Filing and Registered Agent Fees	*1,579*	*1,579*	*1,579*
		Legal and Professional Fees	*431,347*	*455,791*	*455,791*
		Management and Marketing	-	*4,357,420*	*4,357,420*
		Miscellaneous	*33,150*	*33,500*	*33,500*
		Office Expenses	*13,408*	*17,372*	*17,372*
		Other Expenses	-	*4,168*	*4,168*
		Payroll Reimbursement	*58,006*	-	-
		Payroll Fees	*545*	*997*	*997*
		Postage	*114*	*1,599*	*1,599*
		Personnel	*18,750*	*18,750*	*18,750*
		Professional Consultant IT	-	*33,750*	*33,750*
		Sales and Promotional Expenses	*110,894*	*118,594*	*118,594*
		Small Tools and Equipment	*728*	*3,417*	*3,417*
		Supplies	*1,956*	*2,509*	*2,509*
		Merchant Fees	*1,038,788*	*5,064,925*	*5,064,925*
		Product Development	*6,000*	*6,000*	*6,000*
		Software Development	*81,288*	*81,288*	*81,288*

2013					
	Form 1120 Relevant Lines and Description		Original Return (1)	Amended Return (2)	Per IRS (3)
		Contract Labor	*50,525*	*59,443*	*59,443*
		Information Technology	*440,682*	*440,682*	*440,682*
		Travel Meals	-	*22*	*22*
		Website	*650*	*780*	*780*
	27	**Total Deductions**	2,963,526,039	1,171,098,004	11,797,458
	28	**Taxable Income before NOL (line 11 less 27)**	(2,101,985,935)	(3,143,852)	1,156,156,694
	29a	Net Operating Loss Deduction	-	-	-
	30	**Taxable Income (line 28 less 29a)**	(2,101,985,935)	(3,143,852)	1,156,156,694
	31	**Total Tax** [6]	-	-	404,654,843
Payments	32	Total Payments [7]	15,858,111	15,792,982	-
	34	Amount Owed	-	-	404,654,843
	35	Overpayments	15,858,111	15,792,982	-

Note 1: In September 2016, KPMG prepared and TelexFree filed its original return, which reported no tax liability and requested a refund of amounts paid with respect to its 2013 tax year. The original return was prepared based on the best available information at the time.

Note 2: In March 2018, the 2013 return was amended to (i) address inconsistencies between SIG and the profit and loss statement used to prepare the original return, and (ii) to include the activities of all TelexFree entities on TelexFree's return.

Note 3: In a statutory notice of deficiency, the IRS proposed a 2013 tax deficiency in the amount of $300,507,248 based on TelexFree's original return. We assume the IRS would take the position that TelexFree had taxable income of $1,156,156,694 since the 2013 amended return reported more income than the original return.

Note 4: Over the course of 2012 and 2013, TelexFree included in income a net receivable totaling at least $186,053,089 from an affiliate, Ympactus. Ympactus's operations ceased and all of its assets were seized by the Brazilian authorities in 2013, rendering the debt unrecoverable. Accordingly, TelexFree booked an offsetting bad debt expense of $186,344,898, which was reported on the returns KPMG prepared on TelexFree's behalf. The IRS proposed to disallow the bad debt

Note 5: The IRS proposed to disallow in full the deduction claimed on TelexFree's original return for credits issued to members of the Ponzi/pyramid scheme for advertising, VoIP package sales, and recruiting. On the original return, the deduction claimed for such expense was $2,774,233,174. This deduction was reduced to $972,955,648 on the amended return based on the reconstructed data in SIG.

Note 6: In the statutory notice of deficiency, the IRS proposed a late filing penalty under IRC § 6651(a)(1) of $75,126,857, which is in addition to any tax due.

Note 7: The total payments amount reported on the amended return was updated to reflect IRS records.

KPMG

TelexFree - Expert Report Exhibit B

2014					
	Form 1120 Relevant Lines and Description		**Original Return (1)**	**Amended Return (2)**	**Per IRS (3)**
Income	1a	Gross Receipts	163,113,395	2,067,416,945	2,067,416,945
		Direct Receipts	*163,113,395*	*200,621,569*	*200,621,569*
		Indirect Credit Redemptions	-	*1,866,795,376*	*1,866,795,376*
		Ympactus Service Income	-	-	-
	1b	Returns and Allowances	-	1,425	1,425
	2	Cost of Goods Sold	1,563,042	1,563,042	1,563,042
	3	Gross Profit (line 1a less 1b less 2)	161,550,353	2,065,852,478	2,065,852,478
	5	Interest	-	-	-
	11	**Total Income**	161,550,353	2,065,852,478	2,065,852,478
Deductions	13	Salaries and Wages	19,170	19,170	19,170
	14	Repairs and Maintenance	990	990	990
	16	Rents	30,763	30,763	30,763
	17	Taxes and Licenses	61,291	61,291	61,291
	22	Advertising	17,721	17,721	17,721
	26	Other Deductions	2,450,046,128	2,601,316,691	10,611,085
		Gross Credit Liability Accrual [4]	*2,442,705,606*	*2,442,705,606*	-
		Casualty Loss Deduction [5]	-	*148,000,000*	-
		Estate Operating Expenses	-	*3,271,988*	*3,271,988*
		Travel, Meals and Entertainment	*34,021*	*34,021*	*34,021*
		Bank Charges	*3,629*	*3,629*	*3,629*
		Consulting Expense	*3,896,209*	*3,896,209*	*3,896,209*
		Events	*6,668*	*6,668*	*6,668*
		Filing and Registered Agent Fees	*269,145*	*269,145*	*269,145*
		Legal and Professional Fees	*2,140,637*	*2,140,637*	*2,140,637*
		Office Expenses	*11,482*	*11,482*	*11,482*
		Payroll Expenses	*21,451*	*21,451*	*21,451*
		Postage	*90*	*90*	*90*
		Personnel	*47,344*	*47,344*	*47,344*

2014					
	Form 1120 Relevant Lines and Description		Original Return (1)	Amended Return (2)	Per IRS (3)
		Refund	*1,425*	-	-
		Small Tools and Equipment	*1,749*	*1,749*	*1,749*
		Merchant Fees	*313,623*	*313,623*	*313,623*
		Software Development	*51,684*	*51,684*	*51,684*
		Contract Labor	*283,642*	*283,642*	*283,642*
		Information Technology	*257,663*	*257,663*	*257,663*
		Website	*60*	*60*	*60*
	27	**Total Deductions**	2,450,176,063	2,601,446,626	10,741,020
	28	**Taxable Income before NOL (line 11 less 27)**	(2,288,625,710)	(535,594,148)	2,055,111,458
	29a	Net Operating Loss Deduction	-	-	-
	30	**Taxable Income (line 28 less 29a)**	(2,288,625,710)	(535,594,148)	2,055,111,458
	31	**Total Tax** [6]	-	-	719,289,010
Payments	32	Total Payments	-	-	-
	34	Amount Owed	-	-	719,289,010
	35	Overpayments	-	-	-

Note 1: In July 2017, KPMG prepared and TelexFree filed an original return that reported no tax liability for the 2014 tax year.

Note 2: In March 2018, the 2014 return was amended to (i) address inconsistencies between SIG and the profit and loss statements used to prepare the original return, and (ii) claim additional deductions that were not included on the original return (i.e., a casualty loss deduction for assets frozen or seized by court order in 2014, and bankruptcy estate operating expenses).

Note 3: The IRS has not yet issued a statutory notice of deficiency for 2014, we assume the IRS would take the position that TelexFree generated $2,055,111,458 in taxable income in 2014 based on the proposed adjustments to TelexFree's original and amended return.

Note 4: The IRS proposed to disallow in full the $2,442,705,606 deduction TelexFree claimed for credits issued to members of the Ponzi/pyramid scheme for advertising, VoIP package sales, and recruiting.

Note 5: The IRS proposed to disallow in full the $148,000,000 casualty loss deduction TelexFree sustained when its assets were frozen or seized by court order. These losses were not reported on the original return because the return already showed a $2.3 billion loss.

Note 6: In a Notice of Proposed Adjustment, the IRS proposed a late filing penalty under IRC § 6651(a)(1) of $13,481,991, which is in addition to any tax due.

Exhibit C

UNITED STATES BANKRUPTCY COURT
DISTRICT OF MASSACHUSETTS
CENTRAL DIVISION

In re:	Chapter 11 Cases
TELEXFREE, LLC, TELEXFREE, INC. TELEXFREE FINANCIAL, INC., Debtors.	14-40987-MSH 14-40988-MSH 14-40989-MSH

ORDER AUTHORIZING THE CHAPTER 11 TRUSTEE TO RETAIN AND EMPLOY KPMG LLP AS TAX COMPLIANCE ACCOUNTANT AND TAX CONSULTANT

Upon the application (the "Application") of the Chapter 11 Trustee, in the above-captioned Chapter 11 cases (the "Trustee"), for the entry of an order pursuant to sections 327(a) and 1107(a) of title 11 of the United States Code, 11 U.S.C. §§ 101-1532 (the "Bankruptcy Code"), Rule 2014(a) of the Federal Rules of Bankruptcy Procedure (the "Bankruptcy Rules") and the Local Rules of Bankruptcy Practice and Procedure of the United States Bankruptcy Court for the District of Massachusetts (the "Local Rules"), authorizing the Trustee to employ and retain KPMG LLP ("KPMG)") as tax compliance accountant and tax consultants to the Trustee in the above-captioned chapter 11 cases;[1] and upon the Declaration of Joseph W. Middleton, a CPA and partner at KPMG (the "Declaration") in support thereof; and the Court being satisfied based on the representations made in the Application and in the Declaration that KPMG represents no interest adverse to the Debtors' estates with respect to the matters upon which they are to be engaged, that they are disinterested persons as that term is defined under section 101(14) of the Bankruptcy Code, as modified by section 1107(b) of the Bankruptcy Code, and that their employment is necessary and in the best interests of the Trustee, the Debtors'

[1] Capitalized terms not otherwise defined herein shall have the definitions ascribed to them in the Application.

estates and their creditors; the terms of the Engagement Letter are reasonable terms for the purposes of section 327 of the Bankruptcy Code; and consideration of the Application and the relief requested therein being a core proceeding pursuant to 28 U.S.C. § 157(b); and venue being proper before this Court pursuant to 28 U.S.C. §§ 1408 and 1409; and due and proper notice of the Application having been provided; and it appearing that no other or further notice need be provided; and after due deliberation and sufficient cause appearing therefore, it is hereby:

ORDERED that the Application is granted as modified herein; and it is further

ORDERED that in accordance with sections 327(a) and 1107(a) of the Bankruptcy Code, Bankruptcy Rule 2014, and Local Rule 2014-1, the Trustee is authorized to employ and retain KPMG as tax compliance accountant and tax consultants to the Trustee on the terms set forth in the Application and the Engagement Letter, as modified by this Order; and it is further

ORDERED that KPMG shall be compensated in accordance with sections 330 and 331 of the Bankruptcy Code, the Bankruptcy Rules, the Local Rules, this Order and any other applicable orders of this Court; and it is further

ORDERED that the terms and conditions of the Engagement Letter, as modified by this Order, are approved; and it is further

ORDERED that to the extent the Trustee and KPMG enter into any additional engagement letter(s), the Trustee will file such engagement letter(s) with the Bankruptcy Court and serve such engagement letter(s) upon the applicable notice parties. All additional services will be subject to the provisions of this Order and any subsequent orders that may be entered; and it is further

ORDERED that the following terms apply during the pendency of the Chapter 11 cases:

(a) KPMG shall not be entitled to indemnification, contribution or reimbursement for services other than those described in the Engagement

Letter and the Application, unless such services and indemnification therefor are approved by the Court;

(b) The Debtors shall have no obligation to indemnify KPMG, or provide contribution or reimbursement to KPMG, for any claim or expense that is either: (i) judicially determined (the determination having become final) to have arisen from KPMG's bad faith, self-dealing, breach of fiduciary duty (if any such duty exists), gross negligence or willful misconduct; or (ii) judicially determined (the determination having become final), based on a breach of KPMG's contractual obligations to the Debtor; or (iii) settled prior to a judicial determination as to the exclusions set forth in clauses (i) and (ii) immediately above, but determined by the Court, after notice and a hearing to be a claim or expense for which KPMG should not receive indemnity, contribution or reimbursement under the terms of KPMG's retention by the Debtors pursuant to the terms of the Engagement Letter and Application, as modified by this Order; and

(c) If, before the later of: (i) the entry of an order confirming a chapter 11 plan in this case (that order having become a final order no longer subject to appeal); and (ii) the entry of an order closing these chapter 11 cases, KPMG believes that it is entitled to the payment of any amounts by the Debtors on account of the Debtors' indemnification, contribution and/or reimbursement obligations under the Engagement Letter (as modified by this Order) and Application, including without limitation the advancement of defense costs, KPMG must file an application therefor in this Court, and the Debtors may not pay any such amounts to KPMG before the entry of an order by this Court approving the payment. This subparagraph (c) is intended only to specify the period of time under which the Court shall have jurisdiction over any request for fees and expenses by KPMG for indemnification, contribution or reimbursement, and not a provision limiting the duration of the Debtors' obligation to indemnify KPMG. All parties in interest shall retain the right to object to any demand by KPMG for indemnification, contribution or reimbursement; and it is further

ORDERED that during the pendency of the Chapter 11 cases, the first sentence of paragraph 6 and all of paragraph 8(b) of the Standard Terms and Conditions are deleted; and it is further

ORDERED that notwithstanding anything in the Application or the Engagement Letter or Standard Terms and Conditions attached hereto to the contrary, (i) during the pendency of the Chapter 11 cases, this Court retains exclusive jurisdiction over all matters arising out of and/or

pertaining to KPMG's engagement until such jurisdiction is relinquished, and (ii) the engagement shall be governed by the laws of the Commonwealth of Massachusetts without regard to its conflict of laws provisions; and it is further

ORDERED that during the pendency of the Chapter 11 cases, this Court shall retain jurisdiction with respect to any matters, claims, rights or disputes arising from or related to the implementation of this Order.

Dated: October 1, 2015

HONORABLE MELVIN S. HOFFMAN
CHIEF UNITED STATES BANKRUPTCY JUDGE

692706

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April 17, 2019

Mr. Stephen B. Darr
Trustee for TelexFree, LLC, TelexFree, Inc., and TelexFree Financial, Inc.
c/o Huron Consulting Group, Inc.
100 High Street #2301
Boston, MA 02110

Re: Expert Report/Testimony for TelexFree Consolidated Chapter 11 Cases: (1) 14-40987-MSH; (2) 14-40988-MSH; and (3) 14-40989-MSH.

Dear Steve:

This letter ("Engagement Letter") confirms our understanding and agreement between you, as Chapter 11 Trustee ("Trustee") for TelexFree, LLC, TelexFree, Inc., and TelexFree Financial, Inc. (the "TelexFree Companies") and KPMG LLP ("KPMG") whereby Trustee has engaged KPMG to provide advisory services in connection with the above referenced matter.

Understanding of Our Role

KPMG's work is to assist Trustee in a dispute with the Internal Revenue Service ("IRS") regarding the TelexFree Companies' federal income tax liabilities for the 2012, 2013, and 2014 taxable years in the above-referenced matter and to perform such other tasks as may be identified and mutually agreed to during the course of this engagement. KPMG understands that Trustee intends to submit to the United States Bankruptcy Court an expert opinion in the form of a written report from KPMG, prepared by Thomas Greenaway, and to call Mr. Greenaway to give expert testimony at the trial.

All observations and recommendations will be those of the KPMG personnel working on this matter. Trustee will make available to KPMG, in a timely manner, the information necessary for KPMG to complete the services under this Engagement Letter. Trustee acknowledges that the Trustee's failure to do so could adversely affect KPMG's ability to provide services under this Engagement Letter. KPMG will make all requests for documents through Trustee.

Conflicts

At the present time, the Trustee has informed KPMG there are no other parties involved in this matter that would require KPMG to perform an internal search for relationships. If identified during the course of this engagement, the Trustee agrees that it will inform KPMG of other parties to this matter. At such time, KPMG will perform a limited internal search for relationships on those parties.

If identified, KPMG will advise the Trustee of the general nature of any services provided by KPMG, or other member firms of the KPMG network of independent firms and firms and entities controlled by, or under common control with, one or more such member firms (collectively, "Member Firms") to the parties (i.e., audit, tax and/or advisory).

KPMG LLP is a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity

KPMG

If the Trustee fails to promptly notify KPMG of its objection to any identified relationships, the Trustee agrees that the identified relationships do not (i) constitute a limitation on the services requested, (ii) create a basis for disqualification of KPMG or its professionals, or (iii) constitute a conflict of interest for purposes of KPMG's engagement to perform the services under this Engagement Letter for the Trustee. The Trustee expressly waives its right to assert any such conflict against KPMG.

KPMG's process for conducting searches of potential conflicts takes place at the time the parties are identified and provided by the Trustee. However, if KPMG becomes aware of any potential conflicts after the start of the engagement, KPMG will promptly inform the Trustee. In addition, during the course of this engagement, the Trustee agrees that he will inform KPMG of additional parties in this matter or name changes for those parties previously provided. At such time, KPMG will perform an additional limited internal search for relationships on those parties. If identified, KPMG will advise the Trustee of the general nature of any services provided to that subject (i.e., audit, tax and/or advisory).

KPMG reserves the right to resign from this engagement at any time if a conflict, as contemplated by the professional standards of the AICPA, law or regulation, arises or becomes known to KPMG that prohibits KPMG from conducting this engagement, or in KPMG's judgment, would impair KPMG's ability to perform objectively. If KPMG serves as independent auditors of a party, KPMG may require consent from the party, which will be determined on a case-by-case basis.

Engagement Staffing

I, Thomas Greenaway, will participate as Engagement Partner, maintaining overall responsibility for the engagement, including billing and client relations. Michelle Marion will serve as the engagement Manager and will be actively involved in the performance of the engagement and will use such other staff for assistance as deemed necessary.

Indemnification and Limitation of Liability[1]

The Trustee agrees to indemnify and hold harmless KPMG, the other Member Firms, and their affiliates, and their respective partners, principals, employees, and agents (collectively, the "KPMG Parties") from any and all liabilities, costs, and expenses (including, without limitation, attorney's fees and expenses), claims, demands, actions, proceedings, recoveries, settlements or judgments brought against, paid, incurred or suffered by or asserted against any of the KPMG Parties in connection with a third party claim by reason of, or in any way relating to this engagement, other than as finally determined by the arbitration panel contemplated in the Alternative Dispute Resolution section of this Engagement Letter to be caused by KPMG or the applicable KPMG Party's own bad faith or willful misconduct. The foregoing indemnification obligation shall apply regardless of whether the third party claim alleges a breach of contract, violation of statute or tort (including without limitation negligence) by KPMG or the applicable KPMG Party. KPMG shall promptly notify the Trustee of any claim for which a KPMG Party seeks indemnification.

KPMG and the other KPMG Parties shall have no liability to Trustee or the TelexFree Companies or to any other person or entity for any action taken or omitted to be taken by KPMG or any of the other KPMG Parties in respect of this engagement, except for matters that are finally determined by the arbitration panel contemplated

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[1] Subject to the "Order Authorizing the Chapter 11 Trustee to Retain and Employ KPMG LLP as Tax Complinace Accountant and Tax Consultant" entered October 1, 2015



in the Alternative Dispute Resolution section of this Engagement Letter to be caused by KPMG or the applicable KPMG Parties' own bad faith or willful misconduct. The provisions of this paragraph shall apply regardless of the form of action, damage, claim, liability, cost, expense or loss asserted, whether in contract, statute, tort (including but not limited to negligence) or otherwise.

Alternative Dispute Resolution[2]

Any dispute or claim arising out of or relating to this Engagement Letter or the services provided hereunder shall be submitted first to non-binding mediation (unless either party elects to forego mediation by initiating a written request for arbitration) and if mediation is not successful within 90 days after the issuance by one of the parties hereto of a request for mediation then to binding arbitration in accordance with the Rules for Non-Administered Arbitration of the International Institute for Conflict Prevention and Resolution ("CPR Arbitration Rules"). Any issue concerning the extent to which any dispute is subject to arbitration, or any dispute concerning the applicability, interpretation, or enforceability of these dispute resolution procedures, including any contention that all or part of these procedures is invalid or unenforceable, shall be governed by the Federal Arbitration Act and resolved by the arbitrators. By operation of this provision, the parties hereto agree to forego litigation over such disputes in any court of competent jurisdiction.

Mediation, if selected, may take place at a location to be designated by the parties using Mediation Procedures of the International Institute for Conflict Prevention and Resolution, with the exception of paragraph 2 (Selecting the Mediator). Arbitration shall take place in New York, New York. The arbitration panel shall have no power to award non-monetary or equitable relief of any sort except as provided in CPR Rule 13 (Interim Measures of Protection). Damages that are inconsistent with any applicable agreement between the parties, that are punitive in nature, or that are not measured by the prevailing party's actual damages shall be unavailable in arbitration or any other forum. In no event, even if any other portion of these provisions is held to be invalid or unenforceable, shall the arbitration panel have power to make an award or impose a remedy that could not be made or imposed by a court deciding the matter in the same jurisdiction.

Any party hereto may seek to enforce any written agreement reached by the parties during mediation, or to confirm and enforce any final award entered in arbitration, in any court of competent jurisdiction. Notwithstanding the agreement to such procedures, any party hereto may seek equitable relief to enforce its rights in any court of competent jurisdiction.

Timing and Professional Fees

KPMG is prepared to begin work upon receipt of a signed copy of this Engagement Letter, with the start date anticipated on or about April 16, 2019, or at a time mutually determined by Trustee and KPMG.

KPMG's fees for these services will be based on hourly rates and any out-of-pocket expenses incurred by KPMG in connection with the performance of the services herein. KPMG's professional fees for these services are based upon the level of experience of the professionals providing the services and the amount of time required to complete the engagement.

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[2] Subject to the "Order Authorizing the Chapter 11 Trustee to Retain and Employ KPMG LLP as Tax Complinace Accountant and Tax Consultant" entered October 1, 2015

KPMG

KPMG's current hourly rates by professional level for these services are:

Professional	Hourly Rate
Partner/Director	$900
Senior Manager	$750
Manager	$600
Senior Tax Associate	$500
Tax Associate	$400

Notwithstanding the hourly rates shown above, our fees for this engagement will not exceed a blended rate of $650 per billing cycle for all professionals involved.

Because of the unpredictable nature of a dispute, KPMG generally does not attempt to quantify the total expected fees in the matter prior to commencing work. The time incurred by KPMG will depend on the extent and nature of available information, the outcome of certain procedural and legal tasks, and on information that KPMG's procedures may reveal as work progresses. KPMG will work closely with Trustee to make this engagement cost effective.

KPMG's fees and expenses are not contingent upon the final results, nor does KPMG guarantee any result or resolution in the above-referenced matter.

In addition, KPMG will be compensated for any time and expenses (including fees and expenses of legal counsel) that may be incurred in considering or responding to discovery requests or other requests for documents or information, or in participating as a witness or otherwise in any legal, regulatory or other proceedings, as a result of KPMG's performance of these services.

Where KPMG is reimbursed for expenses, it is KPMG's policy to bill clients the amount incurred at the time the good or service is purchased. If KPMG subsequently receives a volume rebate or other incentive payment from a vendor relating to such expenses, KPMG does not credit such payment to client. Instead, KPMG applies such payments to reduce its overhead costs, which costs are taken into account in determining KPMG's standard billing rates and certain transaction charges which may be charged to clients.

All fees, charges and other amounts payable to KPMG under the Engagement Letter do not include any sales, use, excise, value added or other applicable taxes, tariffs or duties, payment of which shall be the Trustee's sole responsibility, excluding any applicable taxes based on KPMG's net income or taxes arising from the employment or independent contractor relationship between KPMG and its personnel.

Other Matters

Subject to the "Order Authorizing the Chapter 11 Trustee to Retain and Employ KPMG LLP as Tax Complinace Accountant and Tax Consultant" entered October 1, 2015, all disputes with regard to, arising out of, or relating to services provided pursuant to this Engagement Letter (whether based in contract, tort, statute, regulation, or otherwise and whether pending in court or in an arbitral forum) shall be governed by and construed in accordance with the substantive and procedural laws of the State of New York, including without limitation, its statutes of limitations, without regard to the conflict of laws provisions of New York or any other state or jurisdiction.

KPMG understands that its work product and files may become subject to discovery; however, until such materials are sought by subpoena or other process, they will be maintained by KPMG as confidential. It is



agreed that KPMG's work product and filesand all other working papers and other documents prepared by KPMG pursuant to this engagement will be maintained as confidential materials and will not be disclosed to third parties without Trustee's consent, except as may be required by law, regulation, or judicial or administrative process. KPMG agrees to notify Trustee promptly of any of the following events: (a) a request by anyone to examine, inspect, or copy such documents or records; or (b) any attempt to serve, or the actual service of, any court order, subpoena, or summons upon KPMG that requires the production of such documents or records. It is further understood that if KPMG is not requested by Trustee to provide expert testimony or an expert report in connection with this matter, all opinions of KPMG personnel and work product shared by KPMG with Trustee shall be maintained as confidential and shall not be shared with any other person or entity.

KPMG's services as described in this Engagement Letter constitute an Advisory engagement conducted under the AICPA Standards for Consulting Services. Such services are not intended to be an audit, examination, attestation, special report or agreed-upon procedures engagement as those services are defined in AICPA literature applicable to such engagements conducted by independent auditors. Accordingly, these services will not result in the issuance of a written communication to third parties by KPMG directly reporting on financial data or internal control or expressing a conclusion or any other form of assurance.

KPMG may communicate with Trustee by electronic mail or otherwise transmit documents in electronic form during the course of this engagement. Trustee accepts the inherent risk of these forms of communication (including the security risks of interception of or unauthorized access to such communications, the risks of such corruption of such communications and the risks of viruses or other harmful devices) and agrees that it may rely only upon a final hardcopy version of a document or other communication that KPMG transmits to Trustee unless no such hard copy is transmitted by KPMG to Trustee.

KPMG uses the services of third party service providers within and outside of the United States to provide at KPMG's direction administrative, analytical and clerical support services to KPMG. These parties may have access to certain of your information including confidential information. KPMG represents to Trustee that each such Member Firm or third party service provider has agreed to conditions of confidentiallty with respect to such information to the same or similar extent as KPMG has agreed to herein.

KPMG has full responsibility to cause these parties to comply with such conditions of confidentiality and KPMG shall be responsible for any consequences of their failure to comply. Accordingly, Trustee consents to KPMG's disclosure to a Member Firm or third party service provider and the use by them of data and information including confidential information, received from or at the request or direction of Trustee for the purposes set forth in this Engagement Letter. Trustee further agrees that any claim relating to the services under the Engagement Letter may only be made against KPMG and not any other Member Firm or third party service provider referred to above.

Conflict Waiver

As we discussed, due to our preparation of returns in connection with the TelexFree Companies' Chapter 11 Bankruptcy proceedings, a potential conflict of interest may exist with respect to our representation of Trustee in proceedings before the United States Bankruptcy Court on the same matter.

However, if Trustee desires to retain KPMG to represent Trustee on this matter, Trustee hereby agrees that any assistance provided by KPMG at the request of Trustee with respect to the advisory services described herein should not constitute a conflict of interest for KPMG in light of the services that KPMG has previously provided to Trustee. However, to the extent that any assistance provided by KPMG at the request of Trustee

KPMG

with respect to the advisory services described herein is or may be considered a conflict of interest, Trustee hereby consents to a waiver of its rights to assert any such conflict against KPMG.

Applicable Standards

If KPMG is considered to be a tax return preparer under Treasury Regulation §301.7701-15, we will apply elevated standards in providing tax advice. These standards are dependent on certain characteristics of the entity to which our services will be directed as follows:

1. For U.S. public companies or "large private entities" (i.e., private entities with prior year gross revenues of $300 million or more): We must be able to determine that (1) there is "substantial authority" for an undisclosed return position and (2) a disclosed return position has at least a "realistic possibility" of being sustained on its merits. The laws of some states (e.g., New York) also may impose more stringent return preparation standards for state tax returns. For advice pertaining to a "Tax Shelter" (as defined in IRC §6662(d)(2)(C)(ii)) or a "reportable transaction" with a significant purpose of tax avoidance, the return positions must be at least "more likely than not" to be sustained on the merits; if the taxpayer is advised regarding potential taxpayer penalties, there must be "substantial authority" for our advice.

2. For "other private entities" (i.e., entities that do not fall within the definitions above as a U.S. public company or large private entity): The return position must be at least "more likely than not" sustained on the merits.

3. If a return position relates to a transaction that is a "principal purpose transaction," we must arrive at a "should" confidence level with respect to the position.

4. We will not render any advice with respect to a federal or state "listed transaction" or any transaction that is substantially similar to a federal or state "listed transaction."

In determining whether a return position meets the appropriate standard, we will not take into account the possibility that a tax return will not be audited, that an issue will not be raised on audit, or that an issue will be settled. We will inform you as soon as possible if, during our analysis, we determine circumstances exist that prevent us from advising you under these standards.

Written advice provided to you under this engagement letter will be based on facts, representations, assumptions, and other information you provide to us, the completeness, accuracy and timeliness of which are critical factors in our ability to timely and accurately complete our services. Unless you request and we agree under a separate writing (a newly issued engagement letter or addendum to this engagement letter) after our advice has been issued in final form to you, KPMG will not update our advice to take into account your updating the facts you provide to us through your discovery of new or additional facts, or your updating any information that may have formed the basis of any assumptions we made in developing our advice. In rendering advice, we will consider tax authorities that are subject to change, retroactively and/or prospectively, and any such changes could affect the advice we issue to you.

KPMG

Entire Agreement[3]

This Engagement Letter constitutes the entire agreement between KPMG and Trustee with respect to the services under this Engagement Letter and supersedes all other oral and written representation, understandings or agreements relating thereto.

Any work performed in connection with this engagement before the execution date of this letter is also governed by the terms of this letter.

Very truly yours,

KPMG LLP

Thomas Greenaway
Principal

Enclosure:

ACCEPTED

Huron Consulting Group, Inc.

Authorized Signature

Trustee
Title

4/17/19
Date

[3] Subject to the "Order Authorizing the Chapter 11 Trustee to Retain and Employ KPMG LLP as Tax Complinace Accountant and Tax Consultant" entered October 1, 2015

Exhibit D

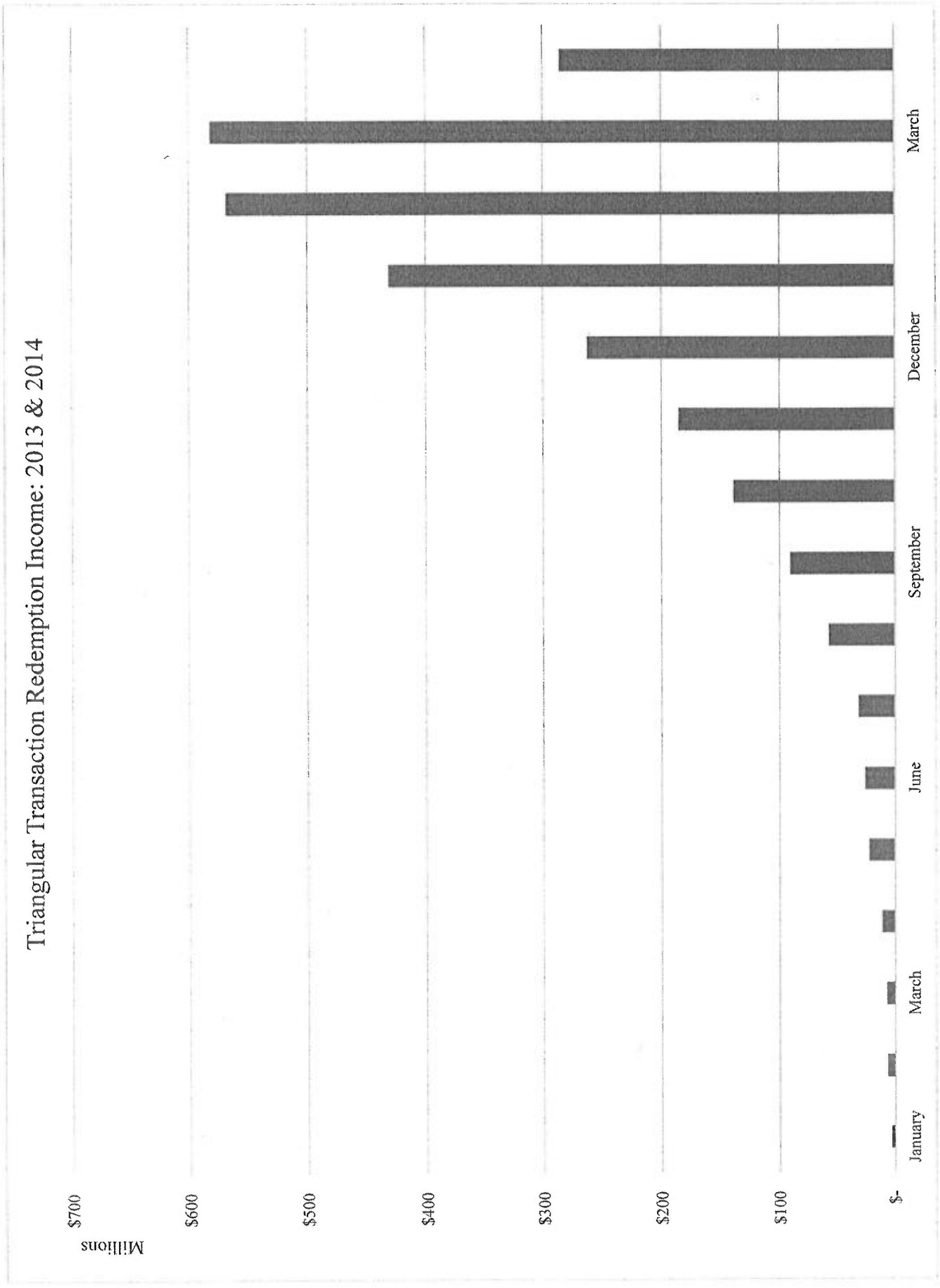
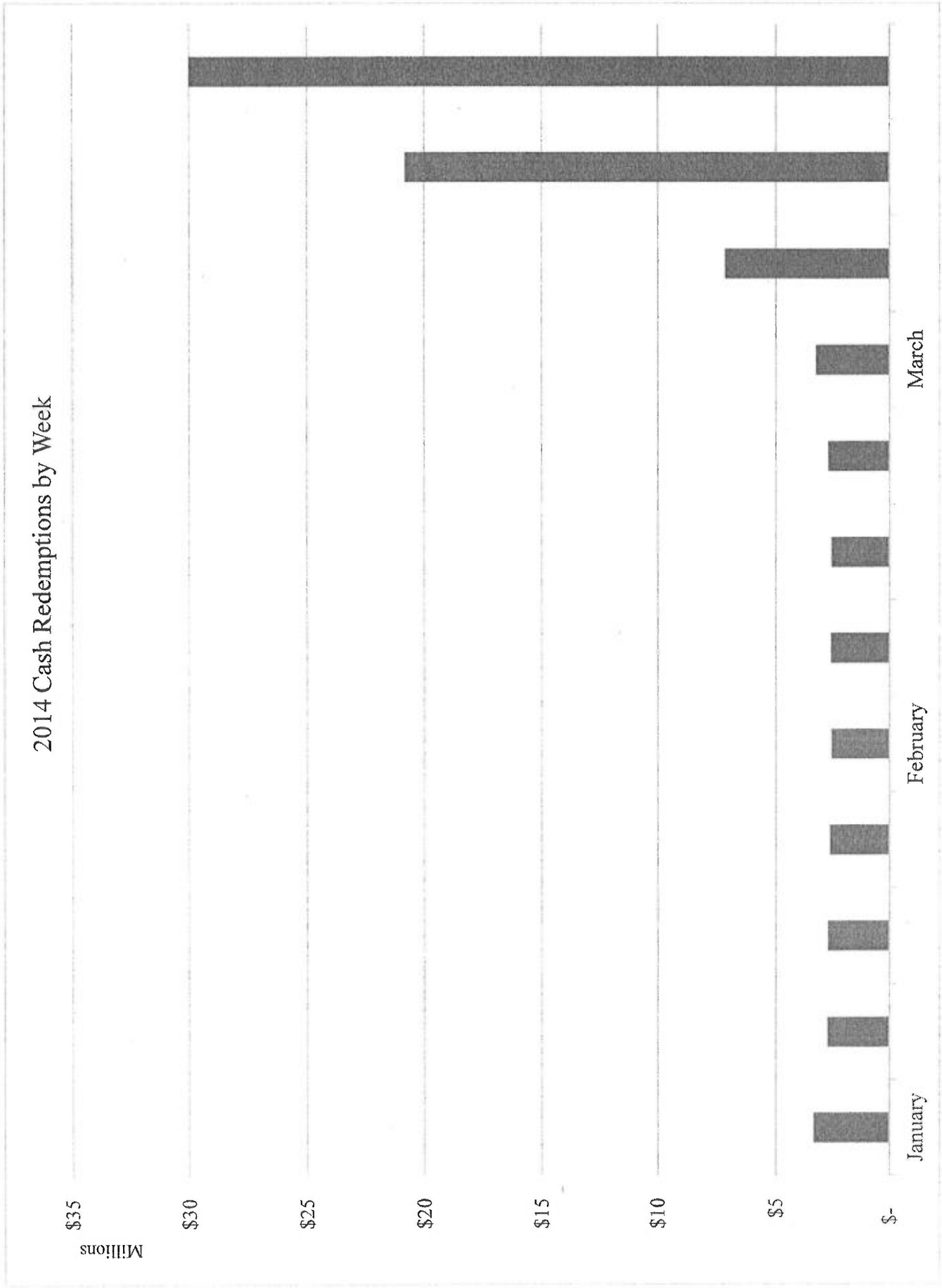

Triangular Transaction Redemption Income: 2013 & 2014
Millions
$700
$600
$500
$400
$300
$200
$100
$-
January
March
June
September
December
March

Exhibit E


2014 Cash Redemptions by Week
Millions
$35
$30
$25
$20
$15
$10
$5
$-
January
February
March

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

STATEMENT OF ASSUMED FACTS

I. BACKGROUND

1. On April 13, 2014 (the "Petition Date"), each of TelexFree, Inc., TelexFree, LLC, and TelexFree Financial, Inc. (collectively, the "Debtors" or "TelexFree") 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.

2. The Debtors initially operated as debtors-in-possession pursuant to Sections 1107 and 1108 of the Bankruptcy Code, and the cases are still pending under Chapter 11 of the Bankruptcy Code.

3. On the Petition Date, the Debtors filed a motion for joint administration of the cases, with TelexFree, LLC designated as the lead case [docket entry 4]. By order dated April 24, 2014, the order for joint administration was approved [docket entry 77].

4. TelexFree operated an illegal Ponzi or pyramid scheme. Specifically, TelexFree operated a multi-level marketing ("MLM") company engaged in the business of selling a voice over internet protocol service, or "VoIP" for a monthly charge of $49.90 to conduct international phone calls. The sale of VoIP was, however, incidental. Revenues from the sale of VoIP plans, which was ostensibly the product being sold by TelexFree, constituted less than one percent of total revenues. Less than one percent of the minutes available on VoIP plans that were sold were actually used. The primary business of TelexFree was the sale of membership plans to persons who joined TelexFree ("Participants") and who paid membership fees in order to earn credits promised by TelexFree.

5. TelexFree conducted little or no legitimate VoIP business operations.

6. TelexFree produced little or no earnings.

7. The source of payments to Participants was from cash infused by new Participants.

8. On April 15, 2014, the Securities and Exchange Commission ("SEC") commenced an action against the Debtors and others in the United States District Court for the District of Massachusetts. In connection with the commencement of the SEC action, the United States seized $148,000,000 of the Debtors' property, consisting of cash and other personal and real property, as well as the Debtors' electronic records. In 2017, the United States seized an additional $19,000,000 of the Debtors' cash.

9. On or about April 22, 2014, the Office of the United States Trustee filed a motion for the appointment of a Chapter 11 Trustee [docket entry 65].

10. On April 23, 2014, the SEC filed a motion to transfer venue of the cases to the United States Bankruptcy Court for the District of Massachusetts (the "Court") [docket entry 67]. By order dated May 6, 2014, the motion to change venue was approved [docket entry 199]. The cases were transferred to the Court on May 9, 2014 [docket entry 206].

11. On May 30, 2014, this Court allowed the United States Trustee's motion to appoint a Chapter 11 trustee, and Stephen B. Darr was appointed trustee (the "Chapter 11 Trustee") on June 6, 2014 [docket entries 234 and 250] and continues to serve in that position.

II. MECHANICS OF THE TELEXFREE PROGRAM

12. After his appointment, the Chapter 11 Trustee and his advisors retrieved and, through a painstaking data analysis and recovery process, reconstructed copies of the TelexFree electronic records that had been seized by the federal authorities. These electronic records consisted principally of a program identified as "SIG" which was used to track the activity of individual Participants in the TelexFree business.

13. The Chapter 11 Trustee obtained TelexFree's financial records from financial institutions and payment processors through Federal Rule of Bankruptcy Procedure 2004 examinations.

14. Through a comparison of SIG to the TelexFree financial records, the Chapter 11 Trustee confirmed the integrity and accuracy of the SIG information.

15. The integrity and accuracy of the TelexFree electronic records was further established through the claims determination process implemented by the Chapter 11 Trustee. During the course of these cases, the Chapter 11 Trustee sought and obtained approval of an electronic claims filing process whereby Participants input their personal data into an interactive website claims portal ("Portal") and thereby gain access to their Participant activity based upon

SIG. More than eighty percent (80%) of Participants who filed electronic proofs of claim agreed with the computation of their claim based upon the activity recorded in SIG.

16. Based upon the examination of SIG data, the financial records, marketing materials, and membership contracts, the Chapter 11 Trustee determined the mechanics of the TelexFree program and how transactions were processed and recorded.

17. TelexFree kept its books and records on the accrual method of accounting.

18. TelexFree's business was based upon the sale of membership plans. In order to purchase a membership plan, TelexFree charged $50 for a Participant to become a "member" or "partner" in TelexFree. The Debtor had two one-year membership plan options. Participants purchased an AdCentral plan for $289 or an AdCentral Family plan for $1,375.

19. In connection with the purchase of a membership plan, a Participant established a "User Account" with TelexFree. Once a User Account was established and the Participant paid the membership fee, SIG tracked the activity of the Participant in that User Account, including the earning and redemption of credits. Many Participants purchased multiple membership plans, and a new User Account was established each time a plan was purchased.

20. Participants earned credits through: (i) advertising ("Advertising"); and (ii) recruiting other Participants and selling VoIP packages ("Commissions").

21. In order to earn credits for Advertising, the membership plans required Participants to place daily internet advertisements for TelexFree (one per day for AdCentral plans and five per day for AdCentral Family plans). Participants earned credits for Advertising performed by them, which were issued and deposited into the Participant's account on a weekly basis after the Participant demonstrated that the ads were placed ($20 per week in the case of AdCentral and $100 per week for AdCentral Family plans).

22. Unless a Participant performed the Advertising services, they were not entitled to, nor were they issued, credits.

23. Participants earned credits for Commissions by recruiting new Participants directly or as part of their "downline" using the MLM structure employed by TelexFree, and by selling the VoIP service. These credits were similarly deposited into a Participant's account as they were earned. Participants could also earn Commissions by selling VoIP packages. In that regard, an AdCentral Participant received ten VoIP packages to sell upon paying the membership fee, and an AdCentral Family Participant received fifty VoIP packages to sell upon paying the membership fee.

24. The credits for Advertising and Commissions were redeemable for cash on a "one dollar per one credit basis" or were used by a Participant to purchase additional membership plans for themselves or for a recruited Participant.

25. Participants purchased their membership plans in one of two ways – either by direct payment to TelexFree (a "Direct Transaction") or by payment of their fees to the Participant who recruited them, in which case the recruiting Participant retained the membership fee and used his/her earned credits to satisfy the membership plan invoice of the recruited Participant (a "Triangular Transaction").

26. A Triangular Transaction either involved two separate Participants or a single Participant. In the case of a single Participant, that Participant used earned credits in an existing User Account to acquire a new membership plan and thereby establish a new User Account. In the case of two separate Participants, the recruiting Participant monetized credits by using accumulated credits to satisfy the invoice for a recruited Participant's membership plan in exchange for payment of the membership fee from the recruited Participant.

27. Triangular Transactions were the predominant method by which Participants purchased membership plans and joined the TelexFree program.

28. TelexFree's books and records reflect that income was derived from: (i) the sale of membership plans through Direct and Triangular Transactions; (ii) receivables and amounts due from Ympactus; (iii) the sale of VoIP products; and (iv) other immaterial items.

29. Revenues from the sale of membership plans or VoIP plans totaled $3,073,471,326 over the life of the TelexFree program, consisting of $6,351,471 in 2012, $999,702,911 in 2013, and $2,067,416,945 in 2014. The cash portion of these revenues was $2,943,517 in 2012, $156,227,156 in 2013, and $200,621,569 in 2014. The balance of the revenues was based upon Triangular Transactions.

30. Through the MLM program, TelexFree expanded exponentially during its approximately two years in operation, and the growth of the business was dependent upon and fueled by the opportunity for Participants to earn credits for Advertising and Commissions.

31. Participants regularly redeemed accumulated credits for cash from TelexFree or for the purchase of additional membership plans until shortly before the Petition Date. In the case of redemption of credits for the purchase of membership plans through Triangular Transactions, recruiting Participants received for their accumulated credits from the recruited Participant.

32. The TelexFree credits were unconditional, freely assignable, and not subject to setoff.

33. By the Petition Date, TelexFree had more than 1,000,000 Participants located in more than 100 countries who had collectively opened approximately 11,000,000 User Accounts.

34. Based upon the SIG records, the following chart accurately reflects the amount of credits issued to Participants and redeemed by Participants for 2012, 2013, and 2014:

	Credits Issued and Redeemed	
Year	**Issued**	**Redeemed**
2012	$ 4,261,846	$ 4,261,846
2013	$ 972,955,648	$ 911,620,550
2014	$2,442,705,606	$1,950,007,485

III. TAX RETURNS

35. TelexFree, LLC is a C corporation for U.S. federal income tax purposes.

36. TelexFree, LLC files federal income tax returns on a calendar year basis.

37. TelexFree, LLC has never engaged in the trade or business of farming.

38. TelexFree, LLC has never performed services in the fields of health, law, engineering, architecture, accounting, actuarial science, performing arts, or consulting.

39. TelexFree, LLC used the accrual method of accounting for computing taxable income. Accordingly, TelexFree, LLC is required to include an item of income in gross income when "all events" fixing TelexFree, LLC's right to receive the income have occurred and the amount of the income can be calculated with reasonable accuracy. Under the accrual method of accounting, TelexFree is entitled to claim deductions for a liability incurred in the taxable year in which: (i) all events have occurred to establish the fact of the liability; (ii) the amount of the liability can be determined with reasonable accuracy; and (iii) economic performance has occurred with respect to the liability.

40. On September 9, 2013, TelexFree, LLC filed an original federal income tax return, Form 1120, for the 2012 tax year, which was signed by Joseph Craft, TelexFree's former Chief Financial Officer.

41. TelexFree, LLC made payments to the Service of $706,714 and $179,987 on October 16, 2013 and December 12, 2013, respectively, with respect to the 2012 tax year.

42. On March 31, 2014, TelexFree, LLC made an estimated payment to the Service in the amount of $15,792,982 with respect to the 2013 tax year prior to the filing of a tax return for 2013.

43. Prior to the Petition Date, TelexFree filed a 2012 original tax return.

44. The Trustee filed on behalf of TelexFree amended tax returns for 2012, and original and amended tax returns for 2013 and 2014.

45. On September 9, 2016, the Chapter 11 Trustee filed on behalf of TelexFree, LLC an amended federal income tax return, Form 1120-X, for the 2012 tax year, reporting no tax liability and requesting a refund of amounts paid with respect to its 2012 tax year ("2012 Return"). This return was based on the best available information at the time. The 2012 Return was filed consistent with Revenue Procedure 2010-27, which establishes the procedures by which bankruptcy trustees may request a tax refund from the IRS under 11 U.S.C. section 505(a)(2)(B) (a "505(a) request"). A duplicate copy of the return was filed under Revenue Procedure 2006-24, which establishes the procedures by which bankruptcy trustees may request a prompt determination of any unpaid tax liability from the IRS under 11 U.S.C. section 505(b)(2) (a "505(b) request").

46. On September 12, 2016, the Chapter 11 Trustee filed on behalf of TelexFree, LLC an original federal income tax return, Form 1120, for the 2013 tax year, which reported no tax liability and requested a refund of amounts paid with respect to its 2013 tax year ("2013 Return"). The 2013 Return was filed under the procedures provided for a 505(a) request, and a duplicate copy of the return was filed under the procedures provided for a 505(b) request.

47. In 2017, the Chapter 11 Trustee and KPMG reported all TelexFree activity on the returns filed on behalf of TelexFree, LLC, as it was the primary operating entity and because it was impossible to separate the activity attributable to any individual entity. Tax returns reporting no activity were filed for TelexFree, Inc. and TelexFree Financial, Inc.

48. On July 6, 2017, the Chapter 11 Trustee filed on behalf of TelexFree LLC an original federal income tax return, Form 1120, for the 2014 tax year, which reported no tax liability ("2014 Return"). The 2014 return was filed under the procedures applicable to a 505(b) request.

49. On March 9, 2018, the Chapter 11 Trustee filed on behalf of TelexFree LLC an amended federal income tax return, Form 1120-X, for the 2012 tax year ("2012 Amended Return") in support of its 2012 Return to report items of income and deductions based on reconstructed transaction data in SIG, and to capture activity for all TelexFree entities. Similar to the 2012 Return, the 2012 Amended Return reported that TelexFree, LLC had no tax liability for the 2012 tax year. The 2012 Amended Return reported gross receipts of $18,220,915 and a deduction for Advertising and Commission costs of $4,261,846.

50. On March 9, 2018, the Chapter 11 Trustee filed on behalf of TelexFree LLC an amended federal income tax return, Form 1120-X, for the 2013 tax year ("2013 Amended Return") to report items of income and deductions based on reconstructed transaction data in the SIG system, and to capture activity for all TelexFree entities. Similar to the 2013 Return, the 2013 Amended Return reported that TelexFree, LLC had no tax liability for the 2013 tax year. The 2013 Amended Return reported gross receipts of $1,173,886,556, and reported deductions for Advertising and Commission costs of $972,955,648 and for a bad debt of $186,344,898.

51. On March 9, 2018, the Chapter 11 Trustee filed on behalf of TelexFree LLC an amended federal income tax return, Form 1120-X, for the 2014 tax year ("2014 Amended Return"), to address inconsistencies with SIG and the general ledgers used to prepare the original 2014 return, and to claim deductions for bankruptcy estate operating expenses and for assets frozen or seized by the government. Similar to the 2014 Return, the 2014 Amended Return reported that TelexFree, LLC had no tax liability for the 2014 tax year. The 2014 Amended Return reported gross receipts of $2,067,416,945, and reported deductions for Advertising and Commission costs of $2,442,705,606 and for a casualty loss of $148,000,000.

52. Copies of the 2012 Amended Return, 2013 Amended Return, and 2014 Amended Return are attached hereto.

Service Activity With Respect to Tax Returns

53. On December 27, 2016, after processing the 2013 Return, the Service issued a refund of $15,532,440 to the Chapter 11 Trustee related to TelexFree, LLC's 2013 tax year (the "2013 Refund"). The 2013 Refund was made up of three components: estimated taxes paid of $15,792,982, plus accrued interest of $55,318, less a $315,860 bad check penalty. The Chapter 11 Trustee filed a penalty abatement request for the bad check penalty, which has not yet been allowed by the Service.

54. The Chapter 11 Trustee deposited the 2013 Refund into his Chapter 11 estate account.

55. On April 25, 2017, the Service issued Notices of Proposed Adjustment ("NOPA") related to TelexFree, LLC's 2013 Return, disallowing deductions for (i) TelexFree's Advertising and Commission costs of $2,161,645,140 and $622,588,034, respectively, and (ii) a bad debt of $186,344,898 related to amounts due from a Brazilian affiliate, Ympactus Commercial Ltda.

("Ympactus"), and imposing a late-filing penalty of $75,126,857. On October 31, 2017, the Service issued a statutory notice of deficiency for tax year 2013 related to the NOPAs issued on April 25, 2017. In the notice of deficiency, the IRS took the position that TelexFree's 2013 taxable income was $858,592,137 and proposed an increase in tax in the amount of $300,507,248, and a late-filing penalty of $75,126,857.

56. On October 31, 2017, the Service disallowed TelexFree, LLC's 2012 Return based on its determination that TelexFree's Advertising and Commission costs were not deductible.

57. On November 7, 2017, the Service issued NOPAs related to TelexFree, LLC's 2014 tax year, disallowing TelexFree's deduction for Advertising and Commission costs totaling $2,442,705,606, and imposing a late-filing penalty of $13,481,991.

58. On November 13, 2018, the Service issued an additional NOPA with respect to TelexFree, LLC's 2014 tax year, disallowing the casualty loss deduction of $148,000,000 claimed on the 2014 Amended Return.

A. Claims Filed by the Service

59. On June 8, 2017, the Service filed an administrative proof of claim against the Chapter 11 estate in the amount of $15,532,440 for tax year 2013, representing the amount of the 2013 Refund [Claim No. 2987 filed with the Court].

60. On June 12, 2017, the Service filed a prepetition proof of claim for 2013 against the Chapter 11 estate in the amount of $356,898,861, 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 Portal, hereafter the "Prepetition Claim"].

61. On November 30, 2017, the Service filed an amended administrative proof of claim [Claim No. 2987-2 filed with the Court] against the Chapter 11 estate asserting an administrative claim in the aggregate amount of $69,460,404 [as amended, the "Administrative Claim"]. The Administrative Claim was amended to add a claim in the amount of $53,927,964 for income tax allegedly incurred for year 2014.

62. On August 14, 2018, and pursuant to Tax Division Directive No. 137, the Defendant agreed to subordinate the Prepetition Claim and $52,593,821 of the Administrative Claim to the payment of allowed administrative claims and allowed claims of Participants. The Defendant has not agreed to subordinate the portion of the Administrative Claim relating to the income tax liability for 2013 in the amount of the 2013 Refund (i.e., $15,532,440) and $1,334,143 of the alleged 2014 income tax liability.

B. Chapter 11 Trustee's Response to Service

I. Deductibility of Advertising and Commission Costs

63. TelexFree was in the trade or business of operating and promoting a Ponzi/pyramid scheme. Ponzi schemes and pyramid schemes require a constant flow of new capital to succeed.

64. TelexFree's business was the sale of membership plans. TelexFree devised a system to incentivize Participants to join TelexFree, to purchase membership plans and to recruit others to join TelexFree and purchase membership plans.

65. TelexFree paid credits to Participants for posting advertisements on the internet in order to keep the TelexFree name before the public, to promote the goodwill of TelexFree, and to enlist new Participants. The advertising ensured TelexFree's name was frequently at the top of a listing of several MLM or business opportunities shown.

66. TelexFree was almost exclusively an internet-based operation. TelexFree and its Participants promoted the business extensively using an online presence including internet advertisements, social media, and internet videos.

67. The promise of substantial returns for Advertising services was an essential element of the TelexFree business model. These promises could only be fulfilled by the posting of advertisements.

68. The credits issued for Advertising services were a primary inducement for Participants to join the TelexFree business.

69. In the context of TelexFree's business, the Advertising services performed were essential to the operation and expansion of the TelexFree business.

70. The credits issued to a Participant for Advertising services represented a fixed and unconditional amount due to the Participant under the terms of his or her membership plan.

71. Participants earned credits for advertisements by logging onto TelexFree's website to download marketing materials, posting advertisements on the chosen websites, and returning to TelexFree's website to validate their posting of the advertisements.

72. The credits issued to Participants for Advertising were normal, usual, and customary expenses associated with the development and operation of the TelexFree business.

73. In the context of TelexFree's business, the credits issued to Participants for Advertising were reasonable in amount and bore a reasonable relationship to the business of operating the TelexFree business.

74. The Advertising costs deducted on TelexFree's 2012 Amended Return, 2013 Amended Return, and 2014 Amended Return are substantiated by the books and records of TelexFree, including SIG.

75. In addition to credits issued for Advertising services, Participants were separately incentivized to perform Commission services.

76. The credits issued for Commission services encouraged Participants to recruit new Participants into the TelexFree business.

77. The credits issued to a Participant for Commission services represented a fixed and unconditional amount due to the Participant under the terms of his or her membership contract with TelexFree.

78. In the context of TelexFree's business, the credits issued to Participants for Commission services were normal, usual, and customary expenses associated with the development and operation of the TelexFree business.

79. In the context of TelexFree's business, the credits issued to Participants for Commission services were reasonable in amount and bore a reasonable relationship to the TelexFree business.

80. The Commission costs deducted on the 2012 Amended Return, 2013 Amended Return, and 2014 Amended Return are substantiated by the books and records of TelexFree.

81. The credits issued to Participants for Advertising and Commission services were regularly redeemed by Participants until shortly before the Petition Date, both for cash and in satisfaction of membership fees due in connection with the purchase of membership plans in Triangular Transactions.

82. The amount of credits redeemed by Participants approximated the amount of credits issued in each year.

83. Individuals did not acquire an equity interest in TelexFree by entering into a membership contract with TelexFree.

84. The Participants had no vote or input into management of TelexFree.

85. The Participants were not employees of TelexFree.

II. Ympactus Bad Debt Deduction

86. Ympactus, an affiliate of TelexFree, operated in Brazil with a business model similar to the model employed by TelexFree.

87. TelexFree provided accounting and administrative services to Ympactus in 2012 and 2013.

88. In both the 2012 Return and 2012 Amended Return, TelexFree LLC and the Chapter 11 Trustee, respectively, reported Ympactus Income of $11,869,444 in accordance with the books and records of TelexFree.

89. In 2013, Brazilian authorities seized all of Ympactus's assets and its operations ceased.

90. In both the 2013 Return and 2013 Amended Return, the Chapter 11 Trustee on behalf of TelexFree LLC reported Ympactus Income of $174,183,645 in accordance with the books and records of TelexFree.

91. In both the 2013 Return and 2013 Amended Return, the Chapter 11 Trustee on behalf of TelexFree LLC reported a write-off of Ympactus Income in the amount of $186,344,898 in accordance with the books and records of TelexFree. There was a write-off of the Ympactus income of $186,053,089 in 2013 because Ympactus had not yet paid the obligation and the Brazilian authorities terminated Ympactus's operations and seized all its assets that year.

92. The debt due and owing from Ympactus to TelexFree is uncollectible because Ympacus was shutdown and its assets seized by the Brazilian government.

93. The Service's disallowance of the Ympactus bad debt deduction without any offsetting adjustment to the reported Ympactus Income is fundamentally inconsistent with a fair presentation of TelexFree's taxable income or loss.

III. Casualty Loss Deduction

94. On April 15, 2014, the Securities and Exchange Commission filed a complaint under seal against TelexFree seeking a preliminary injunction freezing assets held by TelexFree in an effort to, among other things, "preserve any remaining assets for defrauded investors."

95. On April 16, 2014, the United States froze funds in the Debtors' bank accounts and payment processor reserve accounts and seized funds constituting property of, derived from, or traceable to the business activities of TelexFree aggregating approximately $140,000,000 ("Funds").

96. Substantially contemporaneously, the United States seized real property and motor vehicles constituting property of, derived from or proceeds traceable to the business activity of TelexFree aggregating approximately $8,000,000 ("Property").

97. On January 4, 2017, the United States seized United States currency aggregating $19,287,684 ("Currency") which was property of or derived from or proceeds traceable to the business activities of TelexFree.

98. No fines or penalties have been imposed upon TelexFree.

99. The Chapter 11 Trustee has worked closely with the United States in connection with the recovery of funds for victims.

100. The Chapter 11 Trustee did not challenge the order of forfeiture with respect to the Funds and Property as part of an agreement with the United States that the Funds and Property would be turned over to the Chapter 11 Trustee for payment as compensation to victims.

101. On July 11, 2017, in connection with the sentencing of James Merrill for his participation in TelexFree, the District Court ordered restitution to be paid to the victims of TelexFree by the Chapter 11 Trustee (the "Restitution Order"). The Restitution Order was premised upon the agreement between the United States and the Chapter 11 Trustee that the funds subject to the forfeiture proceedings would be delivered to the Chapter 11 Trustee to be administered by the Chapter 11 Trustee for the benefit of the victims of the Ponzi scheme.

102. On June 14, 2018, the District Court ordered that the Funds along with the Currency (the "Liquid Restitution Assets") be turned over to the Chapter 11 Trustee so that the Liquid Restitution Assets may be applied toward restitution consistent with the terms of the Restitution Order.

103. On June 14, 2018, the District Court ordered that the Property be forfeited and that the United States was authorized to deliver the Property or its proceeds to the Chapter 11 Trustee for distribution to victims.

104. The action by the United States in freezing or seizing property of TelexFree or property derived from or constituting proceeds traceable to the business of TelexFree is a loss of property (the "Loss").

105. TelexFree was not insured for the Loss nor otherwise compensated for the Loss.

106. One of TelexFree's principals, Mr. Merrill, has been convicted, and a second, Carlos Wanzeler, has been indicted and fled the country. The Trustee has displaced the Debtors' management and operations have been shut down. The Trustee was appointed to liquidate the Debtors' assets and to pursue recoveries.

107. The Parties agree that the Court may take judicial notice of the papers and Orders entered in the case of *United States of America v. James Merrill*, 4:14-CR-40028-TSH and *Securities & Exchange Commission v. Telexfree, Inc. et al*, 1.14-CV-11858-DJC.

Form **1120X** (Rev. January 2011)
Department of the Treasury Internal Revenue Service

Amended U.S. Corporation Income Tax Return

OMB No. 1545-0132

For tax year ending ▶ 12/31/2012 (Enter month and year.)

Please Type or Print

Name: TELEXFREE, LLC

Employer identification number: [redacted]

Number, street, and room or suite no. (If a P.O. box, see instructions.): 100 HIGH STREET #2301

City or town, state, and ZIP code: BOSTON, MA 02110

Telephone number (optional):

Enter name and address used on original return (if same as above, write "Same."): TELEXFREE LLC 4705 S.DURANGO DR #100-J51 LAS

Internal Revenue Service Center where original return was filed ▶ OGDEN, UT

Fill in applicable items and use Part II on the back to explain any changes

Part I Income and Deductions (see instructions)		(a) As originally reported or as previously adjusted	(b) Net change - Increase or (decrease) - explain in Part II	(c) Correct amount
1 Total income	1	15,407,680.	2,459,180.	17,866,860.
2 Total deductions	2	16,647,623.	1,219,237.	17,866,860.
3 Taxable income. Subtract line 2 from line 1	3	-1,239,943.	1,239,943.	
4 Total tax	4			
Payments and Credits (see instructions)				
5a Overpayment in prior year allowed as a credit	5a			
b Estimated tax payments	5b			
c Refund applied for on Form 4466	5c			
d Subtract line 5c from the sum of lines 5a and 5b	5d			
e Tax deposited with Form 7004	5e			
f Credit from Form 2439	5f			
g Credit for federal tax on fuels and other refundable credits	5g			
6 Tax deposited or paid with (or after) the filing of the original return	6			692,854.
7 Add lines 5d through 6, column (c)	7			692,854.
8 Overpayment, if any, as shown on original return or as later adjusted	8			
9 Subtract line 8 from line 7	9			692,854.
Tax Due or Overpayment (see instructions)				
10 Tax due. Subtract line 9 from line 4, column (c). If paying by check, make it payable to the "United States Treasury" ▶	10			
11 Overpayment. Subtract line 4, column (c), from line 9 ▶	11			692,854.
12 Enter the amount of line 11 you want: Credited to 20 Estimated tax ▶ Refunded ▶	12			692,854.

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Under penalties of perjury, I declare that I have filed an original return and that I have examined this amended return, including accompanying schedules and statements, and to the best of my knowledge and belief, this amended return is true, correct, and complete. Declaration of preparer (other than taxpayer) is based on all information of which preparer has any knowledge.

Signature of officer: Stephen Dan Date: 3/7/18 Title: Trustee

Paid Preparer Use Only

Print/Type preparer's name: JOSEPH MIDDLETON
Preparer's signature: Joseph Middleton
Date: 3/7/18
Check [ ] if self-employed
PTIN: [redacted]
Firm's name ▶ KPMG LLP
Firm's EIN ▶ [redacted]
Firm's address ▶ 60 SOUTH STREET BOSTON, MA 02111
Phone no. 617-988-1000

For Paperwork Reduction Act Notice, see instructions. Form **1120X** (Rev. 1-2011)

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Part II **Explanation of Changes to Items in Part I** (Enter the line number from page 1 for the items you are changing, and give the reason for each change. Show any computation in detail. Also, see **What To Attach** in the instructions.)

If the change is due to a net operating loss carryback, a capital loss carryback, or a general business credit carryback, see **Carryback Claims** in the instructions, and check here . . . . . ▶ ☐

SEE ATTACHED

Taxpayer: TelexFree, LLC
EIN: [redacted]
Tax Period: December 31, 2012

2012 AMENDED RETURN STATEMENT

The taxpayer is amending its return again for the following reasons: to include total activity for the TelexFree operations; report items of income and deductions based, to the extent possible, on the reconstructed transactional data included in the SIG system (TelexFree's information management system); to capture the activities of TelexFree, Inc., another entity in the Ponzi scheme, and to correct the taxpayer's deduction for credits deposited in the Ponzi scheme users' accounts. Due to the relationship between the parties and the nature of the Ponzi scheme, it is impossible to separate the activity attributable to any individual entity within the system.

Based on SIG, the information management system utilized by the TelexFree entities, the amended return now reports all income the TelexFree entities received during 2012 for the sale of membership plans and phone packages. The prior amended return reported gross income based only on the general ledger of TelexFree, LLC.

The amended return also includes operating expenses recorded in the general ledger of TelexFree, Inc. Furthermore, the aggregate deduction for credits deposited in the Ponzi scheme users' accounts (labeled as "Commissions" and "Advertising Credits Expense" on the prior amended return) has been adjusted so it is consistent with the best information available in the SIG system rather than the trailing twelve-month liability used to prepare the first amended return.

AS AMENDED - REQUEST FOR PROMPT REFUND

Form **1120** — Department of the Treasury, Internal Revenue Service

U.S. Corporation Income Tax Return

For calendar year 2012 or tax year beginning 07/19/2012, ending 12/31/2012

▶ Information about Form 1120 and its separate instructions is at www.irs.gov/form1120.

OMB No. 1545-0123

2012

A Check if: 1a Consolidated return (attach Form 851) ☐ b Life/nonlife consolidated return ☐ 2 Personal holding co. (attach Sch. PH) ☐ 3 Personal service corp. (see instructions) ☐ 4 Schedule M-3 attached ☐

TYPE OR PRINT

Name: TELEXFREE, LLC
C/O STEPHEN DARR, BANKRUPTCY TRUSTEE

Number, street, and room or suite no. If a P.O. box, see instructions.: 100 HIGH STREET #2301

City or town, state, and ZIP code: BOSTON, MA 02110

B Employer identification number: [redacted]

C Date incorporated: 07/19/2012

D Total assets (see instructions): $ 15,247,249.

E Check if: (1) X Initial return (2) ☐ Final return (3) ☐ Name change (4) X Address change

Income	1a	Gross receipts or sales	1a 18,220,915.	
	b	Returns and allowances	1b 248,692.	
	c	Balance. Subtract line 1b from line 1a		1c 17,972,223.
	2	Cost of goods sold (attach Form 1125-A)		2 105,363.
	3	Gross profit. Subtract line 2 from line 1c		3 17,866,860.
	4	Dividends (Schedule C, line 19)		4
	5	Interest		5
	6	Gross rents		6
	7	Gross royalties		7
	8	Capital gain net income (attach Schedule D (Form 1120))		8
	9	Net gain or (loss) from Form 4797, Part II, line 17 (attach Form 4797)		9
	10	Other income (see instructions - attach statement)		10
	11	Total income. Add lines 3 through 10 ▶		11 17,866,860.
Deductions (See instructions for limitations on deductions.)	12	Compensation of officers (see instructions - attach Form 1125-E) ▶		12
	13	Salaries and wages (less employment credits)		13 400.
	14	Repairs and maintenance		14
	15	Bad debts		15
	16	Rents		16 8,028.
	17	Taxes and licenses		17
	18	Interest		18
	19	Charitable contributions		19
	20	Depreciation from Form 4562 not claimed on Form 1125-A or elsewhere on return (attach Form 4562)		20 15,121.
	21	Depletion		21
	22	Advertising		22 1,550.
	23	Pension, profit-sharing, etc., plans		23
	24	Employee benefit programs		24
	25	Domestic production activities deduction (attach Form 8903)		25
	26	Other deductions (attach statement) SEE STATEMENT 1		26 4,405,900.
	27	Total deductions. Add lines 12 through 26 ▶		27 4,430,999.
	28	Taxable income before net operating loss deduction and special deductions. Subtract line 27 from line 11		28 13,435,861.
	29a	Net operating loss deduction (see instructions)	29a 13,435,861.	
	b	Special deductions (Schedule C, line 20)	29b	
	c	Add lines 29a and 29b		29c 13,435,861.
Tax, Refundable Credits, and Payments	30	Taxable income. Subtract line 29c from line 28 (see instructions)		30
	31	Total tax (Schedule J, Part I, line 11)		31
	32	Total payments and refundable credits (Schedule J, Part II, line 21)		32 692,854.
	33	Estimated tax penalty (see instructions). Check if Form 2220 is attached ▶ ☐		33
	34	Amount owed. If line 32 is smaller than the total of lines 31 and 33, enter amount owed		34
	35	Overpayment. If line 32 is larger than the total of lines 31 and 33, enter amount overpaid		35 692,854.
	36	Enter amount from line 35 you want: Credited to 2013 estimated tax ▶ Refunded ▶		36 692,854.

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Under penalties of perjury, I declare that I have examined this return, including accompanying schedules and statements, and to the best of my knowledge and belief, it is true, correct, and complete. Declaration of preparer (other than taxpayer) is based on all information of which preparer has any knowledge.

Signature of officer: Stephen Darr — Date: 3/7/18 — Title: Trustee

May the IRS discuss this return with the preparer shown below (see instructions)? X Yes ☐ No

Paid Preparer Use Only

Print/Type preparer's name: JOSEPH MIDDLETON	Preparer's signature	Date: 3/7/18	Check ☐ if self-employed — PTIN: [redacted]
Firm's name ▶ KPMG LLP			Firm's EIN ▶ [redacted]
Firm's address ▶ 60 SOUTH STREET, BOSTON, MA 02111			Phone no. 617-988-1000

For Paperwork Reduction Act Notice, see separate instructions. Form **1120** (2012)

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TELEXFREE, LLC

Form 1120 (2012) [redacted] Page 2

Schedule C Dividends and Special Deductions (see instructions)	(a) Dividends received	(b) %	(c) Special deductions (a) x (b)
1 Dividends from less-than-20%-owned domestic corporations (other than debt-financed stock)		70	
2 Dividends from 20%-or-more-owned domestic corporations (other than debt-financed stock)		80	
3 Dividends on debt-financed stock of domestic and foreign corporations		***	
4 Dividends on certain preferred stock of less-than-20%-owned public utilities		42	
5 Dividends on certain preferred stock of 20%-or-more-owned public utilities		48	
6 Dividends from less-than-20%-owned foreign corporations and certain FSCs		70	
7 Dividends from 20%-or-more-owned foreign corporations and certain FSCs		80	
8 Dividends from wholly owned foreign subsidiaries		100	
9 Total. Add lines 1 through 8. See instructions for limitation			
10 Dividends from domestic corporations received by a small business investment company operating under the Small Business Investment Act of 1958		100	
11 Dividends from affiliated group members		100	
12 Dividends from certain FSCs		100	
13 Dividends from foreign corporations not included on lines 3, 6, 7, 8, 11, or 12			
14 Income from controlled foreign corporations under subpart F (attach Form(s) 5471)			
15 Foreign dividend gross-up			
16 IC-DISC and former DISC dividends not included on lines 1, 2, or 3			
17 Other dividends			
18 Deduction for dividends paid on certain preferred stock of public utilities			
19 Total dividends. Add lines 1 through 17. Enter here and on page 1, line 4 ▶			
20 Total special deductions. Add lines 9, 10, 11, 12, and 18. Enter here and on page 1, line 29b ▶			

Form 1120 (2012)

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TELEXFREE, LLC [redacted]

Form 1120 (2012) Page 3

Schedule J Tax Computation and Payment (see instructions)

Part I - Tax Computation

1	Check if the corporation is a member of a controlled group (attach Schedule O (Form 1120)) ▶ ☐			
2	Income tax. Check if a qualified personal service corporation (see instructions) ▶ ☐		2	
3	Alternative minimum tax (attach Form 4626) SEE STATEMENT 6		3	
4	Add lines 2 and 3		4	
5a	Foreign tax credit (attach Form 1118)	5a		
b	Credit from Form 8834, line 30 (attach Form 8834)	5b		
c	General business credit (attach Form 3800)	5c		
d	Credit for prior year minimum tax (attach Form 8827)	5d		
e	Bond credits from Form 8912	5e		
6	Total credits. Add lines 5a through 5e		6	
7	Subtract line 6 from line 4		7	
8	Personal holding company tax (attach Schedule PH (Form 1120))		8	
9a	Recapture of investment credit (attach Form 4255)	9a		
b	Recapture of low-income housing credit (attach Form 8611)	9b		
c	Interest due under the look-back method - completed long-term contracts (attach Form 8697)	9c		
d	Interest due under the look-back method - income forecast method (attach Form 8866)	9d		
e	Alternative tax on qualifying shipping activities (attach Form 8902)	9e		
f	Other (see instructions - attach statement)	9f		
10	Total. Add lines 9a through 9f		10	
11	Total tax. Add lines 7, 8, and 10. Enter here and on page 1, line 31		11	

Part II - Payments and Refundable Credits

12	2011 overpayment credited to 2012		12	
13	2012 estimated tax payments		13	
14	2012 refund applied for on Form 4466		14	( )
15	Combine lines 12, 13, and 14		15	
16	Tax deposited with Form 7004		16	
17	Withholding (see instructions)		17	
18	Total payments. Add lines 15, 16, and 17		18	
19	Refundable credits from:			
a	Form 2439	19a		
b	Form 4136	19b		
c	Form 8827, line 8c	19c		
d	Other (attach statement - see instructions)	19d 692,854.		
20	Total credits. Add lines 19a through 19d		20	692,854.
21	Total payments and credits. Add lines 18 and 20. Enter here and on page 1, line 32		21	692,854.

Schedule K Other Information (see instructions)

		Yes	No
1	Check accounting method: a ☐ Cash b ☒ Accrual c ☐ Other (specify) ▶		
2	See the instructions and enter the:		
a	Business activity code no. ▶ 454390		
b	Business activity ▶ DIRECT SALES		
c	Product or service ▶ COMMUNICATIONS		
3	Is the corporation a subsidiary in an affiliated group or a parent-subsidiary controlled group?		X
	If "Yes," enter name and EIN of the parent corporation ▶		
4	At the end of the tax year:		
a	Did any foreign or domestic corporation, partnership (including any entity treated as a partnership), trust, or tax-exempt organization own directly 20% or more, or own, directly or indirectly, 50% or more of the total voting power of all classes of the corporation's stock entitled to vote? If "Yes," complete Part I of Schedule G (Form 1120) (attach Schedule G)		X
b	Did any individual or estate own directly 20% or more, or own, directly or indirectly, 50% or more of the total voting power of all classes of the corporation's stock entitled to vote? If "Yes," complete Part II of Schedule G (Form 1120) (attach Schedule G)	X	

Form 1120 (2012)

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TELEXFREE, LLC [redacted]

Form 1120 (2012) Page 4

Schedule K Other Information *continued* (see instructions)

		Yes	No
5	At the end of the tax year, did the corporation:		
a	Own directly 20% or more, or own, directly or indirectly, 50% or more of the total voting power of all classes of stock entitled to vote of any foreign or domestic corporation not included on Form 851, Affiliations Schedule? For rules of constructive ownership, see instructions. If "Yes," complete (i) through (iv) below.		X

(i) Name of Corporation	(ii) Employer Identification Number (if any)	(iii) Country of Incorporation	(iv) Percentage Owned in Voting Stock

b	Own directly an interest of 20% or more, or own, directly or indirectly, an interest of 50% or more in any foreign or domestic partnership (including an entity treated as a partnership) or in the beneficial interest of a trust? For rules of constructive ownership, see instructions. If "Yes," complete (i) through (iv) below.		X

(i) Name of Entity	(ii) Employer Identification Number (if any)	(iii) Country of Organization	(iv) Maximum Percentage Owned in Profit, Loss, or Capital

6	During this tax year, did the corporation pay dividends (other than stock dividends and distributions in exchange for stock) in excess of the corporation's current and accumulated earnings and profits? (See sections 301 and 316.) If "Yes," file Form 5452, Corporate Report of Nondividend Distributions. If this is a consolidated return, answer here for the parent corporation and on Form 851 for each subsidiary.		X
7	At any time during the tax year, did one foreign person own, directly or indirectly, at least 25% of (a) the total voting power of all classes of the corporation's stock entitled to vote or (b) the total value of all classes of the corporation's stock?	X	
	For rules of attribution, see section 318. If "Yes," enter: (i) Percentage owned ▶ 30.00 and (ii) Owner's country ▶ BR		
	(c) The corporation may have to file Form 5472, Information Return of a 25% Foreign-Owned U.S. Corporation or a Foreign Corporation Engaged in a U.S. Trade or Business. Enter the number of Forms 5472 attached ▶		
8	Check this box if the corporation issued publicly offered debt instruments with original issue discount ▶ ☐ If checked, the corporation may have to file Form 8281, Information Return for Publicly Offered Original Issue Discount Instruments.		
9	Enter the amount of tax-exempt interest received or accrued during the tax year ▶ $		
10	Enter the number of shareholders at the end of the tax year (if 100 or fewer) ▶ 3		
11	If the corporation has an NOL for the tax year and is electing to forego the carryback period, check here ▶ ☐ If the corporation is filing a consolidated return, the statement required by Regulations section 1.1502-21(b)(3) must be attached or the election will not be valid.		
12	Enter the available NOL carryover from prior tax years (do not reduce it by any deduction on line 29a.) ▶ $		
13	Are the corporation's total receipts (line 1c plus lines 4 through 10 on page 1) for the tax year and its total assets at the end of the tax year less than $250,000? If "Yes," the corporation is not required to complete Schedules L, M-1, and M-2 on page 5. Instead, enter the total amount of cash distributions and the book value of property distributions (other than cash) made during the tax year ▶ $		X
14	Is the corporation required to file Schedule UTP (Form 1120), Uncertain Tax Position Statement (see instructions)? If "Yes," complete and attach Schedule UTP.		X
15a	Did the corporation make any payments in 2012 that would require it to file Form(s) 1099?	X	
b	If "Yes," did or will the corporation file required Forms 1099?	X	
16	During this tax year, did the corporation have an 80% or more change in ownership, including a change due to redemption of its own stock?		X
17	During or subsequent to this tax year, but before the filing of this return, did the corporation dispose of more than 65% (by value) of its assets in a taxable, non-taxable, or tax deferred transaction?		X
18	Did the corporation receive assets in a section 351 transfer in which any of the transferred assets had a fair market basis or fair market value of more than $1 million?		X

TELEXFREE, LLC [redacted]

Form 1120 (2012) Page 5

Schedule L Balance Sheets per Books

Assets	Beginning of tax year (a)	Beginning of tax year (b)	End of tax year (c)	End of tax year (d)
1 Cash		NONE		1,707,287.
2a Trade notes and accounts receivable				
b Less allowance for bad debts	( )		( )	
3 Inventories				
4 U.S. government obligations				
5 Tax-exempt securities (see instructions)				
6 Other current assets (attach schedule)	STMT 2	NONE		13,509,841.
7 Loans to shareholders		NONE		12,124.
8 Mortgage and real estate loans				
9 Other investments (attach schedule)				
10a Buildings and other depreciable assets	NONE		15,121.	
b Less accumulated depreciation	(NONE)	NONE	(599.)	14,522.
11a Depletable assets				
b Less accumulated depletion	( )		( )	
12 Land (net of any amortization)				
13a Intangible assets (amortizable only)				
b Less accumulated amortization	( )		( )	
14 Other assets (attach schedule)	STMT 2	NONE		3,475.
15 Total assets		NONE		15,247,249.
Liabilities and Shareholders' Equity				
16 Accounts payable				
17 Mortgages, notes, bonds payable in less than 1 year				
18 Other current liabilities (attach schedule)	STMT 2	NONE		7,265,686.
19 Loans from shareholders		NONE		50.
20 Mortgages, notes, bonds payable in 1 year or more				
21 Other liabilities (attach schedule)				
22 Capital stock: a Preferred stock				
b Common stock				
23 Additional paid-in capital				
24 Retained earnings - Appropriated (attach schedule)				
25 Retained earnings - Unappropriated		NONE		7,981,513.
26 Adjustments to shareholders' equity (attach schedule)				
27 Less cost of treasury stock		( )		( )
28 Total liabilities and shareholders' equity		NONE		15,247,249.

Schedule M-1 Reconciliation of Income (Loss) per Books With Income per Return

Note: Schedule M-3 required instead of Schedule M-1 if total assets are $10 million or more - see instructions

1 Net income (loss) per books	7,981,513.	7 Income recorded on books this year not included on this return (itemize): Tax-exempt interest $	
2 Federal income tax per books	4,624,801.		
3 Excess of capital losses over capital gains			
4 Income subject to tax not recorded on books this year (itemize):		8 Deductions on this return not charged against book income this year (itemize):	
5 Expenses recorded on books this year not deducted on this return (itemize):		a Depreciation $	14,522.
a Depreciation $		b Charitable contributions $	
b Charitable contributions $			
c Travel and entertainment $	640.		
SEE STATEMENT 3	843,429.	9 Add lines 7 and 8	14,522.
6 Add lines 1 through 5	13,450,383.	10 Income (page 1, line 28) - line 6 less line 9	13,435,861.

Schedule M-2 Analysis of Unappropriated Retained Earnings per Books (Line 25, Schedule L)

1 Balance at beginning of year	NONE	5 Distributions: a Cash	
2 Net income (loss) per books	7,981,513.	b Stock	
3 Other increases (itemize):		c Property	
		6 Other decreases (itemize):	
		7 Add lines 5 and 6	
4 Add lines 1, 2, and 3	7,981,513.	8 Balance at end of year (line 4 less line 7)	7,981,513.

Form 1120 (2012)

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SCHEDULE G (Form 1120)
(Rev. December 2011)
Department of the Treasury
Internal Revenue Service

Information on Certain Persons Owning the Corporation's Voting Stock

► Attach to Form 1120.
► See instructions on page 2.

OMB No. 1545-0123

Name

TELEXFREE, LLC
C/O STEPHEN DARR, BANKRUPTCY TRUSTEE

Employer identification number (EIN)

[redacted]

Part I Certain Entities Owning the Corporation's Voting Stock. (Form 1120, Schedule K, Question 4a). Complete columns (i) through (v) below for any foreign or domestic corporation, partnership (including any entity treated as a partnership), trust, or tax-exempt organization that owns directly 20% or more, or owns, directly or indirectly, 50% or more of the total voting power of all classes of the corporation's stock entitled to vote (see instructions).

(i) Name of Entity	(ii) Employer Identification Number (if any)	(iii) Type of Entity	(iv) Country of Organization	(v) Percentage Owned in Voting Stock

Part II Certain Individuals and Estates Owning the Corporation's Voting Stock. (Form 1120, Schedule K, Question 4b). Complete columns (i) through (iv) below for any individual or estate that owns directly 20% or more, or owns, directly or indirectly, 50% or more of the total voting power of all classes of the corporation's stock entitled to vote (see instructions).

(i) Name of Individual or Estate	(ii) Identifying Number (if any)	(iii) Country of Citizenship (see instructions)	(iv) Percentage Owned in Voting Stock
CARLOS WANZELER	[redacted]	US	50.00
JAMES MERRILL		US	20.00
CAROLOS COSTA	FOREIGNUS	BR	30.00

Form **1125-A** (Rev. December 2012)

Department of the Treasury Internal Revenue Service

Cost of Goods Sold

▶ Attach to Form 1120, 1120-C, 1120-F, 1120S, 1065, or 1065-B.

▶ Information about Form 1125-A and its instructions is at *www.irs.gov/form1125a.*

OMB No. 1545-2225

Name: TELEXFREE, LLC
C/O STEPHEN DARR, BANKRUPTCY TRUSTEE

Employer identification number: [redacted]

1	Inventory at beginning of year	1	
2	Purchases	2	
3	Cost of labor	3	
4	Additional section 263A costs (attach schedule)	4	
5	Other costs (attach schedule) SEE STATEMENT 4	5	105,363.
6	Total. Add lines 1 through 5	6	105,363.
7	Inventory at end of year	7	
8	Cost of goods sold. Subtract line 7 from line 6. Enter here and on Form 1120, page 1, line 2 or the appropriate line of your tax return (see instructions)	8	105,363.

9a Check all methods used for valuing closing inventory:

(i) ☐ Cost

(ii) ☐ Lower of cost or market

(iii) ☐ Other (Specify method used and attach explanation.) ▶

b Check if there was a writedown of subnormal goods ▶ ☐

c Check if the LIFO inventory method was adopted this tax year for any goods (if checked, attach Form 970) ▶ ☐

d If the LIFO inventory method was used for this tax year, enter amount of closing inventory computed under LIFO 9d

e If property is produced or acquired for resale, do the rules of section 263A apply to the entity (see instructions)? ☐ Yes ☒ No

f Was there any change in determining quantities, cost, or valuations between opening and closing inventory? If "Yes," attach explanation ☐ Yes ☒ No

Section references are to the Internal Revenue Code unless otherwise noted.

General Instructions

Purpose of Form

Use Form 1125-A to calculate and deduct cost of goods sold for certain entities.

Who Must File

Filers of Form 1120, 1120-C, 1120-F, 1120S, 1065, or 1065-B, must complete and attach Form 1125-A if the applicable entity reports a deduction for cost of goods sold.

Inventories

Generally, inventories are required at the beginning and end of each tax year if the production, purchase, or sale of merchandise is an income-producing factor. See Regulations section 1.471-1. If inventories are required, you generally must use an accrual method of accounting for sales and purchases of inventory items.

Exception for certain taxpayers. If you are a qualifying taxpayer or a qualifying small business taxpayer (defined below), you can adopt or change your accounting method to account for inventoriable items in the same manner as materials and supplies that are not incidental.

Under this accounting method, inventory costs for raw materials purchased for use in producing finished goods and merchandise purchased for resale are deductible in the year the finished goods or merchandise are sold (but not before the year you paid for the raw materials or merchandise, if you are also using the cash method).

If you account for inventoriable items in the same manner as materials and supplies that are not incidental, you can currently deduct expenditures for direct labor and all indirect costs that would otherwise be included in inventory costs. See the instructions for lines 2 and 7.

For additional guidance on this method of accounting, see Pub. 538, Accounting Periods and Methods. For guidance on adopting or changing to this method of accounting, see Form 3115, Application for Change in Accounting Method, and its instructions.

Qualifying taxpayer. A qualifying taxpayer is a taxpayer that, (a) for each prior tax year ending after December 16, 1998, has average annual gross receipts of $1 million or less for the 3 prior tax years and (b) its business is not a tax shelter (as defined in section 448(d)(3)). See Rev. Proc. 2001-10, 2001-2 I.R.B. 272.

Qualifying small business taxpayer. A qualifying small business taxpayer is a taxpayer that, (a) for each prior tax year ending on or after December 31, 2000, has average annual gross receipts of $10 million or less for the 3 prior tax years, (b) whose principal business activity is not an ineligible activity, and (c) whose business is not a tax shelter (as defined in section 448(d)(3)). See Rev. Proc. 2002-28, 2002-18, I.R.B. 815.

Uniform capitalization rules. The uniform capitalization rules of section 263A generally require you to capitalize, or include in inventory, certain costs incurred in connection with the following.

- The production of real property and tangible personal property held in inventory or held for sale in the ordinary course of business.
- Real property or personal property (tangible and intangible) acquired for resale.
- The production of real property and tangible personal property by a corporation for use in its trade or business or in an activity engaged in for profit.

See the discussion on section 263A uniform capitalization rules in the instructions for your tax return before completing Form 1125-A. Also see Regulations sections 1.263A-1 through 1.263A-3. See Regulations section 1.263A-4 for rules for property produced in a farming business.

Form **4562**

Department of the Treasury Internal Revenue Service (99)

Depreciation and Amortization
(Including Information on Listed Property)

▶ See separate instructions. ▶ Attach to your tax return.

OMB No. 1545-0172

2012

Attachment Sequence No. 179

Name(s) shown on return: TELEXFREE, LLC
C/O STEPHEN DARR, BANKRUPTCY TRUSTEE

Identifying number: [redacted]

Business or activity to which this form relates: GENERAL DEPRECIATION AND AMORTIZATION

Part I Election To Expense Certain Property Under Section 179
Note: If you have any listed property, complete Part V before you complete Part I.

1	Maximum amount (see instructions)	1	500,000.
2	Total cost of section 179 property placed in service (see instructions)	2	15,121.
3	Threshold cost of section 179 property before reduction in limitation (see instructions)	3	2,000,000.
4	Reduction in limitation. Subtract line 3 from line 2. If zero or less, enter -0-	4	
5	Dollar limitation for tax year. Subtract line 4 from line 1. If zero or less, enter -0-. If married filing separately, see instructions	5	500,000.

6	(a) Description of property	(b) Cost (business use only)	(c) Elected cost

7	Listed property. Enter the amount from line 29	7		
8	Total elected cost of section 179 property. Add amounts in column (c), lines 6 and 7		8	15,121.
9	Tentative deduction. Enter the smaller of line 5 or line 8		9	15,121.
10	Carryover of disallowed deduction from line 13 of your 2011 Form 4562		10	
11	Business income limitation. Enter the smaller of business income (not less than zero) or line 5 (see instructions)		11	500,000.
12	Section 179 expense deduction. Add lines 9 and 10, but do not enter more than line 11		12	15,121.
13	Carryover of disallowed deduction to 2013. Add lines 9 and 10, less line 12 ▶	13		

Note: Do not use Part II or Part III below for listed property. Instead, use Part V.

Part II Special Depreciation Allowance and Other Depreciation (Do not include listed property.) (See instructions.)

14	Special depreciation allowance for qualified property (other than listed property) placed in service during the tax year (see instructions)	14	
15	Property subject to section 168(f)(1) election	15	
16	Other depreciation (including ACRS)	16	

Part III MACRS Depreciation (Do not include listed property.) (See instructions.)

Section A

17	MACRS deductions for assets placed in service in tax years beginning before 2012	17	
18	If you are electing to group any assets placed in service during the tax year into one or more general asset accounts, check here ▶ ☐		

Section B - Assets Placed in Service During 2012 Tax Year Using the General Depreciation System

	(a) Classification of property	(b) Month and year placed in service	(c) Basis for depreciation (business/investment use only - see instructions)	(d) Recovery period	(e) Convention	(f) Method	(g) Depreciation deduction
19a	3-year property						
b	5-year property						
c	7-year property						
d	10-year property						
e	15-year property						
f	20-year property						
g	25-year property			25 yrs.		S/L	
h	Residential rental property			27.5 yrs.	MM	S/L	
				27.5 yrs.	MM	S/L	
i	Nonresidential real property			39 yrs.	MM	S/L	
					MM	S/L	

Section C - Assets Placed in Service During 2012 Tax Year Using the Alternative Depreciation System

20a	Class life				S/L	
b	12-year		12 yrs.		S/L	
c	40-year		40 yrs.	MM	S/L	

Part IV Summary (See instructions.)

21	Listed property. Enter amount from line 28	21	
22	Total. Add amounts from line 12, lines 14 through 17, lines 19 and 20 in column (g), and line 21. Enter here and on the appropriate lines of your return. Partnerships and S corporations - see instructions	22	15,121.
23	For assets shown above and placed in service during the current year, enter the portion of the basis attributable to section 263A costs	23	

TELEXFREE, LLC
Form 4562 (2012) [redacted] Page 2

Part V Listed Property (Include automobiles, certain other vehicles, certain computers, and property used for entertainment, recreation, or amusement.)

Note: *For any vehicle for which you are using the standard mileage rate or deducting lease expense, complete only 24a, 24b, columns (a) through (c) of Section A, all of Section B, and Section C if applicable.*

Section A - Depreciation and Other Information (Caution: *See the instructions for limits for passenger automobiles.*)

24a Do you have evidence to support the business/investment use claimed? ☐ Yes ☐ No 24b If "Yes," is the evidence written? ☐ Yes ☐ No

(a) Type of property (list vehicles first)	(b) Date placed in service	(c) Business/ investment use percentage	(d) Cost or other basis	(e) Basis for depreciation (business/investment use only)	(f) Recovery period	(g) Method/ Convention	(h) Depreciation deduction	(i) Elected section 179 cost
25 Special depreciation allowance for qualified listed property placed in service during the tax year and used more than 50% in a qualified business use (see instructions)						25		
26 Property used more than 50% in a qualified business use:								
		%						
		%						
		%						
27 Property used 50% or less in a qualified business use:								
		%				S/L -		
		%				S/L -		
		%				S/L -		
28 Add amounts in column (h), lines 25 through 27. Enter here and on line 21, page 1						28		
29 Add amounts in column (i), line 26. Enter here and on line 7, page 1						29		

Section B - Information on Use of Vehicles

Complete this section for vehicles used by a sole proprietor, partner, or other "more than 5% owner," or related person. If you provided vehicles to your employees, first answer the questions in Section C to see if you meet an exception to completing this section for those vehicles.

	(a) Vehicle 1		(b) Vehicle 2		(c) Vehicle 3		(d) Vehicle 4		(e) Vehicle 5		(f) Vehicle 6	
30 Total business/investment miles driven during the year (do not include commuting miles)												
31 Total commuting miles driven during the year												
32 Total other personal (noncommuting) miles driven												
33 Total miles driven during the year. Add lines 30 through 32												
	Yes	No	Yes	No	Yes	No	Yes	No	Yes	No	Yes	No
34 Was the vehicle available for personal use during off-duty hours?												
35 Was the vehicle used primarily by a more than 5% owner or related person?												
36 Is another vehicle available for personal use?												

Section C - Questions for Employers Who Provide Vehicles for Use by Their Employees

Answer these questions to determine if you meet an exception to completing Section B for vehicles used by employees who are not more than 5% owners or related persons (see instructions).

	Yes	No
37 Do you maintain a written policy statement that prohibits all personal use of vehicles, including commuting, by your employees?		
38 Do you maintain a written policy statement that prohibits personal use of vehicles, except commuting, by your employees? See the instructions for vehicles used by corporate officers, directors, or 1% or more owners		
39 Do you treat all use of vehicles by employees as personal use?		
40 Do you provide more than five vehicles to your employees, obtain information from your employees about the use of the vehicles, and retain the information received?		
41 Do you meet the requirements concerning qualified automobile demonstration use? (See instructions.)		

Note: *If your answer to 37, 38, 39, 40, or 41 is "Yes," do not complete Section B for the covered vehicles.*

Part VI Amortization

(a) Description of costs	(b) Date amortization begins	(c) Amortizable amount	(d) Code section	(e) Amortization period or percentage	(f) Amortization for this year
42 Amortization of costs that begins during your 2012 tax year (see instructions):					
43 Amortization of costs that began before your 2012 tax year				43	
44 Total. Add amounts in column (f). See the instructions for where to report				44	

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Form 4562 (2012)

11

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TELEXFREE, LLC

FORM 1120, PAGE 1 DETAIL

LINE 26 - OTHER DEDUCTIONS

TRAVEL, MEALS AND ENTERTAINMENT		726.
GROSS CREDIT LIABILITY ACCRUAL	SEE STATEMENT 1A	4,261,846.
BANK CHARGES		17,586.
MERCHANT FEES		84,712.
FILING FEES		1,104.
MISCELLANEOUS		512.
OFFICE EXPENSES		466.
OFFICE SUPPLIES		2,441.
PROFESSIONAL FEES		23,933.
PRODUCT DEVELOPMENT		6,320.
SMALL ITEMS NOT CAPITALIZED		6,254.
TOTAL		4,405,900.

Taxpayer: TelexFree, LLC
EIN: [redacted]
Tax Period: December 31, 2012

2012 Statement Regarding Gross Credit Liability Accrual

The credits deposited in Ponzi scheme users' accounts during 2012 (i.e., $4,261,846) were used by participants to satisfy invoices and redeemed for cash as shown below:

$0	Credits outstanding BOY
$4,261,846	2012 Credits issued to users (deduction claimed on line 26)
($3,407,954)	Credits redeemed by users to satisfy invoices (included in gross receipts in line 1a)
($1,125,103)	Credits redeemed by users for cash
$0	Credits outstanding EOY

STATEMENT 1A

TELEXFREE, LLC

FORM 1120, PAGE 5 DETAIL

	BEGINNING	ENDING
SCH L, LINE 6 - OTHER CURRENT ASSETS		
PROPERTY ON HOLD	NONE	938,871.
LOAN FROM TELEXFREE INC	NONE	701,525.
LOAN TO YMPACTUS	NONE	11,869,445.
TOTAL	NONE	13,509,841.
SCH L, LINE 14 - OTHER ASSETS		
ORGANIZATIONAL COSTS	NONE	3,475.
TOTAL	NONE	3,475.
SCH L, LINE 18 - OTHER CURRENT LIABILITIES		
ACCRUED FEDERAL INCOME TAX	NONE	4,624,801.
ACCRUED STATE TAX	NONE	843,429.
BRAZILLIAN HELP INC	NONE	2,672.
LOAN TO/FROM TELEXFREE LLC	NONE	701,525.
OTHER CURRENT LIABILITIES	NONE	1,093,259.
TOTAL	NONE	7,265,686.

TELEXFREE, LLC

FORM 1120, PAGE 5 DETAIL

SCH M-1, LINE 5 - EXPENSES RECORDED ON BOOKS NOT DEDUCTED ON RETURN

STATE TAXES	843,429.
TOTAL	843,429.

TELEXFREE, LLC

FORM 1125-A DETAIL

LINE 5 - OTHER COSTS

TELECOM & DATABASE NETWORK EXPENSE	14,691.
TERMINATION	90,672.
TOTAL	105,363.

Taxpayer: TelexFree, LLC
EIN: [redacted]
Tax Period: December 31, 2012

2012 Statement Regarding Net Operating Loss Deduction

2012 Taxable Income before NOL		$13,435,861
2013 Net Operating Loss Carryback	($3,143,850)	
2014 Net Operating Loss Carryback	($10,292,011)	
Total NOL C/B	($13,435,861)	
2012 Taxable Income after NOL		0.

STATEMENT 5

Taxpayer: TelexFree, LLC
EIN: [redacted]
Tax Period: December 31, 2012

2012 AMT STATEMENT

The tax year ended December 31, 2012 was the Taxpayer's initial year in existence. During the tax year at issue, Internal Revenue Code section 55(e)(1)(C) exempted initial year taxpayers from Alternative Minimum Tax.

STATEMENT 6

Form **1120X** (Rev. January 2011)
Department of the Treasury Internal Revenue Service

Amended U.S. Corporation Income Tax Return

OMB No. 1545-0132
For tax year ending ▶ 12/31/2013 (Enter month and year.)

Please Type or Print

Name: TELEXFREE, LLC
Employer identification number: [redacted]
Number, street, and room or suite no. (If a P.O. box, see instructions.): 100 HIGH STREET #2301
City or town, state, and ZIP code: BOSTON, MA 02110
Telephone number:

Exhibit 9

Enter name and address used on original return (If same as above, write "Same."): TELEXFREE LLC 125 SUMMER ST #1805 BOSTON MA

Internal Revenue Service Center where original return was filed ▶ CENTRALIZED INSOLVENCY OPERATION PO BOX 7346

Fill in applicable items and use Part II on the back to explain any changes

Part I Income and Deductions (see instructions)		(a) As originally reported or as previously adjusted	(b) Net change - increase or (decrease) - explain in Part II	(c) Correct amount
1 Total income	1	861,540,104.	306,414,049.	1,167,954,153.
2 Total deductions	2	2,963,526,039.	-1,792,428,035.	1,171,098,004.
3 Taxable income. Subtract line 2 from line 1	3	-2,101,985,935.	2,098,842,084.	-3,143,851.
4 Total tax	4			
Payments and Credits (see instructions)				
5a Overpayment in prior year allowed as a credit	5a			
b Estimated tax payments	5b			
c Refund applied for on Form 4466	5c			
d Subtract line 5c from the sum of lines 5a and 5b	5d			
e Tax deposited with Form 7004	5e			
f Credit from Form 2439	5f			
g Credit for federal tax on fuels and other refundable credits	5g			
6 Tax deposited or paid with (or after) the filing of the original return	6			15,792,982.
7 Add lines 5d through 6, column (c)	7			15,792,982.
8 Overpayment, if any, as shown on original return or as later adjusted	8			
9 Subtract line 8 from line 7	9			15,792,982.
Tax Due or Overpayment (see instructions)				
10 Tax due. Subtract line 9 from line 4, column (c). If paying by check, make it payable to the "United States Treasury" ▶	10			
11 Overpayment. Subtract line 4, column (c), from line 9 ▶	11			15,792,982.
12 Enter the amount of line 11 you want: Credited to 20 Estimated tax ▶ 15,792,982. Refunded ▶	12			15,792,982.

Sign Here

Under penalties of perjury, I declare that I have filed an original return and that I have examined this amended return, including accompanying schedules and statements, and to the best of my knowledge and belief, this amended return is true, correct, and complete. Declaration of preparer (other than taxpayer) is based on all information of which preparer has any knowledge.

Stephen Dunn — Signature of officer
3/7/18 — Date
Trustee — Title

Paid Preparer Use Only

Print/Type preparer's name: JOSEPH MIDDLETON
Preparer's signature: Joseph Middleton
Date: 3/7/18
Check ☐ if self-employed
PTIN: [redacted]
Firm's name ▶ KPMG LLP
Firm's EIN ▶ [redacted]
Firm's address ▶ 60 SOUTH STREET BOSTON, MA 02111
Phone no. 617-988-1000

For Paperwork Reduction Act Notice, see instructions. Form **1120X** (Rev. 1-2011)

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Part II **Explanation of Changes to Items in Part I** (Enter the line number from page 1 for the items you are changing, and give the reason for each change. Show any computation in detail. Also, see **What To Attach** in the instructions.)

If the change is due to a net operating loss carryback, a capital loss carryback, or a general business credit carryback, see **Carryback Claims** in the instructions, and check here . . . . . ▶ ☐

SEE ATTACHED STATEMENT

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Taxpayer: TelexFree, LLC
EIN: [redacted]
Tax Period: December 31, 2013

2013 AMENDED RETURN STATEMENT

The taxpayer is amending its return for the following reasons: to include total activity for the TelexFree operations; report items of income and deductions based, to the extent possible, on the reconstructed transactional data included in the SIG system (TelexFree's information management system); to capture the activities of TelexFree, Inc., another entity in the Ponzi scheme, and correct the taxpayer's deduction for credits deposited in the Ponzi scheme users' accounts. Due to the relationship between the parties and the nature of the Ponzi scheme, it is impossible to separate the activity attributable to any individual entity within the system.

Based on SIG, the information management system utilized by the TelexFree entities, the amended return now reports all income the TelexFree entities received during 2013 for the sale of membership plans and phone packages. The original return reported gross income based only on the general ledger of TelexFree, LLC.

The amended return also includes operating expenses recorded in the general ledger of TelexFree, Inc. Furthermore, the aggregate deduction for credits deposited in the Ponzi scheme users' accounts (labeled as "Commissions" and "Advertising Credits Expense" on the prior amended return) has been adjusted so it is consistent with the best information available in the SIG system rather than the trailing twelve-month liability used to prepare the first amended return.

** AS AMENDED ** REQUEST FOR PROMPT REFUND **

Form **1120** Department of the Treasury Internal Revenue Service

U.S. Corporation Income Tax Return

For calendar year 2013 or tax year beginning _____, ending _____

▶ Information about Form 1120 and its separate instructions is at www.irs.gov/form1120.

OMB No. 1545-0123

2013

A Check if:
1a Consolidated return (attach Form 851)
b Life/nonlife consolidated return
2 Personal holding co. (attach Sch. PH)
3 Personal service corp. (see instructions)
4 Schedule M-3 attached

TYPE OR PRINT

Name: TELEXFREE, LLC
C/O STEPHEN DARR, BANKRUPTCY TRUSTEE

Number, street, and room or suite no. If a P.O. box, see instructions.
100 HIGH STREET #2301

City or town, state, or province, country and ZIP code or foreign postal code
BOSTON, MA 02110

B Employer identification number: [redacted]

C Date incorporated: 07/19/2012

D Total assets (see instructions): $ 95,379,106.

E Check if: (1) Initial return (2) Final return (3) X Name change (4) Address change

Income	1a	Gross receipts or sales	1a 1,173,886,556.	
	b	Returns and allowances	1b 3,273,922.	
	c	Balance. Subtract line 1b from line 1a		1c 1,170,612,634.
	2	Cost of goods sold (attach Form 1125-A)		2 2,661,213.
	3	Gross profit. Subtract line 2 from line 1c		3 1,167,951,421.
	4	Dividends (Schedule C, line 19)		4
	5	Interest		5 2,732.
	6	Gross rents		6
	7	Gross royalties		7
	8	Capital gain net income (attach Schedule D (Form 1120))		8
	9	Net gain or (loss) from Form 4797, Part II, line 17 (attach Form 4797)		9
	10	Other income (see instructions - attach statement)		10
	11	Total income. Add lines 3 through 10 ▶		11 1,167,954,153.
Deductions (See instructions for limitations on deductions.)	12	Compensation of officers (see instructions - attach Form 1125-E) ▶		12
	13	Salaries and wages (less employment credits)		13 119,285.
	14	Repairs and maintenance		14
	15	Bad debts		15 186,344,898.
	16	Rents		16 42,806.
	17	Taxes and licenses SEE STATEMENT 1		17 40,366.
	18	Interest		18 15,362.
	19	Charitable contributions SEE STATEMENT 2		19 NONE
	20	Depreciation from Form 4562 not claimed on Form 1125-A or elsewhere on return (attach Form 4562)		20 243,373.
	21	Depletion		21
	22	Advertising		22 25,547.
	23	Pension, profit-sharing, etc., plans		23
	24	Employee benefit programs		24
	25	Domestic production activities deduction (attach Form 8903)		25
	26	Other deductions (attach statement) SEE STATEMENT 3		26 984,266,367.
	27	Total deductions. Add lines 12 through 26 ▶		27 1,171,098,004.
	28	Taxable income before net operating loss deduction and special deductions. Subtract line 27 from line 11		28 -3,143,851.
	29a	Net operating loss deduction (see instructions)	29a	
	b	Special deductions (Schedule C, line 20)	29b	
	c	Add lines 29a and 29b		29c
Tax, Refundable Credits, and Payments	30	Taxable income. Subtract line 29c from line 28 (see instructions)		30 -3,143,851.
	31	Total tax (Schedule J, Part I, line 11)		31 NONE
	32	Total payments and refundable credits (Schedule J, Part II, line 21)		32 15,792,982.
	33	Estimated tax penalty (see instructions). Check if Form 2220 is attached ▶ ☐		33
	34	Amount owed. If line 32 is smaller than the total of lines 31 and 33, enter amount owed		34
	35	Overpayment. If line 32 is larger than the total of lines 31 and 33, enter amount overpaid		35 15,792,982.
	36	Enter amount from line 35 you want: Credited to 2014 estimated tax ▶ Refunded ▶		36 15,792,982.

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Under penalties of perjury, I declare that I have examined this return, including accompanying schedules and statements, and to the best of my knowledge and belief, it is true, correct, and complete. Declaration of preparer (other than taxpayer) is based on all information of which preparer has any knowledge.

Signature of officer: Stephen Darr Date: 3/7/18 Title: Trustee

May the IRS discuss this return with the preparer shown below (see instructions)? X Yes ☐ No

Paid Preparer Use Only

Print/Type preparer's name: JOSEPH MIDDLETON	Preparer's signature: Joseph Middleton	Date: 3/7/18	Check ☐ if self-employed; PTIN: [redacted]
Firm's name ▶ KPMG LLP			Firm's EIN ▶ [redacted]
Firm's address ▶ 60 SOUTH STREET BOSTON, MA 02111			Phone no. 617-988-1000

For Paperwork Reduction Act Notice, see separate instructions. Form **1120** (2013)

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TELEXFREE, LLC

[redacted]

Schedule C Dividends and Special Deductions (see instructions)	(a) Dividends received	(b) %	(c) Special deductions (a) x (b)
1 Dividends from less-than-20%-owned domestic corporations (other than debt-financed stock)		70	
2 Dividends from 20%-or-more-owned domestic corporations (other than debt-financed stock)		80	
3 Dividends on debt-financed stock of domestic and foreign corporations		***	
4 Dividends on certain preferred stock of less-than-20%-owned public utilities		42	
5 Dividends on certain preferred stock of 20%-or-more-owned public utilities		48	
6 Dividends from less-than-20%-owned foreign corporations and certain FSCs		70	
7 Dividends from 20%-or-more-owned foreign corporations and certain FSCs		80	
8 Dividends from wholly owned foreign subsidiaries		100	
9 Total. Add lines 1 through 8. See instructions for limitation			
10 Dividends from domestic corporations received by a small business investment company operating under the Small Business Investment Act of 1958		100	
11 Dividends from affiliated group members		100	
12 Dividends from certain FSCs		100	
13 Dividends from foreign corporations not included on lines 3, 6, 7, 8, 11, or 12			
14 Income from controlled foreign corporations under subpart F (attach Form(s) 5471)			
15 Foreign dividend gross-up			
16 IC-DISC and former DISC dividends not included on lines 1, 2, or 3			
17 Other dividends			
18 Deduction for dividends paid on certain preferred stock of public utilities			
19 Total dividends. Add lines 1 through 17. Enter here and on page 1, line 4 ▶			
20 Total special deductions. Add lines 9, 10, 11, 12, and 18. Enter here and on page 1, line 29b ▶			

TELEXFREE, LLC
Form 1120 (2013) [redacted] Page 3

Schedule J Tax Computation and Payment (see instructions)

Part I-Tax Computation

1	Check if the corporation is a member of a controlled group (attach Schedule O (Form 1120)) ▶ ☐			
2	Income tax. Check if a qualified personal service corporation (see instructions) ▶ ☐		2	
3	Alternative minimum tax (attach Form 4626)		3	NONE
4	Add lines 2 and 3		4	NONE
5a	Foreign tax credit (attach Form 1116)	5a		
b	Credit from Form 8834 (see instructions)	5b		
c	General business credit (attach Form 3800)	5c		
d	Credit for prior year minimum tax (attach Form 8827)	5d		
e	Bond credits from Form 8912	5e		
6	Total credits. Add lines 5a through 5e		6	
7	Subtract line 6 from line 4		7	NONE
8	Personal holding company tax (attach Schedule PH (Form 1120))		8	
9a	Recapture of investment credit (attach Form 4255)	9a		
b	Recapture of low-income housing credit (attach Form 8611)	9b		
c	Interest due under the look-back method - completed long-term contracts (attach Form 8697)	9c		
d	Interest due under the look-back method - income forecast method (attach Form 8866)	9d		
e	Alternative tax on qualifying shipping activities (attach Form 8902)	9e		
f	Other (see instructions - attach statement)	9f		
10	Total. Add lines 9a through 9f		10	
11	Total tax. Add lines 7, 8, and 10. Enter here and on page 1, line 31		11	NONE

Part II-Payments and Refundable Credits

12	2012 overpayment credited to 2013		12	
13	2013 estimated tax payments		13	
14	2013 refund applied for on Form 4466		14	( )
15	Combine lines 12, 13, and 14		15	
16	Tax deposited with Form 7004		16	15,792,982.
17	Withholding (see instructions)		17	
18	Total payments. Add lines 15, 16, and 17		18	15,792,982.
19	Refundable credits from:			
a	Form 2439	19a		
b	Form 4136	19b		
c	Form 8827, line 8c	19c		
d	Other (attach statement - see instructions)	19d		
20	Total credits. Add lines 19a through 19d		20	
21	Total payments and credits. Add lines 18 and 20. Enter here and on page 1, line 32		21	15,792,982.

Schedule K Other Information (see instructions)

		Yes	No
1	Check accounting method: a ☐ Cash b ☒ Accrual c ☐ Other (specify) ▶		
2	See the instructions and enter the:		
a	Business activity code no. ▶ 454390		
b	Business activity ▶ DIRECT SALES		
c	Product or service ▶ COMMUNICATIONS		
3	Is the corporation a subsidiary in an affiliated group or a parent-subsidiary controlled group?		X
	If "Yes," enter name and EIN of the parent corporation ▶		
4	At the end of the tax year:		
a	Did any foreign or domestic corporation, partnership (including any entity treated as a partnership), trust, or tax-exempt organization own directly 20% or more, or own, directly or indirectly, 50% or more of the total voting power of all classes of the corporation's stock entitled to vote? If "Yes," complete Part I of Schedule G (Form 1120) (attach Schedule G)		X
b	Did any individual or estate own directly 20% or more, or own, directly or indirectly, 50% or more of the total voting power of all classes of the corporation's stock entitled to vote? If "Yes," complete Part II of Schedule G (Form 1120) (attach Schedule G)	X	

TELEXFREE, LLC [redacted]

Form 1120 (2013)

Page 4

Schedule K Other Information *continued* (see instructions)

		Yes	No
5	At the end of the tax year, did the corporation:		
a	Own directly 20% or more, or own, directly or indirectly, 50% or more of the total voting power of all classes of stock entitled to vote of any foreign or domestic corporation not included on Form 851, Affiliations Schedule? For rules of constructive ownership, see instructions. If "Yes," complete (i) through (iv) below.	X	

(i) Name of Corporation	(ii) Employer Identification Number (if any)	(iii) Country of Incorporation	(iv) Percentage Owned in Voting Stock
TELEXFREE FINANCIAL, INC	[redacted]	US	100.00

b	Own directly an interest of 20% or more, or own, directly or indirectly, an interest of 50% or more in any foreign or domestic partnership (including an entity treated as a partnership) or in the beneficial interest of a trust? For rules of constructive ownership, see instructions. If "Yes," complete (i) through (iv) below.		X

(i) Name of Entity	(ii) Employer Identification Number (if any)	(iii) Country of Organization	(iv) Maximum Percentage Owned in Profit, Loss, or Capital

6	During this tax year, did the corporation pay dividends (other than stock dividends and distributions in exchange for stock) in excess of the corporation's current and accumulated earnings and profits? (See sections 301 and 316.) If "Yes," file Form 5452, Corporate Report of Nondividend Distributions. If this is a consolidated return, answer here for the parent corporation and on Form 851 for each subsidiary.		X
7	At any time during the tax year, did one foreign person own, directly or indirectly, at least 25% of (a) the total voting power of all classes of the corporation's stock entitled to vote or (b) the total value of all classes of the corporation's stock? For rules of attribution, see section 318. If "Yes," enter:	X	
	(i) Percentage owned ▶ 30.00 and (ii) Owner's country ▶ BR		
	(c) The corporation may have to file Form 5472, Information Return of a 25% Foreign-Owned U.S. Corporation or a Foreign Corporation Engaged in a U.S. Trade or Business. Enter the number of Forms 5472 attached ▶ 1		
8	Check this box if the corporation issued publicly offered debt instruments with original issue discount ▶ ☐ If checked, the corporation may have to file Form 8281, Information Return for Publicly Offered Original Issue Discount Instruments.		
9	Enter the amount of tax-exempt interest received or accrued during the tax year ▶ $		
10	Enter the number of shareholders at the end of the tax year (if 100 or fewer) ▶ 2		
11	If the corporation has an NOL for the tax year and is electing to forego the carryback period, check here ▶ ☐ If the corporation is filing a consolidated return, the statement required by Regulations section 1.1502-21(b)(3) must be attached or the election will not be valid.		
12	Enter the available NOL carryover from prior tax years (do not reduce it by any deduction on line 29a.) ▶ $		
13	Are the corporation's total receipts (page 1, line 1a, plus lines 4 through 10) for the tax year and its total assets at the end of the tax year less than $250,000? If "Yes," the corporation is not required to complete Schedules L, M-1, and M-2. Instead, enter the total amount of cash distributions and the book value of property distributions (other than cash) made during the tax year ▶ $		X
14	Is the corporation required to file Schedule UTP (Form 1120), Uncertain Tax Position Statement (see instructions)? If "Yes," complete and attach Schedule UTP.		X
15a	Did the corporation make any payments in 2013 that would require it to file Form(s) 1099?	X	
b	If "Yes," did or will the corporation file required Forms 1099?	X	
16	During this tax year, did the corporation have an 80% or more change in ownership, including a change due to redemption of its own stock?		X
17	During or subsequent to this tax year, but before the filing of this return, did the corporation dispose of more than 65% (by value) of its assets in a taxable, non-taxable, or tax deferred transaction?		
18	Did the corporation receive assets in a section 351 transfer in which any of the transferred assets had a fair market basis or fair market value of more than $1 million?		X

TELEXFREE, LLC [redacted]

Form 1120 (2013) Page 5

Schedule L Balance Sheets per Books

Assets	Beginning of tax year (a)	Beginning of tax year (b)	End of tax year (c)	End of tax year (d)
1 Cash		1,707,287.		37,640,973.
2a Trade notes and accounts receivable				
b Less allowance for bad debts	( )		( )	
3 Inventories				
4 U.S. government obligations				
5 Tax-exempt securities (see instructions)				
6 Other current assets (attach statement)	STMT 4	13,509,841.		29,951,194.
7 Loans to shareholders		12,124.		91,257.
8 Mortgage and real estate loans				
9 Other investments (attach statement)		NONE		27,368,369.
10a Buildings and other depreciable assets	15,121.		258,495.	
b Less accumulated depreciation	(599.)	14,522.	(38,550.)	219,945.
11a Depletable assets				
b Less accumulated depletion	( )		( )	
12 Land (net of any amortization)				
13a Intangible assets (amortizable only)				
b Less accumulated amortization	( )		( )	
14 Other assets (attach statement)	STMT 4	3,475.		107,368.
15 Total assets		15,247,249.		95,379,106.
Liabilities and Shareholders' Equity				
16 Accounts payable				
17 Mortgages, notes, bonds payable in less than 1 year				
18 Other current liabilities (attach statement)	STMT 4	7,265,686.		54,512,623.
19 Loans from shareholders		50.		50.
20 Mortgages, notes, bonds payable in 1 year or more				
21 Other liabilities (attach statement)	STMT 4	NONE		61,335,098.
22 Capital stock: a Preferred stock				
b Common stock				
23 Additional paid-in capital				
24 Retained earnings - Appropriated (attach statement)				
25 Retained earnings - Unappropriated		7,981,513.		-20,468,665.
26 Adjustments to shareholders' equity (attach statement)				
27 Less cost of treasury stock		( )		( )
28 Total liabilities and shareholders' equity		15,247,249.		95,379,106.

Schedule M-1 Reconciliation of Income (Loss) per Books With Income per Return

Note: Schedule M-3 required instead of Schedule M-1 if total assets are $10 million or more - see instructions

1 Net income (loss) per books	-22,177,778.	7 Income recorded on books this year not included on this return (itemize): Tax-exempt interest $	
2 Federal income tax per books	16,025,349.		
3 Excess of capital losses over capital gains			
4 Income subject to tax not recorded on books this year (itemize):		8 Deductions on this return not charged against book income this year (itemize):	
5 Expenses recorded on books this year not deducted on this return (itemize):		a Depreciation $	205,423.
a Depreciation $		b Charitable contributions $	
b Charitable contributions $	7,500.		
c Travel and entertainment $	1,607.		
SEE STATEMENT 5	3,204,894.	9 Add lines 7 and 8	205,423.
6 Add lines 1 through 5	-2,938,428.	10 Income (page 1, line 28) - line 6 less line 9	-3,143,851.

Schedule M-2 Analysis of Unappropriated Retained Earnings per Books (Line 25, Schedule L)

1 Balance at beginning of year	7,981,513.	5 Distributions: a Cash	6,272,400.
2 Net income (loss) per books	-22,177,778.	b Stock	
3 Other increases (itemize):		c Property	
		6 Other decreases (itemize):	
		7 Add lines 5 and 6	6,272,400.
4 Add lines 1, 2, and 3	-14,196,265.	8 Balance at end of year (line 4 less line 7)	-20,468,665.

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SCHEDULE G (Form 1120)
(Rev. December 2011)
Department of the Treasury
Internal Revenue Service

Information on Certain Persons Owning the Corporation's Voting Stock

▶ Attach to Form 1120.
▶ See instructions on page 2.

OMB No. 1545-0123

Name

TELEXFREE, LLC
C/O STEPHEN DARR, BANKRUPTCY TRUSTEE

Employer identification number (EIN)

[redacted]

Part I Certain Entities Owning the Corporation's Voting Stock. (Form 1120, Schedule K, Question 4a). Complete columns (i) through (v) below for any foreign or domestic corporation, partnership (including any entity treated as a partnership), trust, or tax-exempt organization that owns directly 20% or more, or owns, directly or indirectly, 50% or more of the total voting power of all classes of the corporation's stock entitled to vote (see instructions).

(i) Name of Entity	(ii) Employer Identification Number (if any)	(iii) Type of Entity	(iv) Country of Organization	(v) Percentage Owned in Voting Stock

Part II Certain Individuals and Estates Owning the Corporation's Voting Stock. (Form 1120, Schedule K, Question 4b). Complete columns (i) through (iv) below for any individual or estate that owns directly 20% or more, or owns, directly or indirectly, 50% or more of the total voting power of all classes of the corporation's stock entitled to vote (see instructions).

(i) Name of Individual or Estate	(ii) Identifying Number (if any)	(iii) Country of Citizenship (see instructions)	(iv) Percentage Owned in Voting Stock
CARLOS WANZELER	[redacted]	US	50.00
JAMES MERRILL		US	50.00

Form **4626** — Department of the Treasury, Internal Revenue Service

Alternative Minimum Tax - Corporations

▶ Attach to the corporation's tax return.
▶ Information about Form 4626 and its separate instructions is at www.irs.gov/form4626.

OMB No. 1545-0175

2013

Name: TELEXFREE, LLC
C/O STEPHEN DARR, BANKRUPTCY TRUSTEE

Employer identification number: [redacted]

Note: See the instructions to find out if the corporation is a small corporation exempt from the alternative minimum tax (AMT) under section 55(e).

1	Taxable income or (loss) before net operating loss deduction		1	-3,143,851.
2	Adjustments and preferences:			
a	Depreciation of post-1986 property		2a	
b	Amortization of certified pollution control facilities		2b	
c	Amortization of mining exploration and development costs		2c	
d	Amortization of circulation expenditures (personal holding companies only)		2d	
e	Adjusted gain or loss		2e	
f	Long-term contracts		2f	
g	Merchant marine capital construction funds		2g	
h	Section 833(b) deduction (Blue Cross, Blue Shield, and similar type organizations only)		2h	
i	Tax shelter farm activities (personal service corporations only)		2i	
j	Passive activities (closely held corporations and personal service corporations only)		2j	
k	Loss limitations		2k	
l	Depletion		2l	
m	Tax-exempt interest income from specified private activity bonds		2m	
n	Intangible drilling costs		2n	
o	Other adjustments and preferences SEE STATEMENT 6		2o	NONE
3	Pre-adjustment alternative minimum taxable income (AMTI). Combine lines 1 through 2o		3	-3,143,851.
4	Adjusted current earnings (ACE) adjustment:			
a	ACE from line 10 of the ACE worksheet in the instructions	4a: -3,143,851.		
b	Subtract line 3 from line 4a. If line 3 exceeds line 4a, enter the difference as a negative amount (see instructions)	4b:		
c	Multiply line 4b by 75% (.75). Enter the result as a positive amount	4c:		
d	Enter the excess, if any, of the corporation's total increases in AMTI from prior year ACE adjustments over its total reductions in AMTI from prior year ACE adjustments (see instructions). Note: *You must enter an amount on line 4d (even if line 4b is positive)*	4d:		
e	ACE adjustment. • If line 4b is zero or more, enter the amount from line 4c • If line 4b is less than zero, enter the smaller of line 4c or line 4d as a negative amount		4e	
5	Combine lines 3 and 4e. If zero or less, stop here; the corporation does not owe any AMT		5	-3,143,851.
6	Alternative tax net operating loss deduction (see instructions)		6	
7	Alternative minimum taxable income. Subtract line 6 from line 5. If the corporation held a residual interest in a REMIC, see instructions		7	-3,143,851.
8	Exemption phase-out (if line 7 is $310,000 or more, skip lines 8a and 8b and enter -0- on line 8c):			
a	Subtract $150,000 from line 7 (if completing this line for a member of a controlled group, see instructions). If zero or less, enter -0-	8a: NONE		
b	Multiply line 8a by 25% (.25)	8b: NONE		
c	Exemption. Subtract line 8b from $40,000 (if completing this line for a member of a controlled group, see instructions). If zero or less, enter -0-		8c	40,000.
9	Subtract line 8c from line 7. If zero or less, enter -0-		9	NONE
10	Multiply line 9 by 20% (.20)		10	NONE
11	Alternative minimum tax foreign tax credit (AMTFTC) (see instructions)		11	
12	Tentative minimum tax. Subtract line 11 from line 10		12	NONE
13	Regular tax liability before applying all credits except the foreign tax credit		13	
14	Alternative minimum tax. Subtract line 13 from line 12. If zero or less, enter -0-. Enter here and on Form 1120, Schedule J, line 3, or the appropriate line of the corporation's income tax return		14	NONE

For Paperwork Reduction Act Notice, see separate instructions. Form **4626** (2013)

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TELEXFREE, LLC [redacted]

Adjusted Current Earnings (ACE) Worksheet

Keep for Your Records

▶ See ACE Worksheet Instructions.

1	Pre-adjustment AMTI. Enter the amount from line 3 of Form 4626			1	-3,143,851.
2	ACE depreciation adjustment:				
a	AMT depreciation		2a NONE		
b	ACE depreciation:				
	(1) Post-1993 property	2b(1) NONE			
	(2) Post-1989, pre-1994 property	2b(2)			
	(3) Pre-1990 MACRS property	2b(3)			
	(4) Pre-1990 original ACRS property	2b(4)			
	(5) Property described in sections 168(f)(1) through (4)	2b(5)			
	(6) Other property	2b(6)			
	(7) Total ACE depreciation. Add lines 2b(1) through 2b(6)		2b(7) NONE		
c	ACE depreciation adjustment. Subtract line 2b(7) from line 2a			2c	NONE
3	Inclusion in ACE of items included in earnings and profits (E&P):				
a	Tax-exempt interest income		3a		
b	Death benefits from life insurance contracts		3b		
c	All other distributions from life insurance contracts (including surrenders)		3c		
d	Inside buildup of undistributed income in life insurance contracts		3d		
e	Other items (see Regulations sections 1.56(g)-1(c)(6)(iii) through (ix) for a partial list)		3e		
f	Total increase to ACE from inclusion in ACE of items included in E&P. Add lines 3a through 3e			3f	
4	Disallowance of items not deductible from E&P:				
a	Certain dividends received		4a		
b	Dividends paid on certain preferred stock of public utilities that are deductible under section 247		4b		
c	Dividends paid to an ESOP that are deductible under section 404(k)		4c		
d	Nonpatronage dividends that are paid and deductible under section 1382(c)		4d		
e	Other items (see Regulations sections 1.56(g)-1(d)(3)(i) and (ii) for a partial list)		4e		
f	Total increase to ACE because of disallowance of items not deductible from E&P. Add lines 4a through 4e			4f	
5	Other adjustments based on rules for figuring E&P:				
a	Intangible drilling costs		5a		
b	Circulation expenditures		5b		
c	Organizational expenditures		5c		
d	LIFO inventory adjustments		5d		
e	Installment sales		5e		
f	Total other E&P adjustments. Combine lines 5a through 5e			5f	
6	Disallowance of loss on exchange of debt pools			6	
7	Acquisition expenses of life insurance companies for qualified foreign contracts			7	
8	Depletion			8	
9	Basis adjustments in determining gain or loss from sale or exchange of pre-1994 property			9	
10	Adjusted current earnings. Combine lines 1, 2c, 3f, 4f, and 6f through 9. Enter the result here and on line 4a of Form 4626			10	-3,143,851.

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Form **1125-A** (Rev. December 2012)
Department of the Treasury Internal Revenue Service

Cost of Goods Sold

▶ Attach to Form 1120, 1120-C, 1120-F, 1120S, 1065, or 1065-B.
▶ Information about Form 1125-A and its instructions is at *www.irs.gov/form1125a.*

OMB No. 1545-2225

Name: TELEXFREE, LLC
C/O STEPHEN DARR, BANKRUPTCY TRUSTEE

Employer identification number: [redacted]

1	Inventory at beginning of year	1	
2	Purchases	2	
3	Cost of labor	3	
4	Additional section 263A costs (attach schedule)	4	
5	Other costs (attach schedule) SEE STATEMENT 7	5	2,661,213.
6	Total. Add lines 1 through 5	6	2,661,213.
7	Inventory at end of year	7	
8	Cost of goods sold. Subtract line 7 from line 6. Enter here and on Form 1120, page 1, line 2 or the appropriate line of your tax return (see instructions)	8	2,661,213.

9a Check all methods used for valuing closing inventory:
- (i) ☐ Cost
- (ii) ☐ Lower of cost or market
- (iii) ☐ Other (Specify method used and attach explanation.) ▶

b Check if there was a writedown of subnormal goods ▶ ☐
c Check if the LIFO inventory method was adopted this tax year for any goods (if checked, attach Form 970) ▶ ☐
d If the LIFO inventory method was used for this tax year, enter amount of closing inventory computed under LIFO — 9d
e If property is produced or acquired for resale, do the rules of section 263A apply to the entity (see instructions)? ☐ Yes ☐ No
f Was there any change in determining quantities, cost, or valuations between opening and closing inventory? If "Yes," attach explanation ☐ Yes ☐ No

Section references are to the Internal Revenue Code unless otherwise noted.

General Instructions

Purpose of Form

Use Form 1125-A to calculate and deduct cost of goods sold for certain entities.

Who Must File

Filers of Form 1120, 1120-C, 1120-F, 1120S, 1065, or 1065-B, must complete and attach Form 1125-A if the applicable entity reports a deduction for cost of goods sold.

Inventories

Generally, inventories are required at the beginning and end of each tax year if the production, purchase, or sale of merchandise is an income-producing factor. See Regulations section 1.471-1. If inventories are required, you generally must use an accrual method of accounting for sales and purchases of inventory items.

Exception for certain taxpayers. If you are a qualifying taxpayer or a qualifying small business taxpayer (defined below), you can adopt or change your accounting method to account for inventoriable items in the same manner as materials and supplies that are not incidental.

Under this accounting method, inventory costs for raw materials purchased for use in producing finished goods and merchandise purchased for resale are deductible in the year the finished goods or merchandise are sold (but not before the year you paid for the raw materials or merchandise, if you are also using the cash method).

If you account for inventoriable items in the same manner as materials and supplies that are not incidental, you can currently deduct expenditures for direct labor and all indirect costs that would otherwise be included in inventory costs. See the instructions for lines 2 and 7.

For additional guidance on this method of accounting, see Pub. 538, Accounting Periods and Methods. For guidance on adopting or changing to this method of accounting, see Form 3115, Application for Change in Accounting Method, and its instructions.

Qualifying taxpayer. A qualifying taxpayer is a taxpayer that, (a) for each prior tax year ending after December 16, 1998, has average annual gross receipts of $1 million or less for the 3 prior tax years and (b) its business is not a tax shelter (as defined in section 448(d)(3)). See Rev. Proc. 2001-10, 2001-2 I.R.B. 272.

Qualifying small business taxpayer. A qualifying small business taxpayer is a taxpayer that, (a) for each prior tax year ending on or after December 31, 2000, has average annual gross receipts of $10 million or less for the 3 prior tax years, (b) whose principal business activity is not an ineligible activity, and (c) whose business is not a tax shelter (as defined in section 448(d)(3)). See Rev. Proc. 2002-28, 2002-18, I.R.B. 815.

Uniform capitalization rules. The uniform capitalization rules of section 263A generally require you to capitalize, or include in inventory, certain costs incurred in connection with the following.

- The production of real property and tangible personal property held in inventory or held for sale in the ordinary course of business.
- Real property or personal property (tangible and intangible) acquired for resale.
- The production of real property and tangible personal property by a corporation for use in its trade or business or in an activity engaged in for profit.

See the discussion on section 263A uniform capitalization rules in the instructions for your tax return before completing Form 1125-A. Also see Regulations sections 1.263A-1 through 1.263A-3. See Regulations section 1.263A-4 for rules for property produced in a farming business.

Form **4562**

Department of the Treasury
Internal Revenue Service (99)

Depreciation and Amortization
(Including Information on Listed Property)

▶ See separate instructions. ▶ Attach to your tax return.

OMB No. 1545-0172

2013

Attachment Sequence No. 179

Name(s) shown on return: TELEXFREE, LLC
C/O STEPHEN DARR, BANKRUPTCY TRUSTEE

Identifying number: [redacted]

Business or activity to which this form relates

GENERAL DEPRECIATION AND AMORTIZATION

Part I Election To Expense Certain Property Under Section 179

Note: If you have any listed property, complete Part V before you complete Part I.

1	Maximum amount (see instructions)	1	500,000.
2	Total cost of section 179 property placed in service (see instructions)	2	243,373.
3	Threshold cost of section 179 property before reduction in limitation (see instructions)	3	2,000,000.
4	Reduction in limitation. Subtract line 3 from line 2. If zero or less, enter -0-	4	
5	Dollar limitation for tax year. Subtract line 4 from line 1. If zero or less, enter -0-. If married filing separately, see instructions	5	500,000.

6	(a) Description of property	(b) Cost (business use only)	(c) Elected cost

7	Listed property. Enter the amount from line 29	7		
8	Total elected cost of section 179 property. Add amounts in column (c), lines 6 and 7		8	243,373.
9	Tentative deduction. Enter the smaller of line 5 or line 8		9	243,373.
10	Carryover of disallowed deduction from line 13 of your 2012 Form 4562		10	
11	Business income limitation. Enter the smaller of business income (not less than zero) or line 5 (see instructions)		11	500,000.
12	Section 179 expense deduction. Add lines 9 and 10, but do not enter more than line 11		12	243,373.
13	Carryover of disallowed deduction to 2014. Add lines 9 and 10, less line 12 ▶	13		

Note: *Do not use Part II or Part III below for listed property. Instead, use Part V.*

Part II Special Depreciation Allowance and Other Depreciation (Do not include listed property.) (See instructions.)

14	Special depreciation allowance for qualified property (other than listed property) placed in service during the tax year (see instructions)	14	
15	Property subject to section 168(f)(1) election	15	
16	Other depreciation (including ACRS)	16	

Part III MACRS Depreciation (Do not include listed property.) (See instructions.)

Section A

17	MACRS deductions for assets placed in service in tax years beginning before 2013	17	
18	If you are electing to group any assets placed in service during the tax year into one or more general asset accounts, check here ▶ ☐		

Section B - Assets Placed in Service During 2013 Tax Year Using the General Depreciation System

(a) Classification of property	(b) Month and year placed in service	(c) Basis for depreciation (business/investment use only - see instructions)	(d) Recovery period	(e) Convention	(f) Method	(g) Depreciation deduction
19a 3-year property						
b 5-year property						
c 7-year property						
d 10-year property						
e 15-year property						
f 20-year property						
g 25-year property			25 yrs.		S/L	
h Residential rental property			27.5 yrs.	MM	S/L	
			27.5 yrs.	MM	S/L	
i Nonresidential real property			39 yrs.	MM	S/L	
				MM	S/L	

Section C - Assets Placed in Service During 2013 Tax Year Using the Alternative Depreciation System

20a Class life					S/L	
b 12-year			12 yrs.		S/L	
c 40-year			40 yrs.	MM	S/L	

Part IV Summary (See instructions.)

21	Listed property. Enter amount from line 28	21	
22	Total. Add amounts from line 12, lines 14 through 17, lines 19 and 20 in column (g), and line 21. Enter here and on the appropriate lines of your return. Partnerships and S corporations - see instructions	22	243,373.
23	For assets shown above and placed in service during the current year, enter the portion of the basis attributable to section 263A costs	23	

TELEXFREE, LLC
Form 4562 (2013) [redacted] Page 2

Part V Listed Property (Include automobiles, certain other vehicles, certain computers, and property used for entertainment, recreation, or amusement.)

Note: *For any vehicle for which you are using the standard mileage rate or deducting lease expense, complete only 24a, 24b, columns (a) through (c) of Section A, all of Section B, and Section C if applicable.*

Section A - Depreciation and Other Information (Caution: *See the instructions for limits for passenger automobiles.*)

24a Do you have evidence to support the business/investment use claimed? Yes No 24b If "Yes," is the evidence written? Yes No

(a) Type of property (list vehicles first)	(b) Date placed in service	(c) Business/ investment use percentage	(d) Cost or other basis	(e) Basis for depreciation (business/investment use only)	(f) Recovery period	(g) Method/ Convention	(h) Depreciation deduction	(i) Elected section 179 cost
25 Special depreciation allowance for qualified listed property placed in service during the tax year and used more than 50% in a qualified business use (see instructions)						25		
26 Property used more than 50% in a qualified business use:								
		%						
		%						
		%						
27 Property used 50% or less in a qualified business use:								
		%				S/L -		
		%				S/L -		
		%				S/L -		
28 Add amounts in column (h), lines 25 through 27. Enter here and on line 21, page 1						28		
29 Add amounts in column (i), line 26. Enter here and on line 7, page 1							29	

Section B - Information on Use of Vehicles

Complete this section for vehicles used by a sole proprietor, partner, or other "more than 5% owner," or related person. If you provided vehicles to your employees, first answer the questions in Section C to see if you meet an exception to completing this section for those vehicles.

	(a) Vehicle 1		(b) Vehicle 2		(c) Vehicle 3		(d) Vehicle 4		(e) Vehicle 5		(f) Vehicle 6	
30 Total business/investment miles driven during the year (do not include commuting miles)												
31 Total commuting miles driven during the year												
32 Total other personal (noncommuting) miles driven												
33 Total miles driven during the year. Add lines 30 through 32												
	Yes	No	Yes	No	Yes	No	Yes	No	Yes	No	Yes	No
34 Was the vehicle available for personal use during off-duty hours?												
35 Was the vehicle used primarily by a more than 5% owner or related person?												
36 Is another vehicle available for personal use?												

Section C - Questions for Employers Who Provide Vehicles for Use by Their Employees

Answer these questions to determine if you meet an exception to completing Section B for vehicles used by employees who are not more than 5% owners or related persons (see instructions).

	Yes	No
37 Do you maintain a written policy statement that prohibits all personal use of vehicles, including commuting, by your employees?		
38 Do you maintain a written policy statement that prohibits personal use of vehicles, except commuting, by your employees? See the instructions for vehicles used by corporate officers, directors, or 1% or more owners		
39 Do you treat all use of vehicles by employees as personal use?		
40 Do you provide more than five vehicles to your employees, obtain information from your employees about the use of the vehicles, and retain the information received?		
41 Do you meet the requirements concerning qualified automobile demonstration use? (See instructions.)		

Note: *If your answer to 37, 38, 39, 40, or 41 is "Yes," do not complete Section B for the covered vehicles.*

Part VI Amortization

(a) Description of costs	(b) Date amortization begins	(c) Amortizable amount	(d) Code section	(e) Amortization period or percentage	(f) Amortization for this year
42 Amortization of costs that begins during your 2013 tax year (see instructions):					
43 Amortization of costs that began before your 2013 tax year				43	
44 Total. Add amounts in column (f). See the instructions for where to report				44	

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Form 4562 (2013)

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TELEXFREE, LLC

FORM 1120, PAGE 1 DETAIL

LINE 17 - TAXES AND LICENSES

TELECOM TAX EXPENSE	23,404.
PAYROLL TAX EXPENSE	15,664.
TAXES AND LICENSES	1,298.
TOTAL	40,366.

TELEXFREE, LLC

FORM 1120, PAGE 1 DETAIL

LINE 19 - CONTRIBUTIONS DEDUCTION

1.	TAXABLE INCOME (EXCLUDING CONTRIBUTIONS AND DOMESTIC PRODUCTION ACTIVITIES DEDUCTION)	-3,143,851.
2.	LESS: NOL CARRYOVER	
3.	PLUS: CAPITAL LOSS CARRYBACK	
4.	TAXABLE INCOME WITHOUT REGARD TO CONTRIBUTIONS, SPECIAL DEDUCTIONS, DOMESTIC PRODUCTION ACTIVITIES DEDUCTION, NOL CARRYBACKS, AND CAPITAL LOSS CARRYBACKS	-3,143,851.
5.	CONTRIBUTION DEDUCTION LIMITATION (TAXABLE INCOME X 10%)	NONE
6.	AMOUNT OF DEDUCTIBLE CONTRIBUTIONS	7,500.
7.	CONTRIBUTION DEDUCTION (LESSER OF LINE 5 OR LINE 6)	NONE

LINE 19 - 5 YEAR CONTRIBUTION CARRYOVER

YEAR ENDING	AMOUNT AVAILABLE	AMOUNT UTILIZED	CONVERTED TO NOL CARRYOVER	CARRYOVER TO NEXT YEAR
12/31/2013	7,500.	NONE		7,500.
TOTAL	7,500.	NONE		7,500.

TELEXFREE, LLC

FORM 1120, PAGE 1 DETAIL

LINE 26 - OTHER DEDUCTIONS

TRAVEL, MEALS AND ENTERTAINMENT		194,012.
BANK CHARGES		299,799.
CREDIT CARD FEES		284.
EVENTS		114,038.
FILING AND REGISTERED AGENT FEES		1,579.
MANAGEMENT AND MARKETING		4,357,420.
MERCHANT FEES		5,064,925.
MISCELLANEOUS		33,500.
OFFICE EXPENSES		17,372.
OFFICE SUPPLIES		2,509.
OTHER EXPENSES		4,168.
PAYROLL SERVICE FEE		997.
PERSONELL		18,750.
POSTAGE AND DELIVERY		1,599.
PRODUCT DEVELOPMENT		6,000.
PROFESSIONAL CONSULTANT IT		33,750.
PROFESSIONAL FEES		455,791.
PROMOTIONAL		118,594.
SMALL ITEMS NOT CAPITALIZED		3,417.
SOFTWARE DEVELOPMENT		81,288.
SUBCONTRACTOR		59,443.
PROFESSIONAL IT CONSULTANT		440,682.
GROSS CREDIT LIABILITY ACCRUAL	SEE STATEMENT 3A FOR DETAIL	972,955,648.
WEBSITE DOMAIN		780.
TRAVEL MEALS		22.
TOTAL		984,266,367.

Taxpayer: TelexFree, LLC
EIN: [redacted]
Tax Period: December 31, 2013

2013 Statement Regarding Gross Credit Liability Accrual

The credits deposited in Ponzi scheme users' accounts during 2013 (i.e., $972,955,648) were used by participants to satisfy invoices and redeemed for cash as shown below:

$0	Credits outstanding BOY
$972,955,648	2013 Credits issued to users (deduction claimed on line 26)
($843,475,755)	Credits redeemed by users to satisfy invoices (included in gross receipts in line 1a)
($68,144,795)	Credits redeemed by users for cash
$61,335,098	Credits outstanding EOY

STATEMENT 3A

TELEXFREE, LLC

FORM 1120, PAGE 5 DETAIL

SCH L, LINE 6 -
OTHER CURRENT ASSETS

	BEGINNING	ENDING
PROPERTY ON HOLD	938,871.	16,222,365.
LOAN FROM TELEXFREE INC	701,525.	NONE
LOAN TO YMPACTUS	11,869,445.	NONE
LOAN TO TELEXELECTRIC LLP	NONE	2,022,329.
LOAN TO TELEXFREE FINANCIAL	NONE	4,105,475.
LOAN TO TELEXMOBILE	NONE	500,870.
PREPAID EXPENSES	NONE	1,709,402.
LOAN TO TELEXFREE LLC	NONE	5,390,753.
TOTAL	13,509,841.	29,951,194.

SCH L, LINE 14 - OTHER ASSETS

ORGANIZATIONAL COSTS	3,475.	3,475.
SOFTWARE	NONE	97,949.
SECURITY DEPOSITS	NONE	5,944.
TOTAL	3,475.	107,368.

SCH L, LINE 18 -
OTHER CURRENT LIABILITIES

ACCRUED FEDERAL INCOME TAX	4,624,801.	19,964,029.
ACCRUED STATE TAX	843,429.	3,812,940.
BRAZILLIAN HELP INC	2,672.	2,672.
LOAN TO/FROM TELEXFREE LLC	701,525.	5,390,753.
OTHER CURRENT LIABILITIES	1,093,259.	17,676,275.
TELECOM TAXES PAYABLE	NONE	23,404.
COMMISSIONS PAYABLE	NONE	7,642,550.
TOTAL	7,265,686.	54,512,623.

SCH L, LINE 21 - OTHER LIABILITIES

ACCRUED ADVERTISING CREDITS	NONE	61,335,098.
TOTAL	NONE	61,335,098.

TELEXFREE, LLC

FORM 1120, PAGE 5 DETAIL

SCH M-1, LINE 5 - EXPENSES RECORDED ON BOOKS NOT DEDUCTED ON RETURN

STATE TAXES	2,969,511.
LOSS ON INVESTMENT	48,663.
PENALTIES	186,720.
TOTAL	3,204,894.

TELEXFREE, LLC

FORM 4626 DETAIL

LINE 20 - OTHER ADJUSTMENTS - CONTRIBUTIONS DEDUCTION

1.	AMTI (EXCLUDING CONTRIBUTIONS AND DOMESTIC PRODUCTION ACTIVITIES DEDUCTION)	-3,143,851.
2.	LESS: NOL CARRYOVER	
3.	PLUS: CAPITAL LOSS CARRYBACK	
4.	AMTI WITHOUT REGARD TO CONTRIBUTIONS, SPECIAL DEDUCTIONS, DOMESTIC PRODUCTION ACTIVITIES DEDUCTION, NOL CARRYBACKS, AND CAPITAL LOSS CARRYBACKS	-3,143,851.
5.	CONTRIBUTION DEDUCTION LIMITATION (AMTI X 10%)	NONE
6.	AMOUNT OF DEDUCTIBLE CONTRIBUTIONS	7,500.
7.	CONTRIBUTION DEDUCTION (LESSER OF LINE 5 OR LINE 6)	NONE

5 YEAR CONTRIBUTIONS CARRYOVER

YEAR ENDING	AMOUNT AVAILABLE	AMOUNT UTILIZED	CARRYOVER TO NEXT YEAR
12/31/2013	7,500.	NONE	7,500.
TOTAL	7,500.	NONE	7,500.

LINE 20 - CONTRIBUTIONS ADJUSTMENT

REGULAR CONTRIBUTIONS	NONE
AMT CONTRIBUTIONS	NONE
CONTRIBUTION ADJUSTMENT	NONE

TELEXFREE, LLC

FORM 1125-A DETAIL

LINE 5 - OTHER COSTS

DIRECT INBOUND DIAL & ACCESS NUMBERS	45,930.
TELECOM & DATABASE NETWORK EXPENSE	513,198.
TERMINATION	2,102,085.
TOTAL	2,661,213.



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BY ELECTRONIC AND CERTIFIED MAIL

June 28, 2017

U.S. Department of Justice, Tax Division
Civil Trial Section, Northern Region
Attn: Trial Attorney Carl L. Moore
P.O. Box 55
Washington, DC 20044

RE: In re Telexfree, LLC
Case No. 14-40987

Dear Mr. Moore:

As you requested during our conference call with Trustee's counsel on June 1, 2017, with this letter we provide a written response to the Notices of Proposed Adjustment (NOPAs) the Internal Revenue Service ("Service" or IRS) issued regarding the 2013 return filed on behalf of TelexFree, LLC. For purposes of this letter, we assume the reader's familiarity with our technical positions taken on the return, which we outlined in our letters to the Service dated February 1, 2017 and March 28, 2017, attached as **Exhibit A**, and our Information Document Request (IDR) responses, which we assume the Service provided to you.

As you know, the Service issued four NOPAs in its examination of TelexFree's 2013 return. In summary, NOPAs 001 and 002 disallow TelexFree's deductions for payments to (or promises to pay) participants for advertising and recruitment services and product sales. NOPA 003 disallows TelexFree's bad debt deduction for an uncollectible account receivable, while NOPA 004 proposes a late-filing penalty of approximately $75 million. The proposed adjustments in the NOPAs exceed $2.9 billion and, based on the proposed adjustments, the Service estimates a 2013 deficiency (including additions to tax) of approximately $375 million.

The positions set out in the NOPAs would be troubling in any case—but they are particularly troubling given the circumstances of this case. We are glad that you recognize, along with your colleagues in the Department of Justice and other federal enforcement agencies, the importance of delivering as much cash as possible to the victims of the Ponzi/pyramid scheme—though the victims will never fully recover their losses.[1]

Rather than identify every position we disagree with in the NOPAs, in this letter we highlight only certain concerns to illustrate the lack of foundation for the Service's positions.

[1] *See* June 28, 2017 letter from Counsel for the Trustee, supporting the application of Tax Division Directive 137 to this matter.

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In summary, below we explain why TelexFree's advertising and commissions expenses are ordinary and necessary expenses under section 162[2] and should not be characterized as unreasonable compensation or dividend payments. Additionally, we discuss the sufficiency of TelexFree's books and records. Next, we consider the Service's failure to propose conforming adjustments regarding the credit income running through TelexFree's return and TelexFree's 2013 account receivable. Finally, we discuss the Service's proposed attempt to disallow the bad debt deduction of an uncollectible accounts receivable accrual.

In NOPAs 001 and 002, the IRS posits several arguments to disallow TelexFree's deduction for its advertising and commissions' expenses. First, the IRS argues that TelexFree's liabilities for advertising, sales, and recruiting—payments that led to its exponential growth—are not ordinary and necessary business expenses under section 162.[3] In fact, the inverse of this statement is true. TelexFree was in the trade or business of promoting a Ponzi scheme. The most distinct feature of a Ponzi scheme is that it can only survive if it continues to attract new participants.[4] According to the sentencing memorandum filed by the U.S. Attorney's Office in the prosecution of James Merrill ("Merrill Sentencing Memorandum"),[5] these payments (or promises to pay) the IRS characterizes as valueless or unhelpful were core to the business model that made TelexFree one of the largest Ponzi schemes of all time. The magnitude of TelexFree's expenses for advertising, recruiting, and sales is a direct function of the billions of transactions that ran through the business. TelexFree was very successful in recruiting new participants. Recognizing that TelexFree was a Ponzi/pyramid scheme, the expenses at issue must be viewed as normal, usual, or customary as they drove the business.

The IRS characterizes TelexFree as a VoIP business, however, and evaluates its expenses based on that perception. Additionally, the IRS draws a distinction between expenses incurred to continue the Ponzi scheme and those incurred for the VoIP business. For example, on page 4 of NOPA 002 the Service states: "the commissions induced individuals to become, remain and recruit participants, thereby furthering the Ponzi scheme rather than the VoIP business." The misguided premise underlying this statement is that it matters whether an expense furthered a legitimate VoIP business or the Ponzi scheme. As discussed in our response to IDRs 001 and 002, illegal operations are taxed on their net income and may therefore claim a deduction for expenses incurred to operate the business.[6]

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[2] Unless otherwise indicated, all section references in this opinion letter are to the Internal Revenue Code of 1986, as amended (the "Code" or "I.R.C."), or to the regulations thereunder promulgated by the U.S. Treasury Department ("Regulations" or "Treas. Reg."), as the context requires.

[3] NOPA 002, p. 4. In NOPA 002, the IRS incorrectly states that the proposed adjustment relates to the placement of ads only. TelexFree's expense for commissions also relates to recruiting and product sales. Additionally, the IRS incorrectly states that 99.57 percent of TelexFree's total commissions' expense relates to the placement of ads. *See* Merrill Sentencing Memorandum, p. 10 (stating 95.7 percent of commissions and bonuses earned by the participants related to ad posting and recruiting). It is unclear how the IRS arrived at its percentage as we cannot follow the calculation in footnote 5 of NOPA 002.

[4] *See, e.g., Webster v. Omnitrition Int'l, Inc.*, 79 F.3d 776, 781 (9th Cir. 1996); *United States v. Gold Unlimited, Inc.*, 177 F.3d 472, 479 (6th Cir. 1999).

[5] Merrill Sentencing Memorandum, attached as **Exhibit B**. James Merrill was one of the leading public faces of the global TelexFree business.

[6] *See, e.g., Commissioner v. Sullivan*, 356 U.S. 27 (1958).

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Because the expenses at issue were integral to TelexFree's operation and are customary for a Ponzi/pyramid scheme, these expenses should be deductible under section 162.

Next, the IRS argues that TelexFree's entire advertising and commissions' expense should be disallowed because it constitutes unreasonable compensation. Reasonable compensation plays no role in analyzing the deductibility of advertising expenses—the expenses at issue here. Advertising expenses are deductible if they are reasonable in amount, bear a reasonable relationship to the business, and are substantiated.[7]

Even assuming these expenses should be recharacterized as compensation, however, the credits and payments made to individual participants were reasonable. In its analysis, the Service does not mention how much participants actually received. The IRS may have overlooked the simple fact that TelexFree's expenses for advertising and other commissions are as large as they were because there were so many participants (approximately 11 million by user account), not because the weekly or annual payments to individual participants were exorbitant. Many participants earned as little as $20 per week for advertising and the highest payment was $100 per week per account. For the individual earning a weekly payment of $20, we estimate the process took between 30 and 60 minutes each week.[8] A payment of $20 in exchange for 30 to 60 minutes of work hardly seems unreasonable.

Regardless, the expenses for advertising should be characterized as advertising expenses, not compensation, for purposes of determining their deductibility. Advertising was the core service the participants provided under their contractual arrangement with TelexFree. Participants in the Ponzi/pyramid scheme placed from one to five internet ads per day. To do so, participants downloaded marketing materials from TelexFree's website, posted the requisite number of advertisements, and returned to TelexFree's website to "validate" the ads they posted. The advertising ensured TelexFree's name was continuously before the public and, for those classified sites that included multiple TelexFree ads, ensured TelexFree was frequently at the top of a listing of business opportunities. In other words, the bulk of payments to participants was in exchange for their promotion of TelexFree's membership plans online (and to a lesser extent, their promotion of TelexFree's products).

Framing the issue more broadly, all payments to (or promises to pay) participants under TelexFree's membership plans were made to retain and attract additional participants. The continued addition of participants—which was dependent on payments to participants here—is the sole way a Ponzi scheme can continue as a going concern.

Promotional expenses incurred to drive membership are deductible advertising and marketing expenses. In *Transamerica Corp. v. United States*,[9] the court held that a taxpayer's payments to solicit purchases of the taxpayer's stock and increase the taxpayer's income constituted ordinary and necessary advertising expenses.

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[7] Treas. Reg. § 1.162-1(a); *Rodgers Dairy v. Commissioner*, 14 T.C. 66 (1950); *Gill v. Commissioner*, T.C. Memo. 1994-92.

[8] This estimate is based on the assumption that a participant took approximately four to ten minutes each day to download marketing material from TelexFree's website, post an advertisement, and then return to TelexFree's site to validate its advertisement.

[9] 65 F. Supp. 470, 475 (Ct. Cl. 1946).

Transamerica, a holding company, invested in several corporations engaged in banking, insurance, and real estate. The taxpayer's largest source of income was dividends received from its investments—particularly Bank of America. For several reasons, the reputation of the taxpayer and Bank of America was badly damaged during the relevant years. In fact, certain security dealers encouraged the taxpayer's stockholders to sell their stock, claiming that the taxpayer and its subsidiaries were insolvent. Public confidence in the taxpayer declined significantly. To combat this trend, the taxpayer developed an advertising and publicity campaign. The taxpayer paid salespeople employed by a subsidiary to solicit and execute orders of stock by third parties, advertise the stability and financial standing of the taxpayer, and participate in meetings and lectures. The taxpayer's stock ownership and earnings rose as a direct result of the services provided by the salespeople. The IRS argued the commissions paid to the salespeople were connected with the sale of corporate stock and therefore nondeductible capital expenditures.

The court disagreed, concluding the commissions were part of an advertising and publicity campaign to improve the taxpayer's business and income. Accordingly, the court held that the expense was deductible from income as an ordinary and necessary expense of carrying on the business in which the taxpayer was engaged.

Similar to the facts in *Transamerica*, the amounts TelexFree paid to participants maintained and built interest in the company, and were paid in exchange for the advertisement of TelexFree's business online, by word of mouth, and through personal contact. Additionally, these incentives were highly successful in attracting and promoting TelexFree to new participants and retaining current participants. These incentives became even more critical when the Brazilian authorities shut down Ympactus in June 2013. As noted above, at TelexFree's height, there were more than 11 million user accounts. Similar to the court's holding in *Transamerica*, TelexFree's advertising and commissions' expenses should be treated as deductible advertising and publicity expenses.

The IRS next argues the payments to participants should be classified as non-deductible dividends or distributions based on the unfounded conclusion that the participants held equity interests in TelexFree. To support the assertion that participants held equity interests, the Service refers to the Securities and Exchange Commission's charge under the Exchange Act of 1934 ("Exchange Act") and the Securities Act of 1933 ("Securities Act") that TelexFree dealt in unregistered securities.

As an initial matter, the definition of a security under the Exchange Act and the Securities Act has no relevance to federal tax analysis. Even assuming participants held security interests for SEC purposes, that fact, would not lead to the conclusion that TelexFree's payments to participants constituted distributions on equity for tax purposes. In contrast to the broad securities-law definition of a security, a security constitutes an equity interest for tax purposes only if the instrument provides the holder with the right to share in the profits of the venture, subject to the associated risks of loss.[10] Here, the participants' membership interests did not carry any economic rights consistent with those of an owner. Participants did not participate in the assets, profits, losses, or liquidation surplus of TelexFree. Instead, the participants were entitled to payments in exchange for advertising, recruiting, or product sales. Accordingly, there are no grounds for the IRS's arbitrary leap from the SEC's charge to the conclusion that the participants held equity interests for tax purposes.

[10] *See, e.g., Commissioner v. Meridian & Thirteenth Realty Co.*, 132 F.2d 182, 186 (7th Cir. 1942).

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One of the more curious aspects of NOPAs 001 and 002 is the IRS's repeated declaration that TelexFree's books and records fail to substantiate its payments to (or promises to pay) participants. The NOPAs state, as a purported fact, that the 2013 return included estimates of these amounts. For example, on page 5 of NOPA 002, the IRS states "the taxpayer relied on estimates to prepare its return." During the examination, the Trustee and Huron Consulting (the federal government's forensic experts in the criminal prosecution of James Merrill) assembled and provided the Service with transactional detail regarding these expenses. For selected dates during 2013, the transactional detail identified the name of participants who received deposits, the participants' account numbers and addresses, and the date and amount of the deposits. The IRS's self-imposed time constraints were the only reason the IRS did not request, and the Trustee did not provide, transactional detail for every day during 2013 and every single transaction. As the IRS was informed in our response to IDR 006, it takes approximately six hours for a dedicated server to generate one daily report from the special computer system utilized by the Trustee to access TelexFree's SIG accounting system ("SIG"). In addition to the transactional detail, the Trustee and Huron Consulting supplied the IRS with other SIG records that showed the total deposits to participants' accounts for each day during 2013.

The Trustee's access to TelexFree's SIG system was the culmination of a painstaking data recovery and analysis project implemented by the Trustee and Huron Consulting with the assistance of investigators from Homeland Security Investigations and the SEC. HSI provided copies of electronic information contained in TelexFree's computers and servers to the Trustee. Once the data from TelexFree's computers and servers were obtained, the Trustee and his team "virtualized" (i.e., created a computer environment replicating the original configuration) the system following a multi-step process, since the federal authorities were in possession of the original servers.[11] The result was a working version of SIG, which enabled the Trustee and his professionals to conduct search queries and sort data.

As noted in our letter to the IRS dated March 28, 2017, the claims process has confirmed the reliability of the Trustee's records: almost all of the claims filed by victims based on TelexFree's books and records are consistent with the records at issue here.

Also, the government is taking inconsistent positions on the substantiation issue. We respectfully refer you to statements made by the U.S. Attorney's Office concerning the reliability of the records at issue. The following statements are quotations from the Merrill Sentencing Memorandum:

- "These figures are not an estimate, extrapolation or prediction – TelexFree's business records preserved every transaction by every person who ever invested in the company. These are real dollars, lost by real people …." Merrill Sentencing Memorandum, p. 4.

- "According to TelexFree's own business data, which captured every transaction by every TelexFree participant for the life of the company …." Merrill Sentencing Memorandum, p. 22.

[11] Extensive testing was performed to determine that the appropriate configurations of the data were achieved. Data from additional servers were later identified that were necessary to operate the network. Once the key components of the system were identified and operating, passwords were obtained through research into document productions received by the Trustee, communications with federal authorities, and a variety of investigative tools. Finally, an intensive analysis was performed to better understand the database structure, table relationships, data fields, and process flow.

- "As noted above, there is no serious debate about the losses caused by TelexFree. Because TelexFree's servers preserved every transaction by every participant, the government can determine how many participants were "net losers" …." Merrill Sentencing Memorandum, p. 30.

Additionally, the Merrill Sentencing Memorandum identified the professionals employed by Huron Consulting who assembled the credit data provided to the IRS here, as the government's "forensic experts."[12]

The discrepancy between the government's complete reliance on the records in Merrill's criminal prosecution and the IRS's position regarding the exact same records appears to be related to a protective disclosure included in the 2013 return, which states "the return may contain estimates" (emphasis added). There is no legal foundation for the IRS's position that TelexFree's records, which identify "every transaction by every TelexFree participant over the life of the company," are insufficient to substantiate its deductions under section 6001.

Beyond the merits of the arguments raised in NOPAs 001 and 002, the IRS showed a lack of consistency in its selection of adjustments (or more specifically, the offsetting adjustment it failed to propose). Before the issuance of NOPAs 001 and 002, TelexFree's representatives explained to the IRS that a substantial amount of income reported on TelexFree's 2013 return was "credit income." That is, almost 70 percent of the gross income reported on the return is attributable to participants' use of credits to satisfy invoices for membership plans or VoIP packages. Nevertheless, the IRS issued NOPA 001 and 002 proposing adjustments to any deductions TelexFree claimed based on credit activity and sought no further information concerning the amount of TelexFree's gross income that was attributable to the same credit activity.

This same inconsistency arises with the proposed adjustment to TelexFree's bad debt deduction in NOPA 003. Under the section 166 regulations, a debt arising out of a receivable of an accrual-method taxpayer is deemed to be an enforceable obligation to the extent the receivable was included in the taxpayer's income in the year of (or a year preceding) the bad debt deduction.[13] In effect, the regulations create a safe harbor when analyzing debt arising from an account receivable. As stated in our response to IDR 005, TelexFree booked a receivable totaling $186,053,099 (approximately $300,000 less than its 2013 bad debt deduction) during 2012 and 2013. As shown in our IDR 001 and 002 response, approximately $174.1 million of this amount was included in TelexFree's 2013 gross income. The remaining $11 million receivable was included in income in 2012. The IRS's failure to review the records the Trustee provided during the examination is evident from its statement on page 4 of NOPA 003 ("the taxpayer has not demonstrated that the income that the purported debt represents has been included in income for 2013 or any other taxable year, as required by section 1.166-1(c)."). Again, the IRS proposes an adjustment to TelexFree's deductions without any consideration of an offsetting adjustment to TelexFree's income.

[12] Merrill Sentencing Memorandum, p. 23.

[13] Treas. Reg. § 1.166-1(c).

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In addition to this lack of consistency, NOPA 003 discusses authority that has no bearing on TelexFree's bad debt deduction. Although the traditional debt-equity factors are irrelevant to the straightforward test of whether an account receivable constitutes a bona fide debt for an accrual-basis taxpayer (see safe harbor above), the IRS makes the unfounded suggestion that the receivable recorded by TelexFree and included in its income should not be treated as debt because interest was not charged, the parties did not agree to a fixed repayment schedule, and there was no fixed maturity date. As noted above, an account receivable constitutes a bona fide debt under section 166 if the taxpayer is an accrual-method taxpayer and reported the receivable as income in the year the taxpayer claims a bad debt deduction or a prior year. Because TelexFree included a $186 million receivable in its 2012 and 2013 income, as we informed the IRS previously, the bad debt analysis should stop there.

Conclusion

In accordance with the discussion above, we disagree with the adjustments the IRS proposed in the NOPAs issued to TelexFree, LLC. As a final note, we suggest that the government may bear the burden of proof with respect to any tax dispute in this matter for several different reasons. We hope it does not come to that. We look forward to working together with you, through Counsel for the Trustee, to resolve this case.

Should you require any additional information concerning our response to the NOPAs or anything else, please call me at 617-988-1221.

Very truly yours,

KPMG LLP



Thomas Greenaway
Principal, Tax

Enclosures

cc: S. Darr, Trustee for the Debtor
H. Murphy, Counsel for the Trustee

Exhibit A - 2.1.17 Letter to IRS

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BY ELECTRONIC MAIL ONLY

February 1, 2017

Christine DeRosa
Team Coordinator
LB&I Team 1472
Internal Revenue Service
JFK Federal Building
15 New Sudbury St.
Boston, MA 02203

Re: In re Telexfree, LLC
U.S. Bankruptcy Court for the District of Massachusetts
Docket No. 14-40987
Response to Information Document Requests 001 & 002

Dear Christine:

It was good to talk to you recently about the above-referenced joint bankruptcy cases regarding Telexfree, LLC, Telexfree, Inc., and TelexFree Financial, Inc. (collectively, the "Debtors"). Telexfree, LLC (the "Taxpayer") is a domestic LLC that elected to be treated as a C corporation for federal and state income tax purposes. Telexfree, Inc. and Telexfree Financial, Inc. elected to be S corporations for federal and state income tax purposes.

As we discussed, section 505 of the United States Bankruptcy Code ("Bankruptcy Code") gives the Internal Revenue Service 120 days to review a properly filed refund claim before the refund claim may be redetermined by a Court.[1] The refund claims at issue in this case were received by the Internal Revenue Service ("Service") on September 12, 2016, so the 120-day review period ran on or around January 10, 2017.[2] Proof of mailing and receipt of the refund claims by the Service is included as **Exhibit A**. On behalf of the Trustee, we agreed to extend the 120-day period 60 days to March 11, 2016, in order to allow you and your team time to evaluate the 2012 and 2013 refund claims.

The Service Center issued a $15.8 million refund related to the 2013 overpayment to the Taxpayer on December 27, 2016. Therefore, the only refund outstanding is the refund amount requested on the Taxpayer's amended 2012 return.

We write this letter to respond to Information Document Requests ("IDR") 001 and 002, attached as **Exhibit B**. We are working to compile the detailed information in IDR 001 paragraph d and IDR 002 paragraph b, which consists of several million entries. We plan to provide you with this information next week. We reserve our right to supplement this response as we discuss only some of the authority in support the Taxpayer's refund claims below.

---

[1] *See also* Rev. Proc. 2010-27.
[2] The 2012 refund claim is deemed filed on September 9, 2016 under I.R.C. § 7502.

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Introduction

As described on the tax returns and as we discussed on our call, the Debtors operated a Ponzi/pyramid scheme from April 2012 to April 2014, when they filed petitions for relief under Chapter 11 of the Bankruptcy Code. While the Debtors purported to be in the business of selling Voice over Internet Protocol phone packages ("VoIP Packages"), the primary purpose of their business operation was to reward participants ("Participants") for the recruitment of additional Participants. The Debtors also compensated Participants for advertising and product sales.

The Taxpayer's refund claims were prepared using the books and records provided by the Chapter 11 Trustee appointed by the Bankruptcy Court to oversee the Debtors' Chapter 11 cases. Homeland Security Investigation, the investigative arm of the Department of Homeland Security, provided the Trustee with copies of electronic information contained in the Debtors' computers and servers. The Trustee used this data to recreate the information management system used by the Debtors, which tracked account activity of the Ponzi/pyramid scheme's Participants, including membership plan sales, issuance of invoices, accumulation and use of credits, and amounts received from and disbursed to the various accounts held by Participants. The Debtors' operations, described in greater detail below, involved more than 11 million user accounts ("User Accounts") representing a total number of Participants in excess of 1 million from multiple countries.[3]

The books and records show that the Debtors operated at a loss each year as the Ponzi/pyramid scheme provided Participants with significant and unsustainable returns on their services. The income reported on the Taxpayer's returns represent amounts the Debtors received from Participants for membership plans or phone packages. The deductions claimed by the Taxpayer are for amounts owed to Participants for advertising services, other general operating expenses, and commissions due to Participants for product and membership plan sales.

Case Background

On April 13, 2014 (the "Petition Date"), each of the Debtors filed voluntary petitions for relief under Chapter 11 of the Bankruptcy Code with the United States Bankruptcy Court for the District of Nevada. On the Petition Date, the Debtors filed a motion for joint administration of the cases, with TelexFree, LLC designated as the lead case. By order dated April 24, 2014, the order for joint administration was approved. Prior to the filings, the Commonwealth of Massachusetts, Office of Secretary of State, Securities Division (the "MSD") commenced an investigation into the Debtors' business practices.

On or about April 15, 2014, the MSD commenced an administrative proceeding against the Debtors. Also on April 15, 2014, the Securities and Exchange Commission (the "SEC") commenced an action against the Debtors and others in the United States District Court for the District of Massachusetts. The foregoing actions alleged, among other things, that the Debtors were engaged in an illegal Ponzi/pyramid scheme and the fraudulent unregistered offering of securities. Substantially contemporaneously with the commencement of the SEC action, Homeland Securities Investigation ("HSI") seized the Debtors' assets, books, and records. The federal government seized more than $105 million in cash, including funds on

[3] Many Participants held more than one User Account. Although some versions of Participant contracts contained prohibitions against Participants opening multiple User Accounts, other plan descriptions did not. In any case, any such restriction was not enforced and could not be enforced since the Debtors did not verify the Participants' identities.

deposit and checks payable to the Debtors, their principals, or their affiliates. Federal authorities have also made forfeiture claims against approximately forty (40) other items of real and personal property standing in the name of the Debtors' principals and their affiliates, including automobiles, real properties, and notes secured by mortgages on real properties.

On April 23, 2014, the SEC filed a motion to transfer venue of the cases to the United States Bankruptcy Court for the District of Massachusetts ("the Bankruptcy Court"). By order dated May 6, 2014, the motion to change venue was approved. The cases were transferred to the Bankruptcy Court on May 9, 2014. On May 30, 2014, the Bankruptcy Court allowed the United States Trustee's motion to appoint a Chapter 11 trustee, and the Trustee was appointed on June 6, 2014.

On October 8, 2015, the Trustee filed a Motion for an Order that the court find that the Debtors were engaged in a Ponzi and pyramid scheme and grant appropriate relief. Specifically, the Trustee requested that the court disallow any claim of a Participant based upon accumulated credits in the Participant's user account(s) because the accumulated credits constituted fictitious profits of an illegal scheme.

On November 25, 2015, the Bankruptcy Court ruled that each of the Debtors was engaged in a Ponzi and pyramid scheme, consistent with the Motion. The Bankruptcy Court also ordered that the claims of Participants shall be determined on a Net Equity basis. The order is attached as **Exhibit C**.

Mechanics of Ponzi Scheme

The Debtors purported to be in the business of selling VoIP Packages that cost $49.90 per month to conduct international phone calls. Customers who purchased the VoIP Package 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 to approximately 40 countries.

The Debtors used a multi-level marketing plan, or "MLMP", to sell the VoIP Packages. An MLMP, also referred to as network marketing or referral marketing, is a direct sales strategy in which the sales force is compensated not only for sales they generate, but also for the sales generated by other sales persons that they recruit.[4] MLMP businesses can be legitimate, and notable examples of MLMP's include Herbalife International (selling nutritional supplements, weight management, sports nutrition, and personal care products), Mary Kay, Inc. (selling cosmetics products), and Amway (selling, among other things, health, beauty, and home care products).

Each new distributor in an MLMP recruited by a participant, along with the recruited distributor's recruits (down to six levels in the Debtors' case), becomes part of the first participant's "network", sometimes referred to as the participant's "downline." Eventually one or more pyramid type structures is established underneath the recruiting participant. In addition to earning commission and profits on the products the participant sells, he or she is entitled to receive a commission based on the volume of products or memberships sold by his or her network.

[4] *Whole Living, Inc. v. Tolman*, 344 F. Supp. 2d 739 (D. Utah 2004).

Until March 2014, the Debtors provided Participants with two options (in addition to purchasing VoIP Packages) to become members and to thereby open User Accounts:

a. "AdCentral Plan": $339 for a one-year contract ($50 membership fee plus $289 contract fee). This contract entitled the User Account holder with the right to sell ten VoIP Packages, for which a Participant could receive a commission if the packages were sold, although there was no sale requirement. Participants were required to place one internet ad per day and, for each week in which the Participant placed the required ads, he/she was entitled to one additional VoIP Package, which could be sold or exchanged for $20 in credits with the Debtors. Thus, Participants who posted the required ads were eligible to receive $20 per week for 52 weeks, for a total return of $1,040 (a return of 207% on the investment of $339).

b. "AdCentral Family Plan": $1,425 for a one-year contract ($50 membership fee plus $1,375 contract fee). This contract entitled the User Account holder with the right to sell fifty VoIP Packages, for which a Participant could receive a commission if the packages were sold, although there was no sale requirement. Participants were required to place five internet ads per day and, for each week in which the Participant placed the required ads, he/she was entitled to five additional VoIP Packages, which could be sold or exchanged for $100 in credits with the Debtors. Thus, the Participants who posted the required ads were eligible to receive $100 per week for 52 weeks, for a total return of $5,200 (a return of 265% on the investment of $1,425).

The Debtors had internal controls to verify the Participants' posting of advertisements. Most if not all Participants posted advertisements soon after they committed to do so.

In addition to credits for posting these advertisements, the Debtors issued credits to Participants for the sale of membership plans and the establishment of new User Accounts and issued credits for the sale of VoIP Packages.[5]

The credits issued to Participants, as outlined above, could be redeemed for cash, transferred to another User Account, or applied in satisfaction of an invoice for another User Account. To redeem credits for cash, Participants logged onto the Debtors' online system and made a request for a cash distribution. Cash distributions were paid to Participants through a third-party internet payment system, which limited a Participant's redemption to $10,000 per day.

[5] The Debtors also issued "manual credits" to certain User Accounts. Manual credits were credits issued to User Accounts unrelated to the purchase of a membership plan and not resulting from the placement of advertisements or other components of the compensation scheme. Although some manual credits may have been issued to User Accounts in exchange for cash payment to the Debtors, the Trustee is unable to identify any payment to the Debtors for a significant amount of manual credits that were issued to certain User Accounts. These credits issued without consideration appear to be a fraud within the larger fraud of the Ponzi/pyramid scheme. There also were exchanges of credits between User Accounts unassociated with the issuance and satisfaction of Debtor invoices.

As noted above, Participants could also apply credits in satisfaction of an invoice.[6] That is, a Participant could satisfy his/her own invoice directly by payment in cash to another Participant, who would, in turn, satisfy the invoice by a redemption of accumulated credits. Thus, the recruited Participant's membership fee for a TelexFree plan was paid to the recruiting Participant, rather than to the Debtors. Accordingly, a Participant could monetize accumulated credits by recruiting a Participant to join the Debtors' scheme and using his/her accumulated credits to satisfy the invoice for the later Participant's membership plan in exchange for payment of the membership fee from the new Participant (a "Triangular Transaction"). In a Triangular Transaction, the Debtors issued the membership invoice to the recruited Participant, the recruited Participant paid the membership invoice that was due to the Debtors to the recruiting Participant, and the Debtors redeemed the credits of the recruiting Participant in satisfaction of the invoice.

In fact, it was a regular practice of the Debtors' scheme that membership fees were paid by the use of accumulated credits rather than by cash. While invoices associated with the sale of membership plans or VoIP Packages had a face value of approximately $3.07 billion, only $360 million, or approximately twelve percent (12%) of that amount, was paid in cash to the Debtors. The balance of these invoices was satisfied by the use of Participants' credits. Of the $360 million of cash sales identified, approximately $356.8 million of these transactions were settled in 2013 and 2014.

The majority of cash sales (i.e., $353 million) was related to the sale of membership plans while the remainder (i.e., $6.6 million) was from the sale of VoIP Packages. While there were certain provisions of the MLMP that ostensibly required VoIP Package sales as a requirement for receiving credits, the credits that could be generated for those activities were relatively insignificant and the requirements were easily circumvented by the Participants. Furthermore, of these VoIP cash sales, less than one percent of the available minutes contained in these packages were actually utilized.

The scheme proved unsustainable. For example, by April 13, 2014, the date the Debtors filed for bankruptcy, the trailing twelve-month liability for the weekly credits of $20 and $100 due to Participants in the AdCentral Plan and AdCentral Family Plan, respectively, totaled over $5 billion. Liabilities to Participants for recruitment or product sales were significantly smaller (approximately $625 million in 2013).[7] As noted above, the Participants could generally redeem advertising, product, or recruitment-based credits for cash without restriction other than daily limits.

In early 2014, the Debtors revised their MLMP to address the conclusion reached by the Debtors' former counsel that the Debtors' business constituted an unlawful pyramid scheme. The new MLMP altered the commission structure making the scheme less lucrative to Participants. When news broke that the

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[6] In the case of a Participant satisfying his own invoice directly by payment in cash to the Debtors, the process worked, generally, as follows: (i) the Participant joined the Debtors' organization and created an online account with the assistance of a recruiting Participant; (ii) the Debtors recorded the purchase and issued an invoice number; (iii) a Participant could pay the Debtors directly in the form of cash, check, cashier's check, or wire transfer, or through a third-party online payment processing account; and (iv) the new Participant could then start building a network by recruiting other Participants (or by purchasing new user accounts himself) and generating credits and commissions in accordance with the scheme.

[7] The Trustee's Affidavit does not provide a calculation for the product-based or recruitment-based credits owed to Participants, which appear to be identified as "Agent Commission" on the 2013 Profit and Loss statement of Telexfree, LLC.

Debtors planned to institute the new MLMP, the Debtors were flooded with membership purchases from Participants seeking to receive the enhanced incentives of the old MLMP while it remained operative. As a result of this increase in activity, the Debtors' cash receipts totaled approximately $200 million in the last three full months of operation—with more than $96 million in cash receipts in February 2014 alone. At all times during the Debtors' operations and up to the bankruptcy filing, Participants were able to, and did, request an exchange of their credits for cash from the Debtors. Furthermore, the use of Triangular Transactions and the informal cash-for-credits market described above remained strong up until the bankruptcy filing.

SIG/Records of Activity

The Debtors maintained two computer applications for accessing and processing information from the Debtors' database relating to User Account activity, referred to as "SIG" and the "Back Office". After a User Account was established, SIG tracked the activity of the Participant in that User Account, including the accumulation of credits for bonuses and commissions earned, the use or transfer of credits between User Accounts, and payments made to or from the Participant directly with the Debtors. The Back Office was the program used by Participants to obtain information on their User Account activity.

The Trustee's access to SIG was the culmination of a painstaking data recovery and analysis project implemented by the Trustee and his team of professionals with the assistance of investigators from HSI and the SEC.

HSI provided copies of electronic information contained in the Debtors' computers and servers to the Trustee. Once all of the data from the Debtors' computers and servers were obtained, the Trustee and his team "virtualized" (i.e., created a computer environment replicating the original configuration) the system following a multi-step process, since the Federal Authorities were in possession of the original servers.

Extensive testing was performed to determine that the appropriate configurations of the data were achieved. Data from additional servers were later identified that were necessary to operate the network. Once the key components of the system were identified and operating, passwords were obtained through research into document productions received by the Trustee, communications with Federal Authorities, and a variety of investigative tools. Finally, an intensive analysis was performed to better understand the database structure, table relationships, data fields, and process flow.

The result was a working version of SIG, which enabled the Trustee and his professionals to conduct search queries and sort data. The Trustee and his team have taken a series of steps to confirm the accuracy and reliability of the transaction data reflected in SIG. The Trustee interviewed the Debtors' bookkeeper to understand the mechanics of SIG and how it was employed on a day to day basis. Testing was performed to reconcile balances and activity using available data, which is somewhat limited. This testing included cross-referencing data in related transactions and conducting interviews with several Participants to confirm the accuracy of the SIG data as to their User Accounts. Based on the testing performed to date, SIG transaction data appears to have integrity and provides accurate information regarding membership plan sales, issuance of invoices, accumulation and use of credits, and amounts received from and disbursed to the User Accounts.

The Trustee prepared a Profit and Loss statement for 2013, attached as **Exhibit D**, based on the information contained in the Debtors' computers and servers. According to this data, the Debtors' expense for amounts due to Participants for product and membership plan sales totaled $622,588,034 for 2013.

According to the books and records, the Debtors' primary liability over the course of their operations was associated with advertising services provided by Participants. Participants earned $20 or $100 a week, depending on the plan, for posting internet advertisements. As noted above, the trailing twelve-month liability for the weekly credits of $20 and $100 due to Participants in the AdCentral Plan and AdCentral Family Plan, respectively, totaled over $5 billion by the Petition Date.

The Trustee calculated the Debtors' liability for advertising services using the SIG records he and his team reconstructed. See workpapers, attached as **Exhibit E**. According to these records, the Debtors' net liability for advertising services totaled $9,829,080 by December 31,.2012. By the end of 2013, this liability had increased to $2,161,474,220. Accordingly, under the terms of the contracts entered into with Participants, the Debtors' liability for advertising services had increased by $2,151,645,140 during 2013.

Analysis

Expenses of Illegal Operations

Generally, taxpayers may claim deductions for costs related to criminal or illegal business activity. For example, in *Commissioner v. Sullivan*,[8] the Supreme Court held that amounts a taxpayer paid to lease a space and hire employees for the purpose of carrying on an illegal gambling enterprise were deductible for federal income tax purposes.

Likewise, in *Commissioner v. Tellier*,[9] a taxpayer was found guilty of engaging in business activities that violated the Securities Act of 1933. The taxpayer later deducted his legal defense expenses when calculating his taxable income. The Supreme Court held that the taxpayer was allowed to deduct the legal fees even though he had incurred those fees because of a crime, reasoning that it was ordinary and necessary for a person engaged in a business to expect to have legal fees associated with that business. The *Tellier* Court emphasized that the general purpose of the tax code is to tax a taxpayer's net income, not to punish unlawful behavior. The Court further stated that Congress must pass legislation if illegal operations should be subject to taxation on a different basis than legitimate operations.

Congress has specifically barred the deductibility of certain business expenses on public policy grounds.[10] On the other hand, "a deduction for a trade or expense that would otherwise be allowable under section 162 shall not be denied on the grounds that allowance of such deduction would frustrate a

[8] 356 U.S. 27 (1958).
[9] 383 U.S. 687 (1966).
[10] *See, e.g.*, I.R.C. § 162(c), -(f).

sharply defined public policy."[11] Older common-law "public policy" disallowance cases have been abrogated by Congress.[12]

Consistent with the Supreme Court's holdings in *Sullivan* and *Tellier*, the Taxpayer may claim a deduction for expenses incurred in the operation of its business operations—notwithstanding the fact that the Bankruptcy Court concluded the Debtors were engaged in an unlawful Ponzi and pyramid scheme. The Debtors (like other taxpayers engaged in business) are subject to taxation on their net income.

We limit our discussion below to the deductibility of the advertising-based credits consistent with the request in IDR 001. As noted above, these credits were deposited in the Participants' accounts for the promotion of the Debtors' operation under the terms of its membership plans.

Generally, advertising and other selling expenses are currently deductible (i.e., are not capitalized and amortized) under section 162.[13] Similarly, expenses treated as promoting a taxpayer's goodwill (i.e., "goodwill advertising"), either to current or future customers, are currently deductible under section 162.[14]

We note that goodwill is generally treated as a capital asset. As the court stated in *Canton Cotton Mills v. United States*[15], however:

> But the fact that [goodwill] may enter into an expenditure does not always prevent the deduction of such expenditure as a current business expense ... The benefits of [goodwill] are realized over a period of years; consequently, expenditures made to build it up and to acquire it are logically classed as capital outlay. But [goodwill], once acquired, requires periodic cultivation if it is to continue to produce benefits; and it is, therefore, equally logical to class necessary expenses incurred currently to protect and nurture existing [goodwill] as current business expenses rather than capital expenditures.

Building and expanding on the above logic, in 1965 the Treasury Department enacted Treasury Regulations section 1.162-20, which specifically allowed a current deduction for expenditures related to goodwill. Under Treasury Regulation section 1.162-20(a)(2), "[e]xpenditures for institutional or 'goodwill' advertising which keeps the taxpayer's name before the public are generally deductible as ordinary and necessary business expenses provided the expenditures are related to the patronage the taxpayer might reasonably expect in the future." In other words, the fact that a taxpayer may realize benefits from advertising in a later year does not affect the current deductibility of such expenses. The

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[11] Treas. Reg. § 1.162-1(a). The Senate Finance Committee report for the 1969 Tax Reform Act states "[t]he provision for the denial of the deduction for payments in these situations which are deemed to violate public policy is intended to be all inclusive. Public policy, in other circumstances, generally is not sufficiently clearly defined to justify the disallowance of deductions." S. Rep. No. 91-552, 91st Cong., 1st Sess. (1969), 1969-3 C.B. 597. In expanding the category of nondeductible expenses, the legislative history of the 1971 Tax Reform Act provided: "The committee continues to believe that the determination of when a deduction should be denied should remain under the control of Congress." S. Rep. No. 92-437, 92d Cong., 1st Sess. (1971), 1972-1 C.B. 599.

[12] *E.g., Tank Truck Rentals, Inc. v. Commissioner*, 356 U.S. 30 (1958).

[13] Treas. Reg. § 1.162-1(a); Rev. Rul. 92-80.

[14] Treas. Reg. § 1.162-20(a)(2).

[15] 94 F. Supp. 561 (Ct. Cl. 1951)

Service acknowledged the current deductibility of most goodwill advertising in Revenue Ruling 92-80: "costs are generally deductible under [section 162] even though advertising may have some future effect on business activities, as in the case of institutional or goodwill advertising."

In certain instances, advertising costs must be capitalized if the advertising is directed toward future benefits which exceed those traditionally associated with advertising or goodwill advertising.[16] For example, advertising costs relating to obtaining a license to construct a nuclear power plant must be capitalized.[17]

Here, the advertising-based credits paid to Participants under the terms of the Debtors' membership plans are currently deductible. First, these advertising credits are deductible under Treasury Regulations section 1.162-1(a) because they were paid in exchange for the Participants promotion of the Debtors' membership plans and products. Both the advertising itself and this component of the Debtors' membership plans were designed to—and did—increase the Debtors' customers base and encouraged current Participants to renew their plans, critical to the continuance of the Debtors' operations.

The deductibility of these expenses are also supported by Treasury Regulations section 1.162-20(a)(2), which permits deductions for expenses the Debtors incurred to "protect and nurture" existing goodwill, keep their name before the public, and for expenses reasonably related to the patronage the Debtors expected in the future. Importantly, the future benefits associated with advertising the taxpayer's plans and products (increased sales of products and membership plans and maintenance of their current members) did not exceed those of traditional advertising or goodwill advertising.

Section 162(c)(2) bars deductions for illegal payments and illegal kickbacks. Even assuming the credits were recharacterized as kickbacks, section 162(c)(2) does not change our analysis with respect to the Participant credits. Courts interpret section 162(c)(2) narrowly, requiring that the payment itself be illegal, rather than considering the illegality of the overall scheme. For instance, in *Raymond Bertolini Trucking Co. v. Commissioner*,[18] the court reasoned that a legal kickback is a cost of doing business like any other and Congress has allowed deductions for such expenses. Likewise, in *Carter v. Commissioner*,[19] the Tax Court held that compensation and fuel expenses of a drug smuggler were deductible: "[d]isbursement of these funds does not constitute the making of illegal payments even though the smuggling transaction was obviously illegal." The government bears the burden of proving the application of section 162(c)(2), on a clear-and-convincing standard of proof.[20]

Furthermore, to the extent Participant credits are considered kickbacks, the credits are deductible under the three-element test set out in Revenue Ruling 54-27:

> "Kickback" payments made by taxpayers who are subject to the Federal Trade Commission Act, as amended, to employees or purchasing agents of their customers or prospective customers are not deductible, for Federal income tax

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[16] Revenue Ruling 92-80
[17] *Cleveland Elec. Illuminating Co. v. United States*, 7 Cl. Ct. 220 (1975).
[18] 736 F.2d 1120 (6th Cir. 1989).
[19] T.C. Memo. 1984-443.
[20] I.R.C. § 162(c)(2); *Brizell v. Commissioner*, 93 T.C. 151 (1989) (holding the Service failed to carry burden of proving illegality).

> purposes, unless the following conditions are met: The payments (1) must be normal, usual, and customary in the industry and in the community, (2) must be appropriate and helpful in obtaining business, and (3) must be made with the knowledge and consent of the customer or prospective customer.

As a threshold matter, Telexfree was subject to the Federal Trade Commission Act. The application of the three elements of the test yields a finding of deductibility. First, recruiting "kickback" payments are an essential element of any pyramid scheme. Second, Participant credits drove the growth of the Telexfree business. Third, the pyramid nature of the business was open for all to see on the Telexfree website and in other recruiting materials.

In sum, the Debtors must calculate their net income for purposes of calculating the tax consequences associated with their operations. Disregarding the liabilities owed to Participants of the scheme would work a significant distortion of Debtors' operations (and would ignore the realities of a Ponzi/pyramid scheme). By definition, Ponzi schemes lose money. Thus, to clearly reflect the income—or more precisely, the losses—generated by the Debtors' operations, the liabilities owed to Participants for services (i.e., selling and advertising services) should be considered by the Debtors for federal income tax purposes.

Tax Accounting Guidance

When a taxpayer realizes gross income and expenses for tax purposes, the analysis turns next to the proper accounting period within which the taxpayer must report such items. Generally, a taxpayer must compute its taxable income under the method the taxpayer regularly uses to compute its income for book purposes unless such method does not clearly reflect income.[21]

Subject to this general rule, the Code provides that taxpayers may use the following methods to compute taxable income: (i) a cash receipts and disbursements method (the "cash method"), (ii) an accrual method, (iii) any other method permitted by the Code, or (iv) any combination of the above methods permitted under the Treasury Regulations.[22] Section 448(a) provides that C corporations like TelexFree, LLC, the primary taxpayer amongst the Debtors, may not use the cash method of accounting. Corporations use the accrual method, the general purpose of which is to match—in the same tax year—a taxpayer's revenue with the expenses incurred to generate such revenue.[23]

Under the accrual method of accounting, an item is included in a taxpayer's gross income when all the events fixing the taxpayer's right to receive the income have occurred and the amount can be calculated with reasonable accuracy.[24]

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[21] I.R.C. § 446(a). However, if no method is regularly used by a taxpayer, then the taxpayer shall compute its taxable income under a method that does clearly reflect income. I.R.C. § 446(b).
[22] I.R.C. § 446(c).
[23] *Mooney Aircraft, Inc. v. United States*, 420 F.2d 400 (5th Cir. 1969).
[24] Treas. Reg. § 1.451-1(a).

Regarding the proper period for claiming a deduction for an expense, Treasury Regulations section 1.461-1(a)(2)(i) provides that a liability is incurred (and taken into account for federal income tax purposes) in the taxable year in which:

(1) All events have occurred to establish the fact of the liability and the amount of the liability can be determined with reasonable accuracy (the "all-events test"); and

(2) Economic performance has occurred with respect to the liability.

The term "liability" includes any item allowable as a deduction, cost, or expense for federal income tax purposes.[25] A liability must be fixed, absolute, and unconditional to satisfy the first prong of the all-events test (i.e., that all events have occurred to establish the liability).

A liability may be considered fixed, absolute, and unconditional even though the ultimate recipients of the amount are unknown. For instance, in *United States v. Hughes Properties, Inc.*,[26] the Supreme Court held that a casino operator was entitled to deduct jackpots that were guaranteed under state law but not yet won. The Court agreed with the taxpayer, holding that the liability was fixed, absolute, and unconditional.[27] In its opinion, the Court stated that it made no "conceivable difference" as to basic liability whether the winner was one patron or another.

In addition, the all-events test does not require absolute certainty that a fixed liability will be paid. In *Hughes Properties*, the Court concluded that the casino operator's deduction was permissible even though there was a remote and speculative possibility that the casino operator would go out of business, go into bankruptcy, or patrons would stop playing the slot machines before the jackpot was won. Quoting *Helvering v. Russian Finance & Constr. Corp.*,[28] the Court stated "the existence of an absolute liability is necessary; absolute certainty that it will be discharged by payment is not."

The cases have established a taxpayer-favorable, bright-line rule in accrual-method situations where cash payment is uncertain: "deductions . . . are proper where it cannot be categorically said at the time these deductions were claimed that the [liability] would not be paid, even though the course of conduct of the parties indicated that the likelihood of payment of any part of the disallowed portion was extremely doubtful."[29] Put differently, a taxpayer's solvency is not a condition to expense accrual.[30]

On the other hand, if there is *no* possibility of payment or a payment would not occur for an inordinate amount of time, a liability will not satisfy the all-events test because it is not considered fixed.[31] For

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[25] Treas. Reg. § 1.446-1(c)(1)(ii)(B).
[26] 476 U.S. 593 (1986).
[27] The Court based its holding on the fact that state law effectively fixed the taxpayer's liability for the amount deducted. *Id.* at 602.
[28] 77 F.2d 324, 327 (2d Cir. 1935).
[29] *Cohen v. Commissioner*, 21 T.C. 855, 856 (1954).
[30] *In re Dow Corning*, 270 B.R. 393, 407-408 (E.D. Mich. 2002).
[31] *In re Southwestern States Mktg. Corp. v. United States*, 179 B.R. 813, 817 (N.D. Tex. 1994) (finding all-events test was not satisfied where settlement payment was agreed to while a taxpayer was in bankruptcy and the bankruptcy court found "no likelihood of repayment.") *Brainerd v. Commissioner*, 7 T.C. 1180, 1184 (1946) (disallowance holding supported by finding of "no likelihood" that the liability would ever be paid.)

instance, in *Mooney Aircraft, Inc. v. United States*,[32] the Fifth Circuit held that an aircraft manufacturer could not claim a deduction for bonds issued to customers where most of the bonds could not be paid for 15, 20, or even 30 years. Specifically, from 1961 through 1965, the taxpayer in *Mooney Aircraft* issued a bond with each aircraft it sold, which obligated the taxpayer to pay $1,000 when the aircraft was permanently retired from service. The taxpayer sought to claim a deduction in the year the bonds were issued in an amount equal to the estimated future redemption expense. The Fifth Circuit held that the taxpayer could not claim a deduction in the year the bonds were issued given the length of time between the future expenditure (i.e., the liabilities associated with the bonds) and the corresponding income (i.e., the taxpayer's income for the sale of the airplanes). According to the court, the expenses could not reasonably be viewed as expenses of doing business in the year the airplanes were sold given the length of time that would pass before the bond payments would be made. The court reasoned that the length of time that passed between the bond issuances and the anticipated payments made the improbability of payment even greater.

Even if a liability satisfies the all-events test, a taxpayer may not claim a corresponding deduction any earlier than the taxable year in which economic performance occurs with respect to the liability.[33] As relevant here, when a taxpayer's liability arises because of another person providing services to the taxpayer, economic performance generally occurs upon the provision of services.[34] The Treasury Regulations provide the following example to illustrate this principle in the context of a taxpayer's liability for advertising services.

> **Example 5**: (i) X corporation, a calendar year, accrual method taxpayer, is an automobile dealer. On January 15, 1990, X agrees to pay an additional $10 to Y, the manufacturer of the automobiles, for each automobile purchased by X from Y. Y agrees to provide advertising and promotional activities to X.
>
> (ii) During 1990, X purchases from Y 1,000 new automobiles and pays to Y an additional $10,000 as provided in the agreement. Y, in turn, uses this $10,000 to provide advertising and promotional activities during 1992.
>
> (iii) Under paragraph (d)(2) of this section, economic performance with respect to X's liability for advertising and promotional services provided to X by Y occurs as the services are provided. Consequently, $10,000 is incurred by X for the 1992 taxable year.

In summary, advertising liabilities are deductible by accrual-method taxpayers in the period the services are provided by the advertiser.

As noted above, the Taxpayer adopted the accrual method of accounting. Thus, under section 446 of the Code, the Taxpayer must likewise compute taxable income under the accrual method unless the method does not clearly reflect its income. In this case, the accrual method accurately measures and captures the overall loss of its operations, which is the hallmark of a Ponzi scheme.

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[32] 420 F.2d 400 (5th Cir. 1969).
[33] Treas. Reg. § 1.446-1(a)(1).
[34] Treas. Reg. § 1.461-4(d)(2)(i). This guidance is also applicable when services are provided to the taxpayer or another person at the direction of a taxpayer. Treas. Reg. § 1.461-4(d)(6)(i).

The liabilities owed to Participants for advertising satisfy the requirements set out in Treasury Regulations section 1.461-1(a)(2)(i). First, the all-events test is satisfied because:

a. all events had occurred to establish the fact of the liability, and

b. the amount of the liability could be determined with reasonable accuracy.

With respect to the first-prong of the all-events test, the Participants entered into membership contracts, which entitled the Participants to a defined and agreed credit amount, redeemable for cash, if they posted the required advertisements. The second-prong of the test is likewise satisfied because the liability/credit amount could be calculated under the terms of the contract. Any uncertainty regarding the identity of the Participants/credit holders should have no bearing on the satisfaction of the all-events test, consistent with the Supreme Court's holding in *Hughes Properties*.

As discussed in the authority discussed above, the all-events test is satisfied here even though there was a possibility that the Debtors would not pay Participants for the advertising services. Here, during the two years of the Debtors' operations and up to the bankruptcy filing, Participants were able to, and did, make requests to exchange their credits for cash payments from the Debtors. Furthermore, the use of Triangular Transactions and the informal cash-for-credits market remained strong up until the bankruptcy filing. In fact, the Debtors' bankruptcy filing in April 2014 was largely triggered by the acceleration of the redemption of credits for cash.

Furthermore, this is not an instance in which the liabilities would never be paid, or not be paid for an inordinate amount of time. That is, even though there was some doubt as to whether the liability would ever be paid, there is a direct relationship between the receipt of the income the Debtors received for membership plans or VoIP Packages and the credits. The relationship between the two was not "so distant" and "completely attenuated" as in *Mooney*.

With respect to the additional requirement under Treasury Regulations section 1.461-1(a)(2)(i)—that economic performance occurred with respect to the liability—the Regulations provide that economic performance occurred when the Participants provided the advertising services.[35] This conclusion is consistent with our understanding of the Debtors' treatment of these liabilities on their books and records. The Debtors did not grant credits until the advertisements were placed on the internet.

In accordance with the discussion above, the advertising-based liability accruals satisfy the all-events test in the year the Participants received credit.

We next consider whether any deferred compensation matching rules are implicated in this situation. Where compensation plans defer payment to an independent contractor, section 404 provides that the payor may not claim a deduction until the compensation is includible in the gross income of the independent contractor—even if the all-events test is satisfied and economic performance occurred.

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[35] Treas. Reg. § 1.461-4(d)(2)(i), (d)(7)(Ex. 5).

Where compensation is in the form of property, the income will be subject to tax in the year the property is received to the extent of the property's fair market value over the amount paid for the property.[36] Generally, freely assignable promises to pay (in other words, promissory notes) are treated as cash equivalents. The treatment of such income was most notably addressed in the Fifth Circuit case *Cowden v. Commissioner*.[37]

In *Cowden*, the taxpayer, a landowner, entered into an oil, gas, and mineral lease with an oil and gas company. The company agreed to make supplemental bonus or advance royalty payments to the taxpayer for a set amount of money. The payments were a definitive obligation regardless of the production on the lease, and were to be made over several years and not all at once. The taxpayer assigned the right to receive the payments to a bank for face value less a small discount and then reported the amounts received from the assignment as long-term capital gains. The Service determined that the taxpayer should have been taxed at ordinary rates on the full amount of the obligations regardless of the deferred payment arrangements and the discount because the rights to the payments were equivalent to cash.

In determining whether a promise to pay is the equivalent of cash, the Fifth Circuit considered the following factors: whether the promise to pay is unconditional and assignable, not subject to set-offs, and is the kind that is frequently transferred to lenders or investors at a small discount:

> We are convinced that if a promise to pay of a solvent obligor is unconditional and assignable, not subject to set-offs, and is of a kind that is frequently transferred to lenders or investors at a discount not substantially greater than the generally prevailing premium for the use of money, such promise is the equivalent of cash and taxable in like manner as cash would have been taxable had it been received by the taxpayer rather than the obligation.[38]

We apply these principles in the analysis below.

In this case, section 404 of the Code does not limit the Taxpayer's deduction in the year the credits were provided, since the credits were a form of income to Participants equivalent to cash. In the Participants' hands, the credits were both unconditional and assignable, not subject to set-off, and readily transferable for cash at their face value. As evidenced by the more than 11 million User Accounts, at the time Participants invested cash in the operation and during their recruitment and online advertising pursuits, Participants considered the credits they received to have a cash value equivalent to their face value. As the informal cash-for-credits market remained strong up until bankruptcy, the solvency of the Debtors at any point during the scheme's operation should not alter our conclusion under section 404. As noted above, at all times up to the bankruptcy filing, the credits traded at or above their par value in the market—Participants were willing to pay cash for credits in excess of their face value, presumably to avoid the administrative task of requesting a cash distribution.

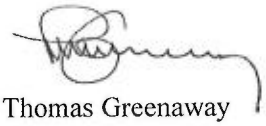
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[36] I.R.C. § 83(a).
[37] 289 F.2d 20 (5th Cir. 1961).
[38] *Id.*

Conclusion

We look forward to working with you to resolve this matter. If you have any questions or need additional information, please call me at 617-988-1221.

Very Truly Yours,
KPMG LLP



Thomas Greenaway
Principal

cc: Stephen Darr, Trustee

Enclosures

Exhibit A

9414 7266 9904 2953 7680 49

US Postal Service®
Certified Mail® Receipt
Domestic Mail Only
No Insurance Coverage Provided

Postage	$
Certified Fee	
Return Receipt Fee (Endorsement Required)	
Restricted Delivery Fee (Endorsement Required)	
Total Postage & Fees	$

FORT POINT STA BOSTON MA 02205
Postmark SEP 9 2016
USPS

Sent To:

Internal Revenue Service
Centralized Insolvency Operation
P.O. Box 7346
Philadelphia, PA 19101-7346

PS Form 3800, February 2014 US Postal Service® **Certified Mail® Receipt** 2

Marion/TCS Telex 9.9.16

9414 7266 9904 2953 7679 98

US Postal Service®
Certified Mail® Receipt
Domestic Mail Only
No Insurance Coverage Provided

Postage	$
Certified Fee	
Return Receipt Fee (Endorsement Required)	
Restricted Delivery Fee (Endorsement Required)	
Total Postage & Fees	$

FORT POINT STA BOSTON MA 02205
SEP 9 2016 Postmark Here
USPS

Sent To:

Internal Revenue Service
Centralized Insolvency Operation
P.O. Box 7346
Philadelphia, PA 19101-7346

PS Form 3800, February 2014 US Postal Service® **Certified Mail® Receipt** 2

Marion/TCS Telex 9.9.16

Tracking Number: 9414726699042953768049

Delivered

Product & Tracking Information

Postal Product:
First-Class Mail®

Features:
Certified Mail™
Return Receipt

DATE & TIME	STATUS OF ITEM	LOCATION
September 12, 2016 , 11:52 am	Delivered	**PHILADELPHIA, PA 19101**
Your item was delivered at 11:52 am on September 12, 2016 in PHILADELPHIA, PA 19101.		
September 12, 2016 , 11:41 am	Available for Pickup	PHILADELPHIA, PA 19101
September 12, 2016 , 10:59 am	Arrived at Unit	PHILADELPHIA, PA 19104
September 12, 2016 , 12:48 am	Departed USPS Facility	PHILADELPHIA, PA 19176
September 10, 2016 , 10:28 pm	Arrived at USPS Facility	PHILADELPHIA, PA 19176
September 9, 2016 , 10:39 pm	Departed USPS Facility	BOSTON, MA 02205
September 9, 2016 , 9:49 pm	Arrived at USPS Facility	BOSTON, MA 02205

Available Actions

Tracking Number: 9414726699042953767998

Delivered

Product & Tracking Information

Postal Product:
First-Class Mail®

Features:
Certified Mail™
Return Receipt

DATE & TIME	STATUS OF ITEM	LOCATION
September 12, 2016 , 11:52 am	Delivered	PHILADELPHIA, PA 19101
Your item was delivered at 11:52 am on September 12, 2016 in PHILADELPHIA, PA 19101.		
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Available Actions

Case 18-04091 Doc 69-4 Filed 11/04/19 Entered 11/04/19 15:46:31 Desc Exhibit 4 Page 27 of 85

9414 7266 9904 2953 7679 81

US Postal Service®
Certified Mail® Receipt
Domestic Mail Only
No Insurance Coverage Provided

Postage	$
Certified Fee	
Return Receipt Fee (Endorsement Required)	
Restricted Delivery Fee (Endorsement Required)	
Total Postage & Fees	$

FORT POINT STA SEP - 9 2016 Postmark

Sent To:

Internal Revenue Service
Attention: Jeff Reynolds
JFK Federal Building
15 New Sudbury Street - M Stop, 20800B
Boston, MA 02203

PS Form 3800, February 2014 US Postal Service® **Certified Mail® Receipt**

Marion Telex - IRS Reynolds 9-9-16

2. Article Number

9414 7266 9904 2953 7679 81

3. Service Type **CERTIFIED MAIL®**

4. Restricted Delivery? *(Extra Fee)* ☐ Yes

1. Article Addressed to:

COMPLETE THIS SECTION ON DELIVERY

A. Received by (Please Print Clearly) B. Date of Delivery

C. Signature

X Paulina Katz ☐ Agent ☐ Addressee

D. Is delivery address different from item 1? ☐ Yes
If YES, enter delivery address below: ☐ No

SEP 16 2016

Internal Revenue Service
Attention: Jeff Reynolds
JFK Federal Building
15 New Sudbury Street - M Stop, 20800B
Boston, MA 02203

PS Form 3811, February 2014 Domestic Return Receipt

Marion Telex IRS Reynolds 9-9-16

Exhibit B

Form 4564	Department of the Treasury Internal Revenue Service Information Document Request	Request Number 001
To: Telexfree, LLC	Subject: Accrued Advertising Credits	
	Submitted to: Tom Greenaway	
	Dates of Previous Requests:	

Description of Documents Requested:

Please provide the following:

1. Accrued Advertising Credits
   a. Please explain what an accrued advertising credit is.

   b. Please explain why the accrued advertising credits were deductible expenses on the 2012 and 2013 tax returns in the amount of the $9,829.080 and $2,151,645,140, respectively.

   c. Please provide any documentation, memoranda, or research supporting the deductions.

   d. Please provide the detailed information regarding payments made to date including the date paid, the amount paid, and the payees, if any.

Note: If the information being requested is unclear or seems overly burdensome for any of the items, please feel free to call me at 617-316-2725 for clarification so that the information will be available when needed.

Information Due By 2/2/2017 At Next Appointment [X] Mail In [ ]

	Name and Title of Requestor: Christine DeRosa, Internal Revenue Agent 1001033183	Date: 1/11/2017
FROM	Office Location: JFK Building LB&I Team 1472 15 New Sudbury St. Boston, MA 02203	Page 1

Form 4564	Department of the Treasury Internal Revenue Service Information Document Request	Request Number 002
To: Telexfree, LLC	Subject: Commissions	
	Submitted to: Tom Greenaway	
	Dates of Previous Requests:	

Description of Documents Requested:

Please provide the following:

1. Commissions
   a. Please provide the detailed information regarding the Commissions deducted in the amount of $622,588,034 on the 2013 return.

   b. Please provide the detailed information regarding payments made to date including the date paid, the amount paid, and the payees.

Note: If the information being requested is unclear or seems overly burdensome for any of the items, please feel free to call me at 617-316-2725 for clarification so that the information will be available when needed.

Information Due By 2/2/2017 At Next Appointment [X] Mail In [ ]

FROM	Name and Title of Requestor: Christine DeRosa, Internal Revenue Agent 1001033183	Date: 1/11/2017
	Office Location: JFK Building LB&I Team 1472 15 New Sudbury St. Boston, MA 02203	Page 1

Exhibit C

UNITED STATES BANKRUPTCY COURT, DISTRICT OF MASSACHUSETTS

Proceeding Memorandum/Order of Court

In Re: Telexfree, LLC **Case Number:** 14-40987 (MSH) **Ch:** 11

Evidentiary Hearing
#623 Motion of Chapter 11 Trustee for Entry of Order Finding that Debtors Engaged in Ponzi and Pyramid Scheme and Related Relief (H. Murphy)
#649 Opposition of Plaintiffs' Interim Executive Committee (W. Baldiga)
#650 Opposition of Carlos N. Wanzeler (W. Moorman)
#652 Reply of Chapter 11 Trustee

COURT ACTION:

Show Cause Order _____ Released _____ Enforced
_____ Granted _____ Approved _____ Moot
_____ Denied _____ Denied without prejudice
_____ Withdrawn in Open Court
_____ Sustained _____ Overruled
_____ Continued to_____
_____ Proposed Order Submitted by_____
_____ Stipulation to be Submitted by_____
_____ Taken Under Advisement

DECISION SET OUT MORE FULLY BY COURT AS FOLLOWS:

Evidentiary hearing held on November 24, 2015. For the reasons set forth on the record of the hearing I hereby find and order that:

1. Each of the debtors in these jointly administered cases operated a Ponzi and pyramid scheme. This ruling is the law of the case in each of the jointly administered cases.
2. The debtors are jointly and severally liable for the claims of the Participants (as that term is defined in the motion) in these cases.

In addition, I find that the relief sought by the trustee in this motion did not require the commencement of an adversary proceeding pursuant to FRBP 7001 and that in any event all creditors and parties in interest, including Participants, received adequate notice and an opportunity to be heard as to prayers (i), (iii) and (iv) of the motion. As to prayer (ii), a further hearing (non-evidentiary) will be held on January 26, 2016, at 10:00 a.m. (Boston time). Responses, including proposed orders, are due by January 19, 2016, at 4:30 p.m. (Boston time). On or before December 7, 2015, the trustee shall serve notice of the hearing and response deadline as well as a plain language explanation of the relief sought in prayer (ii) of the motion on the same parties and in the same manner as the motion was previously served and file a certificate of such service.

IT IS SO ORDERED:

14409871511250000000004

Melvin S. Hoffman
United States Bankruptcy Judge

Exhibit D

Telexfree LLC
Profit and Loss
January - December 2013

	KPMG TR Total		Per Draft TR PBC	Differences				
Income								
Income	$ -							
Income - paid through bank	$ 119,468,920							
Income - paid through system	$ 572,240,960							
Income from Ympactus	$ 174,183,645							
Total Income	$ 865,893,525		$ 865,893,525	$ (0)				
Total Income	$ 865,893,525							
Cost of Goods Sold								
Direct Inbound Dial & Access Numbers	$ 15,256							
Telecom & Database Network Expense	$ 397,322							
Termination	$ 1,850,898							
Total Cost of Goods Sold	$ 2,263,477		$ 2,263,476	$ 1				
Gross Profit	$ 863,630,048							
Expenses								
Advertising	$ 16,569		$ 16,569	$ (0)				
Agent Commission - paid through bank	$ 50,670,291	2	$ 50,670,291	$ (0)	Commissions:		2	$ 622,588,034
Agent Commission - paid through system	$ 571,917,743	2	$ 571,917,743	$ -				
Bad Debts	$ 186,344,898		$ 186,344,898	$ (0)				
Bank Charges	$ 255,369		$ 255,369	$ 0		M-1	P.1 Expense	
Charitable Contributions	$ 7,500	M-1	$ 7,500	$ -	Charitable Cont:	$ (7,500)	$	-
Credit Card Fees	$ 16		$ 16	$ 0				
Depreciation	$ 9,575	M-1	$ 9,575	$ 0	Depreciation:	$ 76,968	$	86,543
Events	$ 109,455		$ 109,455	$ (0)				
Filing and registered agent fees	$ 1,579		$ 1,579	$ -				
Income tax expense				$ -				
Federal Income Tax Expense	$ 16,025,349							
State income and franchise taxes	$ 2,969,511							
Total Income tax expense	$ 18,994,860	M-1	$ 20,163,736	$ (1,168,876)	$ 4,369,171	$ (18,994,860)	$	-

Case 18-04091 Doc 69-4 Filed 11/04/19 Entered 11/04/19 15:46:31 Desc Exhibit 4 Page 35 of 85

Telexfree LLC
Profit and Loss
January - December 2013

	KPMG TR Total		Per Draft TR PBC	Differences			
Interest Expense	$ 14,127		$ 14,127	$ 0			
Meals and Entertainment	$ 2,862	M-1	$ 2,862	$ (0)	M&E:	$ (1,442)	$ 1,442
Merchant Fees	$ 1,038,788		$ 1,038,788	$ 0			
Miscellaneous	$ 33,151		$ 33,151	$ 0			
Office Expenses	$ 13,408		$ 13,408	$ 0			
Office Rental	$ 10,604		$ 10,604	$ (0)			
Office Supplies	$ 1,956		$ 1,956	$ 0			
Payroll Expenses				$ -			
Payroll Fees	$ 545		$ 545	$ 0			
Payroll Reimbursement Expense	$ 58,006		$ 58,006	$ 0	Tax Expense	1	$ 26,356
Payroll Salaries	$ 3,507		$ 3,507	$ 0			
Payroll Tax Expense	$ 2,952	1	$ 2,952	$ -			
Total Payroll Expenses	$ 65,010						
Personnel	$ 18,750		$ 18,750	$ -			
Postage & Delivery	$ 114		$ 114	$ (0)			
Product Development	$ 6,000		$ 6,000	$ -			
Professional Fees	$ 225,256						
Accounting	$ 43,289						
Attorney	$ 162,801						
Total Professional Fees	$ 431,347		$ 431,347	$ (0)			
Promotion Expense	$ 110,894		$ 110,894	$ (0)			
Refund	$ 733,639						
Chargebacks	$ 666,391						
Charged Twice	$ 46,353						
Fraud	$ 646,293						
Total Refund	$ 2,092,676		$ 2,092,676	$ (0)	Returns and allow		
Small Items Not Capitalized	$ 728		$ 728	$ 0			
Software Development	$ 81,288		$ 81,288	$ (1)			
Subcontractor	$ 50,525		$ 50,525	$ (0)			
Technology Consultant				$ -			
Professional Consultant IT	$ 440,682		$ 440,682	$ 0			
Total Technology Consultant	$ 440,682						
Telecom tax expense	$ 23,404	1	$ 23,404	$ -			
Travel	$ 135,569		$ 135,569	$ 0			
Travel Meals	$ 22	M-1	$ 22	$ (0)			
Website Domain	$ 650		$ 650	$ (0)			
Total Expenses	$ 832,900,409						

Telexfree LLC
Profit and Loss
January - December 2013

	KPMG TR Total		Per Draft TR PBC	Differences				
Net Operating Income	$ 30,729,639							
Other Income				$ -				
Interest Earned	$ 2,732		$ 2,732	$ (0)	This is income			
Total Other Income	$ 2,732							
Other Expenses				$ -				
Loss on Investment	$ 48,663	M-1	$ 48,663	$ (0)		Loss on Inv:	$ (48,663)	$ -
Other Expenses	$ -		-	$ -				
Penalties & Settlements	$ 186,720	M-1	$ 186,720	$ (0)		Penalties:	$ (186,720)	$ -
Unknown tax expense (no detail)			$ 37,190	$ (37,190)				
Total Other Expenses	$ 235,383							
Net Other Income	$ (232,651)							
Net Income	$ 30,496,988		$ 29,290,922	$ 1,206,066				
				$ (1)				
KPMG Added: Advertising Bonus Expense	$ 2,151,645,140	Using EOY Bonus accrual less 2012 Bonus						
Net Income/(Loss)	$ (2,121,148,152)							

Monday, Jun 16, 2014 12:57:50 PM PDT GMT-4 - Cash Basis

Tax Adjustments

Federal Income Taxes	$ 18,994,860	$ 15,858,111	$ 3,136,749	
Meals & Ent	$ 1,442	$ 1,442	$ (0)	
Penalties	$ 186,720	$ 186,720	$ (0)	
Depreciation	$ (76,968)	$ (76,968)	$ -	
Loss on Investment	$ 48,663	$ 48,663	$ (0)	
Disallowed Charitable Contribution	$ 7,500	$ -	$ 7,500	
Taxable Income	$ (2,101,985,935)	$ 45,308,890	$ (2,147,294,826)	
		Check to TR	$ 0	$ 0
		Check to TR	$ 0	
		Check to TR	$ -	
Other Items with NO differences for M-3:	$ (2,101,897,951)			

Exhibit E

Exhibit 2

In re: TelexFree, LLC, *et al.*

Trailing Liability Calculation - Advertising Bonus[1,2,3]

Trailing Liability	Outstanding ADCentral Payments	Outstanding ADCentral Family Payments	ADCentral Liability ($20 per week)	ADCentral Family Liability ($100 per Week)	Total Liability
February 2012	$ -	$ -	$ -	$ -	$ -
March 2012	-	-	-	-	-
April 2012	-	-	-	-	-
May 2012	-	102	-	10,200	10,200
June 2012	-	1,871	-	187,100	187,100
July 2012	-	2,881	-	288,100	288,100
August 2012	-	5,659	-	565,900	565,900
September 2012	1,237	5,735	24,740	573,500	598,240
October 2012	5,640	20,526	112,800	2,052,600	2,165,400
November 2012	9,989	39,832	199,780	3,983,200	4,182,980
December 2012	19,484	94,394	389,680	9,439,400	9,829,080
January 2013	31,697	182,875	633,940	18,287,500	18,921,440
February 2013	78,520	356,527	1,570,400	35,652,700	37,223,100
March 2013	164,655	506,542	3,293,100	50,654,200	53,947,300
April 2013	283,453	761,101	5,669,060	76,110,100	81,779,160
May 2013	494,359	1,261,216	9,887,180	126,121,600	136,008,780
June 2013	739,166	1,798,677	14,783,320	179,867,700	194,651,020
July 2013	1,096,143	2,411,703	21,922,860	241,170,300	263,093,160
August 2013	1,684,888	3,656,684	33,697,760	365,668,400	399,366,160
September 2013	2,559,676	5,852,955	51,193,520	585,295,500	636,489,020
October 2013	3,583,231	9,169,675	71,664,620	916,967,500	988,632,120
November 2013	4,826,215	13,775,043	96,524,300	1,377,504,300	1,474,028,600
December 2013	6,357,701	20,343,202	127,154,020	2,034,320,200	2,161,474,220
January 2014	8,284,248	31,105,685	165,684,960	3,110,568,500	3,276,253,460
February 2014	10,409,821	45,926,764	208,196,420	4,592,676,400	4,800,872,820
March 2014	10,611,602	50,826,455	212,232,040	5,082,645,500	5,294,877,540
April 13, 2014	10,021,920	48,251,878	200,438,400	4,825,187,800	5,025,626,200
April 2014	9,432,888	45,682,130	188,657,760	4,568,213,000	4,756,870,760

Notes

1. Trailing liability calculated as of the last day of each month based on the weekly Advertising Bonus as described in TelexFree Participant contracts
2. Includes purchases of AdCentral and AdCentral Family plans and excludes commission other than weekly Advertising Bonus
3. Assumes Participants purchasing AdCentral or AdCentral Family plans would place required advertisements and receive Advertising Bonus each week.

Source: Debtors' Participant database.

Exhibit A - 3.28.17 Letter to IRS



KPMG LLP
60 South Street
Boston, MA 02111

Telephone 617 988 1000
Fax 617 988 0800
Internet www.us.kpmg.com

BY ELECTRONIC MAIL ONLY

March 28, 2017

Christine DeRosa
Team Coordinator
LB&I Team 1472
Internal Revenue Service
JFK Federal Building
15 New Sudbury St.
Boston, MA 02203

Re: In re TelexFree, LLC

Dear Christine:

You told us last week that the Internal Revenue Service plans to deny TelexFree's refund claim for 2012 and issue a notice of deficiency on its 2013 tax year. Your team postulates that the deductions claimed on the returns have not been adequately substantiated, or that the deductions do not satisfy section 162 of the Code.

We urge the Service to reconsider its position. As we exhaustively detailed in our expedited responses to your Information Document Requests, we carefully considered the technical positions in the tax returns the Trustee filed. Furthermore, in substantiating the deductions we relied on the same transactional data that federal law enforcement agencies and the U.S. Attorney used in their related criminal investigations and prosecutions.

In fact, the results of the claims process firmly establishes the reliability of TelexFree's records. Victims and creditors were required by the Bankruptcy Court to file their claims by March 15, 2017 using an electronic claims portal. These claims will serve as the basis for any distribution of funds to the victims and creditors. Although the Trustee has not completed his review of the claims, the Trustee has informed us that more than 85 percent of the claims filed agree with TelexFree's records. Differences in the remaining claims are not due to errors in the records, but instead are due to additional components, such as for loss of future profits, pain-and-suffering, calculation in currencies other than U.S. dollars, and other similar reasons.

Finally, the Trustee, together with the U.S. Attorney, is single-mindedly focused on delivering as much cash as possible to the victims of the loss-making Ponzi and pyramid scheme. The Trustee would object to any attempt by the Service to claim priority over the victims.

KPMG LLP, a U.S. limited liability partnership, is the U.S. member firm of KPMG International, a Swiss cooperative.

In summary, the Trustee has produced credible evidence that supports TelexFree's return positions, and the Trustee has cooperated with your team's requests for information. Conversely, your proposed arguments do not appear to be substantially justified based on our conversation last week.

For these reasons, we respectfully suggest that the Service should not issue a notice of deficiency, should not file any proofs of claim, and should allow the 2012 refund as soon as possible.

Very Truly Yours,
KPMG LLP



Thomas Greenaway
Principal

cc: Stephen Darr, Trustee

Exhibit B - Merrill Sentencing Memo

UNITED STATES DISTRICT COURT
DISTRICT OF MASSACHUSETTS

UNITED STATES OF AMERICA	]	
	]	No. 14-CR-40028-TSH
v.	]	
	]	
JAMES MERRILL	]	

GOVERNMENT'S SENTENCING MEMORANDUM

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CONCLUSION **38**

The United States hereby submits its memorandum in support of its position at sentencing in this case.

INTRODUCTION

Between February 2012 and April 2014, James Merrill was the public leader of a global pyramid scheme in which 1,887,000 people, from over a 100 countries, lost $3,045,000,000. These figures are not an estimate, extrapolation or prediction – TelexFree's business records preserved every transaction by every person who ever invested in the company. These are real dollars, lost by real people, who trusted the TelexFree system and invested, in many cases, their life savings. It is not an exaggeration to say that Merrill and co-defendant Carlos Wanzeler destroyed the lives of thousands of people the world over.

Merrill understood and helped design TelexFree's compensation system; helped explain and promote it to investors; ran the company day-to-day; controlled all of the bank accounts; and exhorted more and more people to sign up. But he knew from the beginning about the risks of pyramid schemes and – more importantly – the flaws in TelexFree's compensation system. Even in the face of mounting customer concerns, lawyers' warnings, legal challenges, and government investigations, Merrill continually lied, affirmatively and by omission, to the millions of investors who trusted him. Meanwhile, he paid himself over $4,500,000.

Merrill insists that, within TelexFree, he made the right noises at the time and urged better compliance, but his co-founders refused to make changes. But throwing up his hands and saying, "What could I do?" is a weak excuse for two years of moral failure: the bottom line is that James Merrill was in charge of the daily operations of TelexFree and managed to never do the one thing that would have counted – warn the public – because that would have hurt the business. Nor could

he even muster the fortitude to just walk out and quit. Instead, he rode TelexFree until the end, profiting on the backs of investors.

In April 2014 TelexFree collapsed, owing about $6,000,000,000 to about 2,000,000 people. Just a few weeks before, company lawyers had asked Merrill if TelexFree had enough money to pay investors. By this point Merrill had run TelexFree for two years, controlled the bank accounts, and received months of stark warnings that TelexFree was a pyramid scheme. His response to the inquiry? "I do not know, but I certainly hope so."[1] Meanwhile, in December 2013 he had wired $10,000,000 to himself and his two co-conspirators.

Merrill deserves 10 years in prison. That sentence is well below what would normally be reasonable for leading the largest pyramid scheme ever prosecuted by the U.S. Department of Justice. Were it not for Wanzeler's greater role, Merrill's belated efforts to fix TelexFree's problems, and his agreement to provide information to U.S. and Brazilian investigators, the government's recommendation would be far higher.

FACTUAL BACKGROUND RELEVANT TO SENTENCING

A vast amount of evidence was developed in this case, but key aspects of it highlight why Merrill deserves a significant prison term. Merrill knew from the beginning that TelexFree was not a legitimate enterprise and yet chose to promote and profit from it. His defense amounts to insisting that he just could not do anything about it and it really bothered him at the time. But James Merrill wasn't in MS-13. He was running a company in Marlborough. Nothing, beyond greed, prevented him from warning TelexFree's investors or quitting. In essence, Merrill's defense

[1] *See Government Exhibit Binder* ("Govt Binder") at Tab 1. The government will provide this binder separately to the Court and ask that it be made part of the record at sentencing.

is that he lacked the courage of his own convictions, *i.e.*, because he worried at the time that he was committing a fraud, it's okay that he was committing a fraud.

I. IT WAS OBVIOUS FROM THE BEGINNING – INCLUDING TO MERRILL – THAT TELEXFREE WAS A PYRAMID SCHEME

Soon after it was founded, it was obvious to someone in Merrill's position that TelexFree was a pyramid scheme. This point is important to understanding Merrill's culpability. Putting aside the bells, whistles, and various complexities of how TelexFree paid its participants, at bottom it worked like this: If someone paid TelexFree $339 and spent five minutes a day posting classified ads on sites provided by TelexFree, they would be paid $20 per week, that is, a guaranteed $1040 a year. If someone paid TelexFree $1425 and posted the ads, they would be paid $100 per week, that is, $5200 a year. This is a return of over 200%, and to earn it the participant was not required to sell anything. Moreover, as Merrill knew, participants could own multiple accounts, thus compounding their returns. Consequently, because TelexFree was not generating revenue from selling its product (the VOIP phone service), these participants could only be paid with funds received from later participants. That's a Ponzi scheme. Since TelexFree also paid participants for recruiting other participants (again without selling anything) it was also a pyramid scheme.[2]

These conclusions are not based on some painstaking exegesis of TelexFree's records. Merrill and Wanzeler openly advertised TelexFree this way. For example, the web site announced the following:

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[2] On the definition of a pyramid scheme, see, *e.g.*, *In re Koscot Interplanetary, Inc.* 86 F.T.C. 1106 (1975) (seminal FTC decision defining a pyramid scheme); *United States v. Gold Unlimited, Inc.*, 177 F.3d 472, 479-80 (6th Cir. 1999) (discussing pyramid scheme characteristics, noting use of initial buy-in fees, instead of product sales, to generate revenue); *Webster v. Omnitrition Int'l, Inc.*, 79 F.3d 776, 788 (9th Cir. 1996) (describing profit through recruitment instead of product sales, including ongoing recruitment by one's own initial recruits, as the *sine qua non* of pyramid schemes).

Be our promoter
Earn money doing announcements on Internet!
Through a ADCENTRAL, that you get for the amount of US$299 (annually).

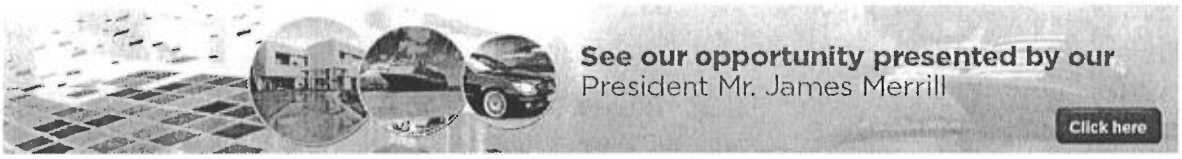
The promoter will receive US$20 each week that makes 7 different announcements in websites of free announcements online, from Monday to Sunday. **All in a way fast, easy, and standardized in your virtual office (BO) Telexfree.**

This will be for the 52 weeks of the year, of your contract, then see the simulation:

52 weeks x $20 (Putting the 7 announcements) = $ 1,040 in the year

Govt Binder Tab 2 (archived site page; all emphasis in original).

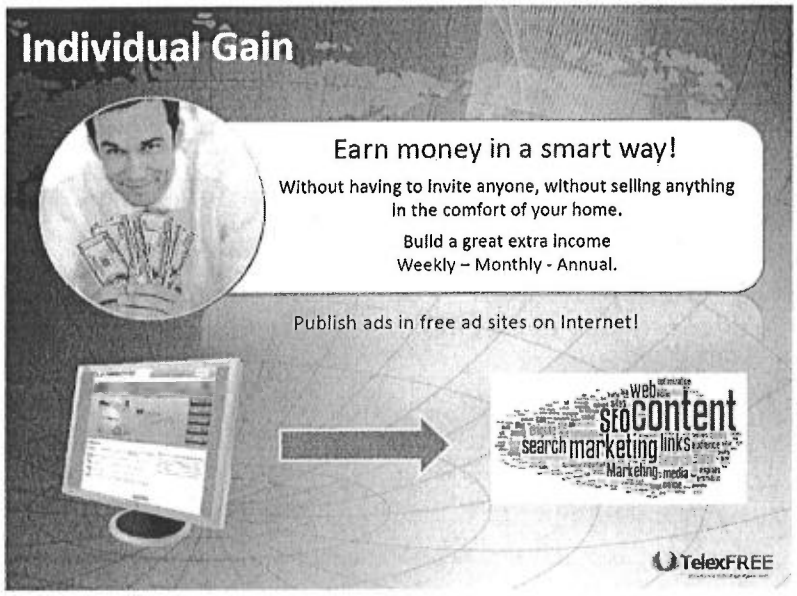
Merrill understood the compensation structure perfectly. In fact, he helped design and explain it. For example, TelexFree's website home page contained the following banner:



Govt Binder Tab 3 (archived home page).

Clicking the link led to a PowerPoint presentation summarizing TelexFree's compensation structure in very simple terms. The slides were designed to help TelexFree participants recruit other people, and most of the TelexFree victims interviewed by the government had seen the PowerPoint in some form. As Merrill admitted to the Massachusetts Securities Division in a deposition, he knew it was used for this purpose. *See MSD Deposition (3/28/14)* at 120-21 (transcript at Tab 4 of Government Binder).

Slide Three of an early version of the PowerPoint says this:



Govt Binder Tab 5 (entire presentation). Later slides then helpfully did the math on the impressive yearly returns TelexFree offered, complete with charts. *Id.* Later versions of the PowerPoint were more discrete, removing the "make money without selling anything!" slide, but the plan and charts were identical.

Merrill reviewed and revised PowerPoint content. For example, in January 2013, Merrill discussed the PowerPoint, slide by slide, with TelexFree's attorney. He then tasked Wanzeler with getting the changes onto the web site (which happened). *See Govt Binder* at 6. Similarly, over time Merrill revised aspects of the PowerPoint, sometimes in conjunction with his marketing manager, Steve Labriola. *See id.* (2/6/13 email to Labriola with attached revision of PowerPoint, telling Labriola to "review it with your team" and opining that "we can start using it").

Merrill also repeatedly explained the compensation plan to others. In mid-2012, Merrill wrote for TelexFree's attorney a lucid three-page summary of TelexFree's compensation plan; in December 2012, Merrill explained and debated the compensation plan with Ryan Mitchell, the VOIP engineer; in August 2013, Merrill sent TelexFree's new attorney a lucid two-page summary

of the compensation plan, a copy of the recruiting PowerPoint, and TelexFree's terms and conditions of use; and, more generally, Merrill routinely debated the plan with staff and outside consultants. *See Govt Binder* at Tab 7 (emails and attachments).

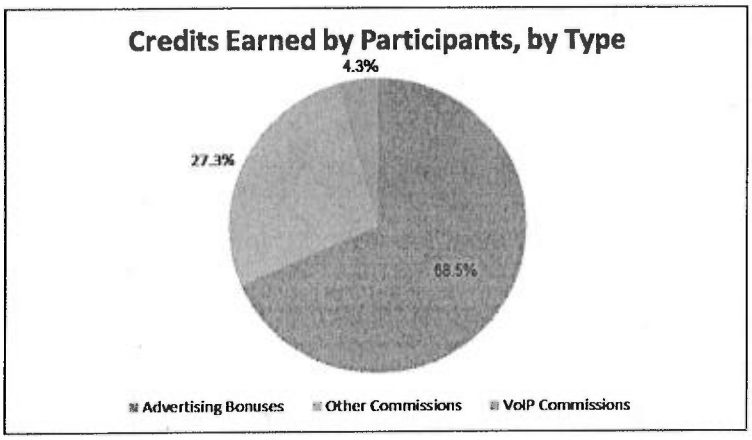
And yet, when deposed by the Massachusetts Securities Division in March 2014, Merrill asserted that he was not familiar with the compensation plan and that Wanzeler was really the guy who understood all that stuff. *See, e.g., MSD Deposition* at 68 ("the comp plan is not my area but I can give you a basic overview of the program") (*Govt Binder* at Tab 4). Yet, Merrill went on to explain the program in detail, including walking through his PowerPoint presentation. *Id.* at 68-79; 138-43.

Merrill also knew – from the start – that TelexFree paid a 90% commission on each VOIP sale. That is, if a participant actually sold the company's VOIP plan for $49.90, TelexFree paid the participant a 90% commission. Merrill also knew that nothing stopped every TelexFree participant from simply selling a VOIP plan to himself to meet the requirement that participants "sell" at least one plan. *See, e.g., MSD Deposition* at 139 ("Q.: And could you be your own customer? A: I could be my own customer.") (*Govt Binder* at Tab 4.) This, as Merrill knew, is a classic pyramid scheme red flag: on paper, company sales look enormous, as every participant "sells" the product to himself so they can then qualify for other bonuses.[3] But no one actually uses the product, which is secondary to the chance to make money posting ads and recruiting others. Of the 12,400,000 or so VOIP plans TelexFree "sold," 97% of them never registered even a minute of use.

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[3] *See, e.g., In re Koscot Interplanetary, Inc.* 86 F.T.C. 1106 (1975); *Webster v. Omnitrition Int'l, Inc.*, 79 F.3d 776, 788-90 (9th Cir. 1996).

Merrill insists that – despite all of the above – he did not know TelexFree was a pyramid scheme, that is, he did not know that TelexFree could only pay current participants by using money from newly-joined participants, because the 90% VOIP sales commission created a strong incentive to actually sell product, as opposed to just posting ads and/or recruiting others. This is false, and obviously so: given the choice between (a) a guaranteed passive income of $100 a week (over 200% a year) and (b) a $45 commission for convincing someone to buy a VOIP plan, everyone will pick the passive return. This is not a guess; once again TelexFree's own business records give the answer: breaking down every participant's account by source of income, that is, separating out commissions from ad-posting, bonuses for recruiting others, and commissions from actually selling the VOIP product, we see the following:



That is, of the approximately $6,000,000,000 in commissions and bonuses earned by TelexFree participants, 4.3% was attributable to selling a VOIP plan ("VoIP Commissions"), and the other 95.7% was attributable to ad-posting commissions and recruitment bonuses that required no sales. In short, apparently it was obvious to everyone except James Merrill that the best way to make money with TelexFree was to get paid for doing nothing, as opposed to getting paid for hawking phone plans.

TelexFree's own staff told Merrill this. In 2012, TelexFree hired an engineer, Ryan Mitchell, to help set up the VOIP system. During a meeting in Brazil in 2012, he listened to Merrill's and Wanzeler's description of TelexFree's business plan and asked them how a company can survive if it takes in $1,425 (payment to join TelexFree) but then pays out $5,200 a year? Mitchell followed up by email, warning Merrill about the compensation plan:

> I had a good meeting with Costa the other day. I think he's a good guy, and I can tell he is smart. I still have concerns about the finances.
>
> What is our customer acquisition cost? What is the liability per customer? What is the expected revenue/value per customer over 12 months? What are our current total liabilities?
>
> If you can't answer these simple questions, there's either something wrong with the business, or everybody is eating bullshit!!

See Govt Binder at Tab 8 (series of emails, Dec. 7-10, 2012). Mitchell went on to note that the money TelexFree was required to pay in commissions and bonuses was far higher than incoming revenue from product sales. *Id.* In response, Merrill acknowledged what now says he never knew about his own company:

> Yes that is the plan [to grow the network and then lower commissions to create positive cash flow for the company]. One additional item is to make sure not all our revenue is from startup fees. If all the revenue is from agent start up fees and we pay agents without them acquiring customers, we would be in trouble.

Id.[4] Hammering home the point, Mitchell replied by reminding Merrill that, so far, people have made "millions" with TelexFree while selling almost nothing:

> Yes, obviously. Considering that we have a variety of agents that have earned millions with very little actual product sold, that makes X (the average liability per agent) a big negative for us (multiplied by 300 thousand agents = a big debt). . . .

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[4] This echoed explicit warnings from TelexFree's lawyer the month before, who told Merrill that "stuff needs to really get bought and sold – it cannot be just the movement of money – that is where Zeek failed." *See Govt Binder* at Tab 26 (11/15/12 email from Gerry Nehra to Merrill). Zeek Rewards was an earlier pyramid scheme that resulted in a federal prosecution in North Carolina.

> So be prepared to know that each agent must bring in a lot of product sales to make up for everything.

Id. (emphasis added). This is in 2012. Over the next two years, Mitchell was proven prescient: when TelexFree crashed in April 2014 it owed its participants over $6,000,000,000 – "big debt" indeed. Had Merrill done something in 2012, this would not have happened. Had Merrill quit the company (instead of lying to investors and paying himself $4,500,000), he would not be culpable.

A. There is No Question that James Merrill Ran TelexFree and had Routine Access to All Information Required to Know the Truth about its Operations

James Merrill ran TelexFree's daily operations and had ready access to all information needed to understand what made it run. To say that he was somehow oblivious to TelexFree's problems is implausible.

1. *Merrill Publicly, Actively Led TelexFree, Through the Web Site and Personal Appearances*

Merrill was the very pubic face of TelexFree and the acknowledged leader of the company. The web site alone shows this. It prominently displayed Merrill at the head of TelexFree, portraying him to TelexFree's predominantly working class, immigrant participants as a rich, white businessman. This kind of photograph was typical:



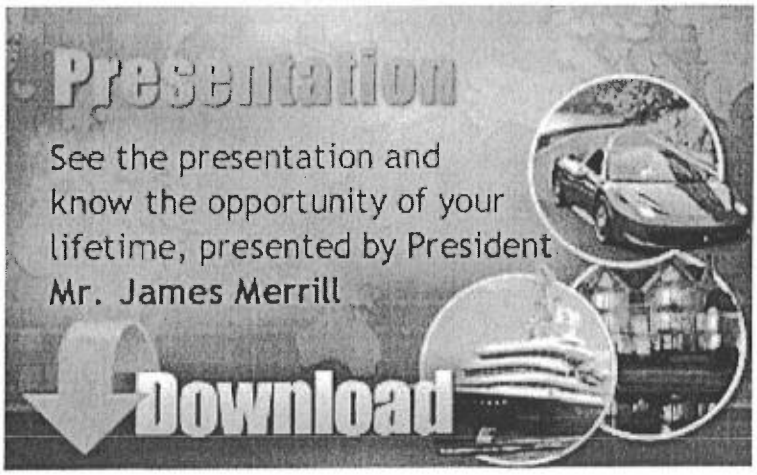
See Govt Binder at Tab 9 (archived page with Merrill biography). The caption to this photo reads, "Arriving at the company for one more day of work." (Though Merrill doesn't own the Hummer;

it belongs to Wanzeler.) Other photos were intended to misrepresent the size and stability of the company to site visitors:



Id. The caption to this photo says Merrill is standing before TelexFree's headquarters in the United States. But not really – TelexFree rented one office in the lower right hand corner of the first floor.

Similarly, as noted above, the site's home page invited visitors to review a "business opportunity" presented by "Mr. Merrill. In later versions, this graphic too invited participants to get rich with TelexFree:



Merrill could influence the web site's content when needed. He insists now that he was helpless to change the site because it was maintained by programmers in Brazil, but this is misleading. For example:

- As noted above, in January 2013, Merrill dictated changes to the recruiting PowerPoint maintained on TelexFree's site. *See Govt Binder* at Tab 6.

- That same month, Merrill forwarded to Costa and Wanzeler a draft of terms and conditions for TelexFree and told them to "please make sure" it was posted to the web site with a link to the compensation plan. *See id.* at Tab 10.

- In February 2013, Merrill revised an announcement about contract changes that had been drafted by Wanzeler and Costa and told a subordinate (Labriola) to call Wanzeler to clarify certain terms. *See id.* at Tab 10 (2/8/13 email to Steve Labriola).[5]

- In July 2013, TelexFree's attorney at that time, Gerry Nehra, told Merrill to change the description of Nehra on the web site because Nehra was getting too many inquiries from outside the United States. Merrill told Wanzeler, Costa, and TelexFree staff to make the change, and the change was made. *See id.* at Tab 10 (7/16/13 email from Merrill).

- In March 2014, Merrill demanded that the picture of a major TelexFree promoter be removed from the site because the promoter had previously been sanctioned by the SEC. The picture was removed.

- On March 28, 2014, the Massachusetts Securities Division questioned Merrill about lying on the TelexFree web site about graduating from college (he did not graduate). *MSD Deposition* at 86 (*Govt Binder* at Tab 4). Merrill protested that he had no control over the site. *Id.* Yet the biography language was changed days later. *See Govt Binder* at Tab 11 (site page before (March 22, 2014) and after (April 4, 2014) MSD deposition).

Merrill's public leadership did not stop at the web site. In one of the most disturbing aspects of TelexFree's operations, the company regularly hosted investor "extravaganzas" to promote TelexFree and celebrate the wealth it generated. These weekend events had an

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[5] "I made some changes but it still sucks. Adjustments not changes what does that mean. Call Carlos and ask about the price either I don't understand something or it has two different prices for the family. It is so embarrassing when this goes up on the at site."

evangelical air, as Merrill strode onto the stage to the tune "Eye of the Tiger," and urged the crowd to do the wave.



Merrill and Wanzeler told the crowds that TelexFree would change their lives. Wanzeler sometimes cried. Successful promoters came on stage and received out-sized checks for millions of dollars:



Among TelexFree's participants Merrill was a celebrity, occasionally mobbed by the crowd when he appeared:



2. *Merrill Controlled TelexFree's Bank Accounts and Had Access to TelexFree's Business Records, Staff, and Participants*

Merrill controlled TelexFree's bank accounts – a bell-weather fact in any fraud case. TelexFree had 32 accounts. Merrill was the signatory, sometimes with others, on 30 of them. *See Govt Binder* at Tab 12 (schedule of accounts). He received the statements at his office in Marlborough. If he wanted to know where TelexFree's revenue was really coming from, all he had to do was read them. Similarly, Merrill negotiated and controlled TelexFree's accounts with its payment processors (third party companies that processed credit card and bank transfers for TelexFree). *See id.* at Tab 13 (schedule of processors).

Moreover, in yet another warning sign, starting in May 2013 banks repeatedly shut down TelexFree's accounts because of suspicious activity. *See id.* at Tab 14 (schedule of bank account closures). Merrill was notified each time this occurred, after which he re-opened the accounts elsewhere.

Merrill also had ready access to data showing how many people, in a given time frame, were using TelexFree's phone service. *See id.* at Tab 15 (email exchange with Ryan Mitchell in which Merrill requests, and receives, phone usage data). Merrill also had ready access to SIG, a

Portuguese acronym for TelexFree's electronic database logging all participant activity. SIG was designed in Brazil and written in Portuguese. But Merrill had user access to SIG and, more importantly, several of his employees in Marlborough used SIG every day and were native Portuguese speakers. Merrill was the President of the company. All he had to do if he wanted information about TelexFree's investors was task them with collecting it.

Similarly, if Merrill wanted to independently confirm whether participants were really selling VOIP plans – as opposed to relying on income from ad-posting and recruitment – all he had to do was ask them. He had ready access to all of TelexFree's major participants, both directly and through his marketing manager. Several regularly visited TelexFree's offices; Merrill saw them at TelexFree "extravaganzas"; the office fielded queries from them every day; and all were reachable by phone and email.

But Merrill never asked. After TelexFree collapsed, these participants told the government they recruited hundreds of people, paid others to post ads for them every day, made millions, yet sold no VOIP and sure didn't know anyone who did. If they told all this to federal agents, they would have told James Merrill.

B. Despite His Own Knowledge and Repeated Warnings from Others, Merrill Lied to TelexFree's Participants From Start to Finish

Merrill's protestations that he was trying to do the right thing in a tough situation – that he was simply "outvoted," as he described it to TelexFree's lawyer – are belied by the fact that, affirmatively and by omission, Merrill simply lied to TelexFree's participants for two years. As noted above, from late 2012 Merrill knew the company had problems, both because he understood the compensation system and because people told him. And while he may have wrung his hands privately, he did nothing publicly.

Quite the reverse. Consider:

In April 2013, the Massachusetts Securities Division began investigating TelexFree as a possible pyramid scheme. In May 2013, a major bank (Bank of America) shut down TelexFree's accounts for suspicious activity and, through TelexFree's lawyer, Merrill began getting anxious queries from the field about whether TelexFree was legitimate.[6] In June 2013, the Brazilian government shut down TelexFree and seized the equivalent of about $360,000,000. Merrill's response to all this? In a public conference call with TelexFree participants on June 20, 2013, he assured everyone that everything was fine, minimized the import of Brazil, omitted that TelexFree was already under investigation in the United States, and ignored the warning signs he himself had been aware of since 2012:

> Hello everybody and I really appreciate everybody getting on this call and we understand your concerns. We are always here to work on your behalf. But what Carlos said is very – very true. We – whatever, you know – we feel like things will work itself out in Brazil, but in the U.S., it does not affect the U.S. market. It's – we're still growing like crazy thanks to your efforts, okay?
>
> Inquiries like this are very common in network marketing. I believe in Brazil, there were – there's still some issue with Herbalife, Amway has had its challenges here in the U.S. We've had such unbelievable growth that we're going to draw attention. And we have some of the best legal minds on this in Brazil.
>
> Again, nothing will affect the U.S. Please continue your – your dedication. This company will persevere, okay? And again, thanks everybody for being on this call. We will – we're getting back to work now on your behalf. Thanks again.

See Govt Binder at Tab 16 (transcript).

Similarly, sticking to the theme that regulators were suspicious merely because TelexFree was a fast-growing company, in August 2013 Merrill's marketing manager, Steve Labriola, told

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[6] For example, in May 2013, TelexFree counsel received a complaint from a Florida resident who compared TelexFree to a company the SEC sued in August 2012 called "Zeek Rewards." Counsel forwarded the email to Merrill and wrote, "I am on board to defend a program that sells long distance to customers. . . no mention of that below." In June 2013, counsel forwarded yet another complaint that TelexFree was operating as an illegal Ponzi/pyramid scheme. In the email counsel asked Merrill, "Continued payment of commissions requires customer sales – does it not?" Merrill responded by saying (despite all evidence to the contrary) that the "incentive to sell [the TelexFree product] was "strong."

participants in a conference call that being shut down by banks was "really exciting" because it meant TelexFree was "growing fast." *See id.* at Tab 17 (transcript).[7] Labriola got this from Merrill and relayed it publicly. Months later, in March 2014, Labriola publicly announced that there was no investigation of TelexFree and that "nothing [was] going on." *See id.* at Tab 18 (transcript). This was seven months after TelexFree's lawyers directly warned Merrill that TelexFree was a pyramid scheme, and one month after the MSD subpoenaed Merrill and Wanzeler to testify – a development TelexFree's lawyer, on February 5, 2014, told Merrill was "a serious escalation."[8] Again, Labriola wasn't freelancing; he discussed this with Merrill, who told him that it was "normal" for multi-level marketing companies to get those kinds of government inquiries.

In the period following the Brazil shutdown in June 2013, the warnings became more urgent, and so Merrill's deception more stark. In July 2013, TelexFree hosted an "extravaganza" in Newport Beach, California. From the stage Merrill was upbeat, telling the crowd how "the big corporations" feared TelexFree and the power of "network marketing." No mention of problems with the company. Following the conference, TelexFree's lawyer was deluged with emails asking if TelexFree was legal. Alarmed by what he saw in these emails, the lawyer begged Merrill to stop taking in new money. On July 29, 2013, the lawyer received an email from a participant who had invested $12,000. He forwarded the email to Merrill and asked,

> How does someone put $12,000 in? not what I approved . . . if the train is about to go off the tracks . . . put the brakes on – now . . . this firm can only defend a business model that sell a service to customers that are using the service . . . I strongly recommend you track and post on your web site – Your ACTIVE customer activity.

---

[7] "Now, the exciting thing is that it's happening because we're growing so fast and doing so many transfers and it's – I'm tickled."

[8] "This is not good and is an escalation. This is serious and not just a formality." *Govt Binder* at Tab 19 (2/5/14 email from TelexFree counsel to Merrill and others).

Days later, on July 30, 2013, he forwarded another email to Merrill, with the following warning:

> Something is very wrong. Please take my name and picture off of the web site.
> I have asked for customer numbers – none have been provided.
> . . . .
> If the train is going off the tracks – STOP THE TRAIN
> You could be days from a regulatory shut-down
> Yes – you stop momentum – but you save the company
>
> One suggestion – accept NO MORE NEW REPS in August
> Until the existing reps produce the active customers needed to right the ship

See Govt Binder at Tab 20 (emphasis in original). Merrill responded by suggesting that the issues were being planted by a "competitor," and said TelexFree really did have customers. He appears to have never considered, even for a moment, stopping the torrent of new investors.

The lies continued, as hundreds of thousands of people continued to sign up. For example, on November 5-6, 2013, TelexFree hosted a corporate event in Orlando, Florida. By this point, the drumbeat of warnings had culminated in not one, but two, lawyers telling Merrill point blank that TelexFree was a pyramid scheme. Yet from the stage Merrill publicly dismissed rumors that the company was a pyramid scheme as uninformed bluster from competitors and blogs. He told the crowd to "trust and believe" in Merrill and Wanzeler:

> I hate to bring up a negative, but it's important. Because negatives get turned into positives. We have plenty of blogs out there that, you know, don't – don't always speak kindly about us, they don't know us. But we know what they're about. They want you guys to go on their website and your competitors will go on their website, drawing traffic that will help them earn a living. I don't blame them. It's business. But what a difference is between you people is trust and belief in what we're doing, and I thank you all for believing in us and helping us get to that next level.

See Govt Binder at Tab 21 (transcript; emphasis added). This assurance was garbage. By this point Merrill knew TelexFree was a ticking bomb – a term used by TelexFree's own lawyers.

As another example, at some point in late 2013 Merrill signed a letter on TelexFree letterhead that said the following:

> TelexFree's business model has been fully reviewed and recognized by third-party experts as having an acceptable business model as per US guidelines for DS/MLM type of business. However, the company has been working diligently on re-launching with a new business model that will be provide a clearer Direct Sales benefit outline to its affiliates and comply with the strictest of US and international guidelines of MLM businesses by consulting with highly knowledgeable marketing, legal, and compliance professionals.

See Govt Binder at Tab 22 (signed letter, without addressee; emphasis added). While it's unclear who received this letter or if it was sent, its central claim is a lie. By the Fall of 2013, TelexFree had been shut down in Brazil, was under investigation by the State of Massachusetts, and Merrill had been told by two separate lawyers that the company was a pyramid scheme – a state of affairs he had begun to address by hiring an outside consultant. Thus, no, the "business model" certainly had not "been fully reviewed and recognized by third-party experts" as legitimate.

Merrill did something similar on December 3, 2013, when he certified to a potential vendor, under oath, that

> in all countries Telex FREE, Inc. provides service to, as of the date of this correspondence, we are not in violation of any of those country's laws with respect to telephony services.

See id. (letter dated 11/27/13 to Brian Struzik). It's possible that this was technically true; note the clause limiting the assurance to law concerning "telephony services." But, as above, overall the assurance in this letter is a lie.

Later that month, on December 26-27, 2013, Merrill wired $10,000,000 from TelexFree's account at Fidelity Bank, keeping $3,000,000 for himself and transferring $7,000,000 to Carlos Wanzeler and Carlos Costa. This made Merrill's total take from TelexFree about $4,500,000:

Date	Source of Funds	Description	Amount
05/17/12 to 08/15/12	Unknown	Deposits to Merrill's Personal Bank of America account (8701)	$249,582
02/04/13	Check drawn on Wanzeler's Personal account at Bank of America (1826)	Deposit to Merrill's Personal Bank of America account (8701)	$865,000
06/11/13	Check drawn on Wanzeler's Personal account at Citizens Bank (111-3)	Deposit to Merrill's Personal Citizens Bank account (125-3)	$290,000
12/26/13	Wire transfer drawn on Telexfree's account at Fidelity Bank (3859)	Wire transfer to Merrill's Personal Middlesex Savings account (6876)	$136,200
12/27/13	Wire transfer drawn on Telexfree's account at Fidelity Bank (3859)	Wire transfer to Merrill's Personal Waddell & Reed account (5999)	$3,000,000
			$4,540,782

A few months later, in April 2014, TelexFree filed for bankruptcy, essentially hiding in plain sight the collapse of a massive pyramid scheme that, by the end, owed its participants more money than the GDP of several third world countries.

II. TELEXFREE DESTROYED THE LIVES OF THOUSANDS OF PEOPLE IN DOZENS OF COUNTRIES

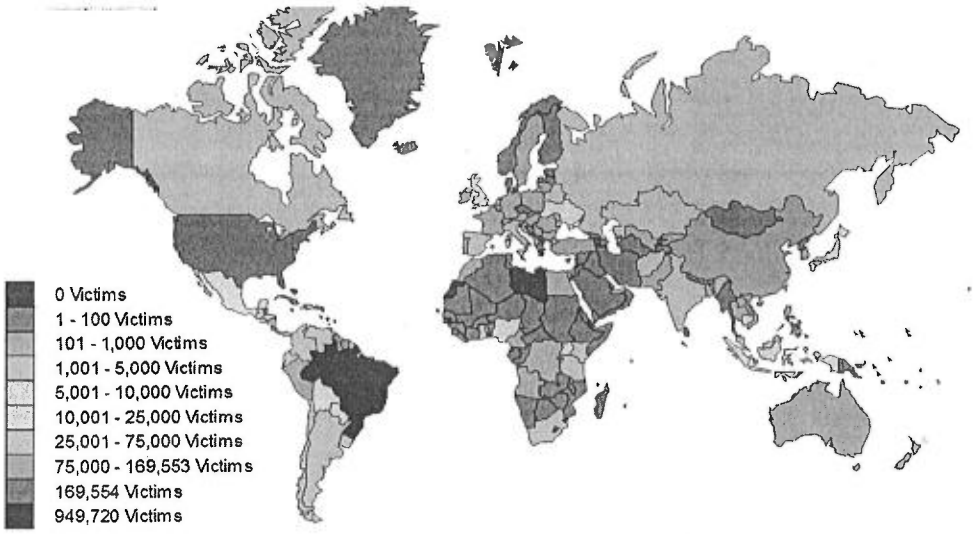
It is nearly impossible to exaggerate the damage caused by Merrill's and Wanzeler's fraud. TelexFree spread like a virus. Ironically, the very aspect of "network marketing" they promoted – that the company would thrive because each participant would not only sell VOIP but would recruit others to do it as well – was what led thousands of people to ruin the lives of their families, friends and colleagues. Each participant eagerly recruited his or her loved ones and acquaintances with the assurance that, if they just posted their ads each day, they'd make $1040 or $5200 a year.

A. TelexFree's Business Data Reveals Staggering Victim Losses Spanning Every U.S. State and Most Foreign Countries

According to TelexFree's own business data, which captured every transaction by every TelexFree participant for the life of the company, 1,886,631 people worldwide lost money in the

scheme. That is, before TelexFree collapsed, these people did not get back at least the amount they invested. Total losses in this group were $3,452,031,022.[9]

This figure is so large that it masks the daily impact on neighborhoods and lives. To understand the true scope of the damage, the government tasked its forensic experts with, first, calculating the total number of victims and total loss and, second, analyzing the victim data and presenting it in various ways.[10] (A report of their findings is attached as Exhibit A to this memorandum and also at Tab 24 of the Government Binder.) The picture is grim. Starting internationally, there were victims in almost every country, with by far the most in the United States and Brazil:



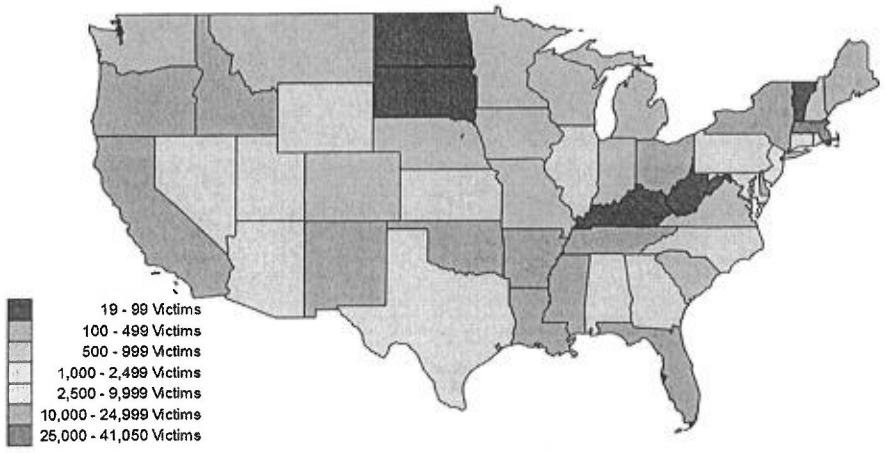
[9] The government's statement of offense conduct contains lower figures – 965,225 victims who lost $1,755,000,000 – because the government's original calculation did not include losses suffered in Brazil. A corporate shell called Ympactus (owned by Merrill, Wanzeler and Costa) entered a licensing agreement with TelexFree to sell TelexFree in Brazil. Investors in Brazil signed up on the same web site, under the identical compensation plan.

[10] These experts are employed by Huron Consulting, the financial consultants used by the Chapter 11 trustee. Huron, working with HSI, reconstituted TelexFree's systems for storing electronic data and were able to mine and process the data to analyze how TelexFree operated and how it impacted participants.

Country	Number of Victims	Country	Number of Victims	Country	Number of Victims	Country	Number of Victims
Brazil	949,720	Cambodia	15,079	Belarus	3,965	India	1,753
United States	169,554	Paraguay	14,450	Malaysia	3,911	Guatemala	1,712
China	98,133	Mexico	11,545	Puerto Rico[1]	3,739	South Africa	1,653
Peru	78,889	Bolivia	10,830	Canada	3,653	Haiti	1,574
Portugal	75,502	Ukraine	10,460	Venezuela	3,279	Netherlands	1,094
Dominican Republic	73,990	Nigeria	8,644	Taiwan	3,270	Moldova	997
Colombia	59,878	United Kingdom	7,356	Afghanistan	2,951	Thailand	983
Ecuador	56,413	El Salvador	7,285	Tanzania	2,911	Costa Rica	905
Spain	37,908	Indonesia	7,056	Rwanda	2,563	France	881
Uruguay	34,804	Japan	5,656	Kenya	2,341	Romania	716
Italy	29,019	Honduras	5,631	Argentina	2,278	Germany	706
Russia	26,745	Chile	4,650	Hong Kong[1]	2,232	Switzerland	659
Uganda	17,253	Kazakhstan	4,314	Ghana	1,885	197 Others	13,256
							1,886,631

See Exhibit A at 16-18.

As for the United States, there were victims in every state, for a total of about 170,000 people who lost $385,507,051:



State	Number of Victims	State	Number of Victims	State	Number of Victims	State	Number of Victims
Massachusetts	41,050	North Carolina	1,541	Wisconsin	691	Delaware	318
Florida	20,605	Pennsylvania	1,483	South Carolina	612	Louisiana	318
California	19,415	Utah	1,444	Missouri	580	Ohio	308
New York	12,803	Rhode Island	1,265	Iowa	564	Maine	301
Texas	6,288	Kansas	1,234	Montana	542	Washington D.C.[1]	219
Alabama	4,658	Wyoming	1,026	Michigan	527	Oregon	166
New Jersey	4,159	Nevada	1,011	New Hampshire	502	New Mexico	136
Connecticut	3,380	Colorado	908	Tennessee	490	Kentucky	94
Maryland	3,363	Virginia	877	Oklahoma	485	Vermont	49
Georgia	2,553	Minnesota	833	Hawaii[1]	467	South Dakota	26
Arizona	1,727	Washington	750	Arkansas	425	North Dakota	20
Illinois	1,633	Indiana	723	Idaho	406	West Virginia	19
Alaska[1]	1,576	Nebraska	700	Mississippi	319	606 Others	23,975
							169,554

See id. at 9-11.

Focusing on the 41,050 TelexFree victims in Massachusetts – which is more than the entire population of Fitchburg – they live in nearly every town: almost 3000 people in Framingham alone, nearly 1500 in Worcester and over a thousand in Lawrence, Everett, Lowell, Revere and Somerville. TelexFree victimized thousands in Boston (923) and surrounding towns, *e.g.*, East Boston (653), Chelsea (676), Jamaica Plain (408), Dorchester (536), and Allston (127).

City / Municipality	Number of Victims	City / Municipality	Number of Victims	City / Municipality	Number of Victims	City / Municipality	Number of Victims
Framingham	2,902	Milford	542	Quincy	222	Stoughton	160
Lawrence	1,995	Dorchester	536	Roslindale	213	Saugus	159
Everett	1,605	Marlborough	527	Hyannis	209	Fall River	152
Worcester	1,425	Medford	454	Ashland	206	Salem	145
Lowell	1,203	Jamaica Plain	408	Brighton	205	Raynham	140
Revere	1,140	Methuen	407	Hudson	190	Newton	137
Somerville	1,062	Woburn	373	Rockland	185	Edgartown	131
Malden	975	Weymouth	341	Norwood	185	Allston	127
Boston	923	Waltham	335	Taunton	177	Watertown	125
Chelsea	676	Hyde Park	325	Mattapan	175	Vineyard Haven	119
Lynn	657	Peabody	302	New Bedford	173	Haverhill	118
East Boston	653	Marlboro	301	Leominster	173	Melrose	114
Brockton	544	Randolph	235	Abington	171	2,870 Others	16,093
							41,050

See id. at 14. Those 41,050 Massachusetts residents lost $120,657,924, with an average loss of $2,940 per victim. Sixteen thousand forty-four people in this state lost over $1,000, with an average loss of $2,117 per person; 2,060 people lost over $10,000, with an average loss of $14,867 per person; 418 lost over $25,000; 127 lost over $50,000; and 35 lost over $100,000 in TelexFree. And this is just Massachusetts. *See id.* at 15. In October 2014, in coordination with the Chelsea Collaborative, the government hosted an outreach event for TelexFree victims in the Chelsea Middle School cafeteria. A thousand people showed up; volunteers collected their names and personal information to help file claims for restitution.

Worldwide, the average TelexFree victim lost a seemingly modest $1,830 in U.S. currency, but this masks two important points: first, if you live in Nicaragua – or Uganda, Cambodia, Paraguay, Kenya, Moldova, Peru, or even just in a working class neighborhood in Stoughton – that's a lot of money. Second, while the average was $1,830, TelexFree defrauded so many people

that, in absolute terms, a large number of people were financially devastated by the scam. For example, 41,416 people lost over $10,000; 4,842 lost over $50,000; and 1,054 people lost over $50,000. Twenty-three people lost over $250,000. *See id.* at 6.

B. Victim Impact Statements and Interviews Corroborate the Damage Implied by the Business Data

Unfortunately, the numbers are confirmed, in vivid terms, by the government's victim interviews and the flood of written victim impact statements.[11]

The stories are depressingly repetitive. TelexFree's victims were overwhelmingly working class people looking to make a few extra dollars on the side. Most were recruited by friends or colleagues, who signed up earlier and were now making money. Most of the victims interviewed had seen Merrill's PowerPoint presentation, shown to them by TelexFree participants who recruited large numbers of people into their "downlines" by hosting TelexFree seminars at private locations and local hotels. So, for example, C.J., a house cleaner in Everett, saw Merrill's PowerPoint at a seminar in Woburn. G.M., an electrician in Lynn, saw the PowerPoint on TelexFree's site and said it convinced him he could make money. E.M., a Boston school bus driver living in Malden, saw it at a seminar in Quincy he attended with a friend.

These people weren't stupid. Ironically – and apparently unlike James Merrill – most victims interviewed by the government were suspicious of TelexFree because it seemed too good to be true. But, after months of seeing their friends and relatives join and make money, they did as well. House cleaners, Dunkin' Donuts workers, nurses, electricians, restaurant workers, they invested tax refunds (very popular), insurance settlement checks, inheritances, 401(k) funds (also

[11] The government submitted a binder of victim impact statements to the U.S. Probation Office and, at the sentencing hearing, will ask that the statements be made part of the record.

popular), and other savings. Some people TelexFree left destitute. Others simply lost money they had been saving for years, suffering a financial setback from which they could not easily recover.

The government received victim statements from as far away as Europe and Africa. A.M.S., single mother in Poland, was recruited by a friend and invested about 16,000 Euro:

> Since I have been promised very attractive profit I borrow money and invested all I had in TelexFree, I bought so called family packs up to 11 each for 1475 dollars. . . . Every day I spend about two hours to make 55 ads. I hoped that I could buy a little apartment in Poland for me and my child after one year.
>
> . . . .
>
> I felt like my world is going all in black I lost my money and I had a big debt. I could not look at myself I felt guilty shame and sadness for many weeks and then months. I knew that there is nothing like easy job from home I had to work now more days and I could not see my little son.
>
> I know I would not get back my time, my nerves but I believe in justice and that I can get my investments back from the people who are responsible for this scam.

I.L.S., from Catanzaro, Italy, invested about $4,500. He reported,

> I have a difficult situation at home. I have haemophilia, are sick of hepatitis C; I have about 100,000 Euros debt with banks and financial institutions and the money that I had invested with telexfree, were used to pay the school for my children. Now I'm definitely put a lot of hur, I was really stupid to believe in TelexFree.
>
> I hope to at least get back my money, do not want anything more, just my money, to keep for my children. Not many, I know, but if my kids, and they ask avranno need something to their father, so at least I can say about it, and not always no!

Similar sentiments were expressed, *e.g.*, by K.E.U, who lives in Uganda,[12] and J.I. in Ireland.[13]

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[12] "I am bewitching their [TelexFree's] local agent here in Entebbe so that he suffers from leprosy. I am in debts suffering with school fees for my 7 children. I would like to be considered for payment. I filled claim forms."

[13] "I invested all the money I kept for children school fees, and since the closure of TelexFree I have been depressed . . . TelexFree broke my heart and nearly sent me to early grave. Please I urge American Authority to whatever means to recover our money and ensure that we get justice[.]"

Victims across the United States also spoke of financial ruin. B.N. wrote,

> The economic consequences were catastrophic because I put all the money I had from work, the money I had to pay for my daughters' college plus the money I obtained from a loan, I put it on TelexFree.

Similarly, J.H. reported,

> I used all my savings . . . and decided to borrow money to buy some more. . . . I still don't know if I will ever get this money back and every day I pray for it. [Merrill's] actions have created a very difficult strain on my family, on my kid's future and on myself, emotionally. I'm still making ends meet and hopefully I will recover this money to pay my family and friends back. It is horrible to look at their faces everyday knowing that I don't know how to repay this debt.

E.D.J. wrote that she and her husband invested $20,000 - $10,000 from refinancing her car with DCU and $10,000 from her husband's 401(k). She asked, "As you can tell I am desperate need of at least knowing if I'll ever be able to recuperate our money and how long would this process take?"

For his part D.L. deemed himself a "failure," writing,

> I lost $16,300 total from this stupid investment that I never have been able to get it back. . . . Those money that I've saved from three years of working hard ruined my whole life, and now I have to live by blaming myself every day. I deserve that, yes I do, but what about my family, my kids? They don't deserve this failure father they have.

Some were succinct. O.E. wrote,

> I am Miss [O.E.], I invested 5600 dollars into telex free on the month of April. That was my life savings. Just barely two weeks the were sued to court. I am devastated. Please what to do. I need help.

This isn't cherry-picking: the government received hundreds of victim statements like these.

Moreover, like D.L. above, numerous victims themselves felt guilt about recruiting friends and loved ones to join TelexFree, or about being unable to pay off debts they now owe because of the collapse. S.H., a U.S. resident, said,

> When TelexFree stopped paying, I feel very bad with myself, my family, coworkers and friends, I didn't have any idea what to tell them, them trusted in me, and for most of them I failed, I spent two years making payments of the personal loan and lost friends that I have for years.

J.P. wrote,

> I encouraged my best friend Jose [Z.] to [invest], and he fell in the scam too. Now I totally lost contact with him because he blames me for his missing money. That cannot be built again and it is not quantifiable in money. Please send the guilty ones to jail forever and refund the people.

G.A.M., another U.S. resident, said in part, "I wish you could help me with this situation because I still feel a burden on my conscience for not having paid this money and this has affected my life, my family, my credit, my peace and my tranquility. I hope you can help. Thank you in advance."

Major TelexFree participants, who had set up storefronts and recruited hundreds of people in their downlines, reported similar guilt. Fausto da Rocha, interviewed by the Boston Globe in June 2014, recruited about 20 acquaintances: "My career is gone. I'm going to clean houses with my wife. Cleaning houses is a good business." A tax preparer in Somerville told the government that, in light of the collapse, he was writing checks to the people he recruited who lost money.

Several news sources in the Dominican Republic and Brazil reported suicides in response to TelexFree's collapse. *See, e.g., With Debts Mounting After Investing in TelexFree, Police Officer Commits Suicide in State of Rio Grande do Norte*, www.ac24horas.com (12/4/13) (*Govt Binder* at Tab 23 (translated from Portuguese). Several victim impact statements alluded to his idea. I.K., country of residence unknown, invested his "life savings" in TelexFree and said in part, "If I don't get my money back I will have only one option; suicide … I cannot even call my dad to talk to him because I feel too embarrassed." C.D., a resident of the Dominican Republic, said he invested more than $16,000 in TelexFree, had little money left, and "I was thinking die by mi own many times." According to the Brazilian Federal Police, in northwestern Brazil entire towns

were financially wiped out by TelexFree; Brazilian news outlets have chronicled the TelexFree fallout for years. *See id.*

SENTENCING CALCULATION AND RESTITUTION

I. THE PROBATION OFFICER'S SENTENCING CALCULATION IS CORRECT

A. The Amount of Loss (+30 Levels)

As noted above, there is no serious debate about the losses caused by TelexFree – it's just math. Because the TelexFree's servers preserved every transaction by every participant, the government can determine how many participants were "net losers," that is, how many participants received from TelexFree less money than they invested, the individual losses incurred and total losses overall.

We know that 1,887,000 TelexFree participants were net losers, and each net loser is a victim of the offense.[14] These people lost a total of $3,045,000,000. *See* Exhibit A at 5-6 (evidence summary prepared by Huron Consulting). This is many magnitudes above $550,000,000, the top rung in the sentencing chart for financial crimes. *See* U.S.S.G. § 2B1.1(b)(1)(P); *PSR* ¶ 70 (same analysis under prior figures, 965,225 victims suffering $1,755,927,755 in loss).

B. Merrill's Role in the Offense (+4 Levels)

As to other enhancements, Merrill "was an organizer or leader of a criminal activity that involved five or more participants or was otherwise extensive." U.S.S.G. § 3B1.1(a). Merrill

[14] The Guidelines define victim as "any person who sustained any part of the actual loss." U.S.S.G. § 2B1.1(b)(2). Sentencing courts accordingly count net losers in pyramid schemes as individuals sustaining actual losses. *See, e.g., United States v. Bunchan*, 580 F.3d 66, 70 (1st Cir. 2009) (affirming sentencing enhancement for pyramid scheme with more than 250 victims). By contrast, individuals who "receive a return or break even" from a fraudulent scheme are not "victims" under the Guidelines. *See, e.g., United States v. Orton*, 73 F.3d 331, 334 (11th Cir. 1996). The statutes governing restitution similarly define victims as those "directly and proximately harmed as a result of the commission of an offense." 18 U.S.C. §§ 3663(a)(2) & 3663A(a)(2). In turn, courts order the operators of pyramid schemes to pay restitution to net losers. *See, e.g., Bunchan*, 580 F.3d at 66–67; *see also United States v. Lazar*, 770 F. Supp. 2d 447, 452 (D. Mass. 2011) (barring restitution to coconspirators). And in the aftermath of a fraud, victims are only entitled to recompense for their net loss, as opposed to unrealized profits. *In re Bernard L. Madoff Inv. Sec. LLC*, 654 F.3d 229, 235 (2nd Cir. 2011).

owned 50% of TelexFree and ran it day to day – a company with over a million customers worldwide – from his offices in Marlborough, Massachusetts. Merrill

- Co-founded the company with Wanzeler and Costa, and was a co-owner of the sister corporate shell in Brazil (Ympactus).
- Supervised the office staff, which ranged from about five to 15 depending on time frame. These people included the marketing manager, key contractors for IT and VOIP based elsewhere, and the staff that handled TelexFree's Quickbooks data, bank and payment processor information, customer complaints, VOIP issues, and other matters.
- Opened and controlled TelexFree's 30 bank accounts and negotiated and signed TelexFree's agreements with third party payment processors.
- Led extravaganza events attended by thousands of participants, addressing the crowds from a stage (or, in one instance, from the deck of a cruise ship rented by TelexFree for the occasion).
- With his co-founders, was involved in all strategic decisions affecting the company, from the web site to the compensation plan to when and how to declare bankruptcy in April 2014.

These are just examples. Yes, it appears that Wanzeler had more control over the internal guts of TelexFree's operations, but the role enhancement is not restricted to one person – the Guidelines say "an" organizer or leader, not "the" organizer or leader. It is enough that Merrill served, to say the least, in a "top echelon role." *United States v. Tejada-Beltran*, 50 F.3d 105, 111 (1st Cir. 1995).

The criminal activity was also quite extensive; while it probably involved five or more people,[15] it certainly involved over a million victims in over a hundred countries and billions in losses, facts satisfying any sane definition of "extensive." *See, e.g., United States v. Dietz,* 950

[15] Merrill, Wanzeler, Costa, Lyvia Wanzeler (Wanzeler's daughter, now under indictment in Brazil), Leonardo Casula (a close associate of Wanzeler, now under indictment in the United States and Brazil), and certain major TelexFree participants, *e.g.*, Sann Rodrigues (recently convicted of visa fraud in the United States and now under indictment in Brazil).

F.2d 50, 53 (1st Cir. 1991) (emphasizing importance of "width, breadth, scope, complexity, and duration of the scheme"); *see also United States v. Kabouni,* 641 Fed. Appx. 6, 8 (1st Cir. April 16, 2016) (affirming that activity was "extensive" where it involved store employees and numerous SNAP beneficiaries, and the illicit transfer of over $1.9 million in SNAP credits over roughly three years); *Tejada-Beltran*, 50 F.3d at 113 (citing *Dietz*).

C. Substantial Hardship to More Than 25 People (+6 Levels)

There can be no serious debate that TelexFree caused substantial financial hardship to at least 25 people. *See* U.S.S.G. § 2B1.1(b)(2)(C). There are nearly two million victims worldwide; 47,572 of them lost at least $10,000 in U.S. currency. *See* Exhibit A at 6 (loss stratification chart). Even without the litany of financial devastation in the victim impact statements submitted to the Court, the odds of at least 25 people not having suffered substantial financial hardship is about zero. *See also, e.g., United States v. Minhas*, ___ F.3d ___, 2017 WL 942661 *2-5 (7th Cir. March 10, 2017) (in companion fraud cases with a total of 426 victims, rejecting argument that enhancement requires individualized assessment of each victim's circumstances where overall evidence showed significant financial loss to a class of victims with modest means).

D. Sophisticated Means (+2 Levels)

Lastly, the Probation Department applied a two level enhancement for use of sophisticated means. *See* U.S.S.G. § 2B1.1(b)(10); *PSR* ¶ 72. As noted by the Probation Officer, TelexFree maintained a sophisticated web site that hosted a separate page for every user (millions of pages). Each user accumulated credits (which could be exchanged for dollars) for a range of bonuses and commissions, including not only the ad-posting mechanism described above but a complex binary recruitment system featuring compounding bonuses depending on how each user arranged his recruits in his downline. The company used payment processors to process, literally, billions of

dollars in transactions over a roughly two-year period. TelexFree had accounts in at least the United States, Brazil, the Dominican Republic and Singapore. Moreover, the company did in fact have a usable VOIP telephone service, although 97% of VOIP plans were never used. The TelexFree scheme checks nearly every box in the application note for this enhancement.[16] *See also, e.g., United States v. Pacheco-Martinez*, 791 F.3d 171, 179 (1st Cir. 2015) (affirming use of enhancement where defendant used multiple corporate shells and varying corporate documents).

Finally, a substantial portion of TelexFree's business, and a substantial portion of the fraud, occurred outside the United States. Programmers in Brazil maintained TelexFree's web site, and two of its founders (Wanzeler and Costa) worked from there. Moreover, as TelexFree grew exponentially over time, thousands of major participants in a hundred countries locally recruited hundreds or thousands of additional victims. *See* U.S.S.G. § 2B1.1(b)(10)(B) ("a substantial part of a fraudulent scheme was committed from outside the United States").

The Probation Officer's overall calculation is correct: Merrill has an adjusted offense level of 43, corresponding to a Guideline range of life.

II. MERRILL DESERVES TEN YEARS IN PRISON, BUT HE DOES NOT DESERVE MORE, SO THE COURT SHOULD ACCEPT THE PENDING RULE 11(c)(1)(C) PLEA AGREEMENT

As is obvious from the above calculation, the sentencing range of zero to ten years presented in the pending Rule 11(c)(1)(C) plea agreement is somewhat below "life." The government did not agree to the ten year limit so it could begin the sentencing process "bidding

[16] "For purposes of subsection (b)(10)(C), 'sophisticated means' means especially complex or especially intricate offense conduct pertaining to the execution or concealment of an offense. For example, in a telemarketing scheme, locating the main office of the scheme in one jurisdiction but locating soliciting operations in another jurisdiction ordinarily indicates sophisticated means. Conduct such as hiding assets or transactions, or both, through the use of fictitious entities, corporate shells, or offshore financial accounts also ordinarily indicates sophisticated means." U.S.S.G. § 2B1.1 App. Note 9.

high." It agreed because Merrill deserves ten years in prison, but not more than that. The Court should accept the plea agreement and sentence Merrill to ten years.

First, as an express condition of this plea, Merrill was required to engage in a proffer with U.S. and Brazilian investigative authorities to fill in the gaps in the government's understanding of TelexFree and to assist both governments' active investigations. *See Plea Agreement* at 4. Without this condition the government would not have entered the agreement.

Second, Merrill knew by mid-2012 that TelexFree was a pyramid scheme – this is obvious from Merrill's PowerPoint presentation, his emails, and doubts expressed by others as early as December 2012. But by the Summer of 2013 the drumbeat of warnings had become so deafening that Merrill, however belatedly, began steps to make TelexFree's compensation system "more compliant." He hired a new lawyer to advise TelexFree and, on that lawyer's advice, a consulting group in Arizona. In this Merrill is distinct from his co-defendant Wanzeler, who appears to have resisted Merrill's initiative and the anticipated changes.[17] In March 2014, Merrill told TelexFree's lawyer that certain changes would have happened sooner, but Merrill was "outvoted." While this excuse for running a two-year criminal enterprise does not exonerate Merrill for the financial devastation he helped to cause, it supports the view that Merrill was not the fraud's prime mover, and eventually tried to fix the problem.

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[17] Of course, Merrill did not want to make the changes too quickly. The new lawyer told the government that in August 2013 he warned Merrill that TelexFree was an illegal pyramid scheme, but that TelexFree was slow to make changes because they were afraid of losing participants. Email from that time corroborates the lawyer. *See Govt Binder* at Tab 25 (9/30/13 email: "You will not survive legally (civil or criminal) or from a business standpoint, unless there is a dramatic change …"; 11/17/13 email: "And, understanding a degree of business/legal risk is being chosen by the company to avoid losing your sales force who must step by step adapt to a system that requires a predominance of revenue from product/service sales over revenue from sales support systems. . . . From our conversations, you know that whatever you can do to mandate and promote retail sales and move toward make them the predominant revenue component, the better for you from a legal standpoint, and 'we will take as much as you can live with' in this regard." It in fact took seven months to make any changes at all, after which TelexFree collapsed. During that period, hundreds of thousands of new participants signed up with TelexFree.

Third, on that note, overall Wanzeler was the worse actor; if he were before the Court, the government would probably seek a 20-year sentence. *See also PSR* ¶ 63. Unlike Merrill, it appears that Wanzeler and Costa were more aware of TelexFree's dubious legality at the beginning and less concerned along the way. According to percipient witnesses, Wanzler was more reluctant than Merrill to give TelexFree's financial information to the MSD during its investigation and, over time, it appears that Wanzeler embezzled and laundered millions of dollars from TelexFree's coffers. It is not a coincidence that Wanzeler fled the United States the very day the government first showed its hand by searching TelexFree's offices in April 2014.

Fourth, on a more general level, while general deterrence is vital in these kinds of cases – a different, nascent pyramid scheme even fled the United States for the Carribean after the arrests in TelexFree – there appears to be no need for specific deterrence of this actor. That is, there is nothing to indicate that Merrill will ever try to do something like this again.

Weighing Merrill's participation in the fraud against the above, a sentence of 10 years is in the public interest.

III. THE GOVERNMENT ANTICIPATES DISTRIBUTING SEIZED TELEXFREE ASSETS TO VICTIMS THROUGH THE VERIFIED CLAIMS PROCEDURE ADMINISTERED BY THE CHAPTER 11 BANKRUPTCY TRUSTEE

The massive losses from TelexFree, coupled with the fact that the government has the means to identify most of the 1.8 million net losers and their loss amounts, creates a complex restitution picture. Because of that, the government proposes an approach to restitution that (a) makes use of the already-running claims process in the bankruptcy proceedings and (b) limits restitution to the amounts disbursed during that process. As discussed below, the Court has the discretion to take both steps.

When the government raided TelexFree's offices in April 2014, in conjunction with the SEC it froze and later seized about $140,000,000 in TelexFree's domestic bank accounts and payment processor reserve accounts. The government also seized real property and vehicles worth about $8,000,000. Finally, on January 4, 2017, the government seized approximately $19,000,000 in cash that appears also to be fraud proceeds from the TelexFree scheme.

Pending entry of a final order of forfeiture and approval from the Department of Justice pursuant to 21 U.S.C. § 853(i), the government anticipates using all of these assets to compensate victims of the fraud. The government would distribute the forfeited assets by first transferring the funds to the Chapter 11 trustee ("Trustee"), under an agreement that the Trustee only use it to compensate victims. The Trustee, using a third party vendor, has set up an online claims process that allows TelexFree victims anywhere in the world to enter their personal and TelexFree account information, after which the system matches that data to TelexFree's business data to verify the claim. The Trustee will do additional anti-fraud screening as well. The claims portal went online on May 26, 2016, with a deadline for claims of March 15, 2017.[18] There will be a process for accepting late-filed claims. After verifying all claims, the Trustee would distribute the funds.

Beyond the Trustee's claims process, however, restitution may be impractical. *See* 18 U.S.C. § 3663A(c)(3) (granting discretion to sentencing court where restitution impractical). After disbursement of the assets seized by the government, literally hundreds of thousands – perhaps more than a million – victims will still be uncompensated. In theory, after whatever sentence

[18] The Trustee's claim system has been publicized, and over 1,000,000 victims have already submitted claims. *See, e.g.*, Beth Healy, *Claim Site is Live for TelexFree Victims*, Boston Globe (June 2, 2016). The order approving the claims process was served by email to all participants for whom the Trustee had an available email addresses (each participant had provided an email address to TelexFree when they signed up) and was posted on the Trustee's website. The Trustee also requested that certain multi-level marketing websites (*behindmlm.com, theponzibook.blogspot.com,* and *Ponzitracker.com*) post notice of the TelexFree claims process on their sites. The Trustee also held informational meetings in impacted neighborhoods to show people how to use the claims process.

Merrill serves, the Clerk's Office could collect a monthly amount from him for further distributions but, relatively speaking, the amounts would be miniscule and it would be impossible to make distributions on a pro rata basis. As to Merrill's assets, they have already been seized and counted in the total amount currently available for compensation.

A. The Court Has Discretion to Fashion a Practical Approach to Restitution

The Mandatory Victims Restitution Act ("MVRA") requires defendants convicted of fraud and other crimes against property to pay restitution to those "directly and proximately harmed" by the offense. 18 U.S.C. § 3663A(c)(1)(A)(ii). The amount of restitution must equal "the full amount of each victim's losses . . . without consideration of the economic circumstances of the defendant." 18 U.S.C. § 3664(f)(1)(A). There are two exceptions: the MVRA does not apply if the sentencing court finds that "(A) the number of identifiable victims is so large as to make restitution impracticable; or (B) determining complex issues of fact related to the cause or amount of the victim's losses would complicate or prolong the sentencing process to a degree that the need to provide restitution to any victim is outweighed by the burden on the sentencing process." § 3663A(c)(3); *see also, e.g., United States v. Hensley*, 91 F.3d 274, 276 (1st Cir. 1996) ("Federal courts possess no inherent authority to order restitution, and may do so only as explicitly empowered by statute.").

These exceptions also mean the Court has discretion to use various means to fashion restitution in a given case. *See, e.g., In re W.R. Huff Asset Mgmt. Co., LLC*, 409 F.3d 555, 563–64 (2nd Cir. 2005) (holding district court did not abuse discretion by accepting settlement agreement as "reasonable substitute restitution" when MVRA exceptions applied). The exceptions are meant to help victims – § 3663A(c)(3)(A) (the complexity exception) ensures that sentencing is not delayed by difficult restitution calculations best left for civil proceedings. *See United States*

v. Reifler, 446 F.3d 65, 136 (2d Cir. 2006) ("Congress plainly intended that sentencing courts not become embroiled in intricate issues of proof."). Similarly, § 3663A(c)(3)(B) – the numerosity exception – prevents defendants from receiving only a trifling amount of restitution. *See United States v. Nathanson*, 948 F. Supp. 2d 1055, 1064 (C.D. Cal. 2013) (noting that the sentencing judge found it "almost insulting" for victims to receive a miniscule restitution payment). Put another way, the MVRA obligates courts to order restitution in full, unless, from the victim's perspective, there are reasons why "it would be better not to have anything." *Id.* This latter point pertains here: after the bankruptcy claims process, in light of the enormous number of victims and overall loss, additional monthly restitution from Merrill would amount to far less than a penny per victim, or just pennies per victim even if a subset of victims could be prioritized for restitution in a principled and fair manner.

Sentencing courts have invoked the numerosity exception in frauds with thousands of victims. *See, e.g.*, *United States v. McVay*, 447 F.3d 1348, 1349–50 (11th Cir. 2006) (invoking exception for executive convicted of securities fraud). As another example, the court sentencing Bernard Madoff in his Ponzi scheme prosecution ruled under § 3663A(c)(3) that restitution was impracticable by the usual means. *See United States v. Madoff*, 09 Cr. 213 (DC) (S.D.N.Y. Sept. 24, 2009) (ECF No. 106). At the time of Madoff's sentencing, the trustee overseeing the liquidation of Madoff's assets had received a mere 15,870 claims. *See Govt's Mem. in Support of Mtn. Pursuant to Title 18, United States Code, Section 3663A(c)(3)*, *United States v. Madoff*, 09 Cr. 213 (DC), at 7 (S.D.N.Y. Sept. 22, 2009) (ECF No. 105).

B. The Government Will Seek Permission to Transfer Forfeited Assets to the Bankruptcy Trustee for Distribution to TelexFree Victims Through the Bankruptcy Claims Process

"The Attorney General has the responsibility for disposing of funds seized under the criminal forfeiture statute." *United States v. Mei Juan Zhang*, 789 F.3d 214, 217 (1st Cir. 2015). The Attorney General can "grant petitions for mitigation or remission of forfeiture, restore forfeited property to victims of a violation of this subchapter, or take any other action to protect the rights of innocent persons which is in the interest of justice and which is not inconsistent with the provisions of this section." 21 U.S.C. § 853(i)(1).

The "interest-of-justice" clause 21 U.S.C. § 853 "grants the Attorney General extraordinarily broad discretion over the handling of forfeited funds." *United States v. Gordon*, No. 03 CR. 1494 (GEL), 2005 WL 2759845, at *3 (S.D.N.Y. Oct. 19, 2005), *aff'd sub nom. DSI Assocs. LLC v. United States*, 496 F.3d 175 (2nd Cir. 2007). The clause also allows the Attorney General to transfer forfeited funds to an outside entity tasked with repaying victims – essentially what the government intends to do here. The court overseeing the fallout of the Madoff Ponzi scheme used a similar solution. *See S.E.C. v. Madoff*, No. 08 CIV. 10791LLS, 2009 WL 980288, at *2 n.1 (S.D.N.Y. Apr. 10, 2009). There, the government, along with the S.E.C. and a trustee appointed under the Securities Investor Protection Act, wanted to stop fraud victims from filing a bankruptcy petition against Madoff, arguing that it would needlessly divert funds from the remission process. *Id.* at *1. The judge not only allowed the victims to proceed, but suggested that the *bankruptcy* trustee oversee the distribution of funds to victims: "The Attorney General, under his statutory authority to 'take any other action to protect the rights of innocent persons which is in the interest of justice' might consider saving administrative costs by delegating forfeited property to the bankruptcy estate." *Id.* (citing 21 U.S.C. § 853(i)).

In another example, in the securities fraud enforcement action against executives at Adelphia Communications Corporation, the government entered into an agreement with both defendants and third parties to facilitate compensation to victims. *W.R. Huff*, 409 F.3d at 558. The Second Circuit upheld the district court's order exempting the defendants from restitution under the MVRA's exceptions and approving the settlement. *Id.* at 563–64.

C. **The Government Will Submit a Proposed Order to the Court on Restitution**

The government will submit a proposed restitution order to the Court addressing the government's anticipated transfer of funds to the Trustee and providing that, beyond funds disbursed during the bankruptcy claims process, restitution is impracticable pursuant to 18 U.S.C. § 3663A(c)(3)(A).[19]

There are far more victims in this case (1.8 million) than in others where sentencing courts have ruled that restitution is impracticable under the numerosity exception. *See, e.g., W.R. Huff*, 409 F.3d at 563; ("tens of thousands of victims"); *Nathanson*, 948 F. Supp. 2d at 1057 (2,400 victims). Beyond the assistance of the Trustee's process, the number of victims in this case would overwhelm the court's ability to oversee the administration of additional restitution.

First, in the normal course a restitution order must identify every victim entitled to restitution. *See United States v. Catoggio*, 326 F.3d 323, 328 (2nd Cir. 2003) ("Identification of victims is a statutory prerequisite to the application of the MVRA."). Here, listing the names of

[19] As it did on January 4, 2017, of this year, it is always possible that the government recovers additional TelexFree funds. If the government does recover substantial additional funds after the bankruptcy claims process is complete, the government will petition the Court to revisit its restitution order and seek to distribute the additional funds to victims who (a) filed a claim in the bankruptcy claims process but (b) received no compensation or incomplete compensation because the amount of funds was not enough to cover all verified claims.

all victims would be impossible – the number exceeds the parameters of a Excel spreadsheet and would require a stand-alone database.

Second, if restitution was ordered for all victims – including those not reimbursed in the claims process – the court would be repaying victims, for 20 years, miniscule amounts derived from monthly payments by Merrill. In certain circumstances, the court is free to order that some victims get paid before others, see 18 U.S.C. § 3664(i); but pro rata distribution is appropriate in the absence of differentiating criteria. *See, e .g., United States v. Mueffelman*, 400 F. Supp. 2d 368, 386 (D. Mass. 2005), *aff'd*, 470 F.3d 33 (1st Cir. 2006) (ordering restitution paid on pro rata basis when no way to distinguish among victims). A few hundred dollars a month cannot be distributed pro rata to a million victims in dozens of countries.

Third, forcing the Clerk's Office to develop a process to disperse funds to 1.8 million victims worldwide would not be realistic, especially where a third party vendor is essentially already doing it. In sum, transfer of available assets is by far the fastest way to get compensation (a) to actual victims of the fraud, (b) in the correct amounts, (c) as fast as practicable.

CONCLUSION

The Court should sentence James Merrill to ten years in prison and three years of supervised release. The government also respectfully requests that the Court impose restitution as outlined above and pursuant to a proposed order to be submitted to the Court.

Respectfully submitted,

William Weinreb
Acting United States Attorney

By: */s/ Andrew Lelling*
Andrew E. Lelling
Neil J. Gallagher, Jr.
Assistant U.S. Attorneys

Date: March 16, 2017

CERTIFICATE OF SERVICE

I hereby certify that this document, filed through the ECF system, will be sent electronically to the registered participants as identified on the Notice of Electronic Filing, and paper copies will be sent to those indicated as non-registered participants, on March 15, 2017.

/s/ Andrew Lelling
Andrew E. Lelling

Copy Only Filed in RO Bankruptcy Proc 200624

Form **1120X** (Rev. January 2011)
Department of the Treasury Internal Revenue Service

Amended U.S. Corporation Income Tax Return

OMB No. 1545-0132
For tax year ending ▶ 12/31/2014 (Enter month and year.)

Please Type or Print

Name: TELEXFREE, LLC
Employer identification number: [redacted]
Number, street, and room or suite no. (If a P.O. box, see instructions.): C/O STEPHEN DARR, BKR TTEE 100 HIGH ST #2301
City or town, state, and ZIP code: BOSTON, MA 02110
Telephone number (optional):

Enter name and address used on original return (If same as above, write "Same.")
125 SUMMER STREET #1805 BOSTON, MA 02110

Internal Revenue Service Center where original return was filed ▶ CENTRALIZED INSOLVENCY OPERATION PO BOX 7346

Fill in applicable items and use Part II on the back to explain any changes

Part I Income and Deductions (see instructions)		(a) As originally reported or as previously adjusted	(b) Net change - increase or (decrease) - explain in Part II	(c) Correct amount
1 Total income	1	161,550,353.	1,906,302,125.	2,065,852,478.
2 Total deductions	2	2,450,176,063.	151,270,563.	2,601,446,626.
3 Taxable income. Subtract line 2 from line 1	3	-2,288,625,710.	1,753,031,562.	-535,594,148.
4 Total tax	4			
Payments and Credits (see instructions)				
5a Overpayment in prior year allowed as a credit	5a			
b Estimated tax payments	5b			
c Refund applied for on Form 4466	5c			
d Subtract line 5c from the sum of lines 5a and 5b	5d			
e Tax deposited with Form 7004	5e			
f Credit from Form 2439	5f			
g Credit for federal tax on fuels and other refundable credits	5g			
6 Tax deposited or paid with (or after) the filing of the original return	6			
7 Add lines 5d through 6, column (c)	7			
8 Overpayment, if any, as shown on original return or as later adjusted	8			
9 Subtract line 8 from line 7	9			
Tax Due or Overpayment (see instructions)				
10 Tax due. Subtract line 9 from line 4, column (c). If paying by check, make it payable to the "United States Treasury" ▶	10			
11 Overpayment. Subtract line 4, column (c), from line 9 ▶	11			
12 Enter the amount of line 11 you want: Credited to 20 Estimated tax ▶ . Refunded ▶	12			

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Sign Here

Under penalties of perjury, I declare that I have filed an original return and that I have examined this amended return, including accompanying schedules and statements, and to the best of my knowledge and belief, this amended return is true, correct, and complete. Declaration of preparer (other than taxpayer) is based on all information of which preparer has any knowledge.

Signature of officer: Stephen Darr Date: 3/7/18 ▶ Title: Trustee

Paid Preparer Use Only

Print/Type preparer's name: JOSEPH MIDDLETON
Preparer's signature: Joseph Middleton
Date: 3/7/18
Check ☐ if self-employed
PTIN: [redacted]
Firm's name ▶ KPMG LLP
Firm's EIN ▶ [redacted]
Firm's address ▶ 60 SOUTH STREET BOSTON, MA 02111
Phone no. 617-988-1000

For Paperwork Reduction Act Notice, see instructions. Form **1120X** (Rev. 1-2011)

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Part II **Explanation of Changes to Items in Part I (Enter the line number from page 1 for the items you are changing, and give the reason for each change. Show any computation in detail. Also, see What To Attach in the instructions.)**

If the change is due to a net operating loss carryback, a capital loss carryback, or a general business credit carryback, see Carryback Claims in the instructions, and check here . . . . . ▶ ☐

AMENDED RETURN CHANGES SEE STATEMENT 1

Taxpayer: TelexFree, LLC
EIN: [redacted]
Tax Period: December 31, 2014

2014 AMENDED RETURN STATEMENT

The taxpayer is amending its original return to address inconsistencies with SIG (TelexFree's information management system) and the general ledgers used to prepare the original return and claim additional deductions. The amended return reflects all income the TelexFree entities received during 2014 for the sale of membership plans and phone packages according to SIG.

In addition, the 2014 amended return claims casualty loss deductions for assets seized by the SEC during 2014, and bankruptcy estate operating expenses, items that were not included in the original return.

** AS AMENDED ** REQUEST FOR PROMPT DETERMINATION

Form **1120** Department of the Treasury Internal Revenue Service

U.S. Corporation Income Tax Return

For calendar year 2014 or tax year beginning _____, ending _____

▶ Information about Form 1120 and its separate instructions is at www.irs.gov/form1120.

OMB No. 1545-0123

2014

A Check if:
1a Consolidated return (attach Form 851)
b Life/nonlife consolidated return
2 Personal holding co (attach Sch. PH)
3 Personal service corp. (see instructions)
4 Schedule M-3 attached

TYPE OR PRINT

Name: TELEXFREE, LLC
C/O STEPHEN DARR, BANKRUPTCY TRUSTEE

Number, street, and room or suite no. If a P.O. box, see instructions.
100 HIGH STREET #2301

City or town, state, or province, country and ZIP or foreign postal code
BOSTON, MA 02110

B Employer identification number: [redacted]

C Date incorporated: 07/19/2012

D Total assets (see instructions): $ NONE

E Check if: (1) Initial return (2) Final return (3) Name change (4) Address change

Income	1a	Gross receipts or sales	1a 2,067,416,945.	
	b	Returns and allowances	1b 1,425.	
	c	Balance. Subtract line 1b from line 1a		1c 2,067,415,520.
	2	Cost of goods sold (attach Form 1125-A)		2 1,563,042.
	3	Gross profit. Subtract line 2 from line 1c		3 2,065,852,478.
	4	Dividends (Schedule C, line 19)		4
	5	Interest		5
	6	Gross rents		6
	7	Gross royalties		7
	8	Capital gain net income (attach Schedule D (Form 1120))		8
	9	Net gain or (loss) from Form 4797, Part II, line 17 (attach Form 4797)		9
	10	Other income (see instructions - attach statement)		10
	11	Total income. Add lines 3 through 10 ▶		11 2,065,852,478.
Deductions (See instructions for limitations on deductions.)	12	Compensation of officers (see instructions - attach Form 1125-E) ▶		12
	13	Salaries and wages (less employment credits)		13 19,170.
	14	Repairs and maintenance		14 990.
	15	Bad debts		15
	16	Rents		16 30,763.
	17	Taxes and licenses SEE STATEMENT 1		17 61,291.
	18	Interest		18
	19	Charitable contributions SEE STATEMENT 2		19 NONE
	20	Depreciation from Form 4562 not claimed on Form 1125-A or elsewhere on return (attach Form 4562)		20
	21	Depletion		21
	22	Advertising		22 17,721.
	23	Pension, profit-sharing, etc., plans		23
	24	Employee benefit programs		24
	25	Domestic production activities deduction (attach Form 8903)		25
	26	Other deductions (attach statement) SEE STATEMENT 3		26 2,601,316,691.
	27	Total deductions. Add lines 12 through 26 ▶		27 2,601,446,626.
	28	Taxable income before net operating loss deduction and special deductions. Subtract line 27 from line 11		28 -535,594,148.
	29a	Net operating loss deduction (see instructions)	29a	
	b	Special deductions (Schedule C, line 20)	29b	
	c	Add lines 29a and 29b		29c
Tax, Refundable Credits, and Payments	30	Taxable income. Subtract line 29c from line 28 (see instructions)		30 -535,594,148.
	31	Total tax (Schedule J, Part I, line 11)		31 NONE
	32	Total payments and refundable credits (Schedule J, Part II, line 21)		32
	33	Estimated tax penalty (see instructions). Check if Form 2220 is attached ▶ ☐		33
	34	Amount owed. If line 32 is smaller than the total of lines 31 and 33, enter amount owed		34 NONE
	35	Overpayment. If line 32 is larger than the total of lines 31 and 33, enter amount overpaid		35
	36	Enter amount from line 35 you want: Credited to 2015 estimated tax ▶ Refunded ▶		36

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Under penalties of perjury, I declare that I have examined this return, including accompanying schedules and statements, and to the best of my knowledge and belief, it is true, correct, and complete. Declaration of preparer (other than taxpayer) is based on all information of which preparer has any knowledge.

Signature of officer: Stephen Darr | Date: 3/9/18 | Title: Trustee

May the IRS discuss this return with the preparer shown below (see instructions)? X Yes ☐ No

Paid Preparer Use Only

Print/Type preparer's name: JOSEPH MIDDLETON	Preparer's signature: Joseph Middleton	Date: 3/7/18	Check ☐ if self-employed; PTIN: [redacted]
Firm's name ▶ KPMG LLP			Firm's EIN ▶ [redacted]
Firm's address ▶ 60 SOUTH STREET, BOSTON, MA 02111			Phone no. 617-988-1000

For Paperwork Reduction Act Notice, see separate instructions. Form 1120 (2014)

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TELEXFREE, LLC
Form 1120 (2014) [redacted] Page 2

Schedule C Dividends and Special Deductions (see instructions)

		(a) Dividends received	(b) %	(c) Special deductions (a) x (b)
1	Dividends from less-than-20%-owned domestic corporations (other than debt-financed stock)		70	
2	Dividends from 20%-or-more-owned domestic corporations (other than debt-financed stock)		80	
3	Dividends on debt-financed stock of domestic and foreign corporations		see instructions	
4	Dividends on certain preferred stock of less-than-20%-owned public utilities		42	
5	Dividends on certain preferred stock of 20%-or-more-owned public utilities		48	
6	Dividends from less-than-20%-owned foreign corporations and certain FSCs		70	
7	Dividends from 20%-or-more-owned foreign corporations and certain FSCs		80	
8	Dividends from wholly owned foreign subsidiaries		100	
9	Total. Add lines 1 through 8. See instructions for limitation			
10	Dividends from domestic corporations received by a small business investment company operating under the Small Business Investment Act of 1958		100	
11	Dividends from affiliated group members		100	
12	Dividends from certain FSCs		100	
13	Dividends from foreign corporations not included on lines 3, 6, 7, 8, 11, or 12			
14	Income from controlled foreign corporations under subpart F (attach Form(s) 5471)			
15	Foreign dividend gross-up			
16	IC-DISC and former DISC dividends not included on lines 1, 2, or 3			
17	Other dividends			
18	Deduction for dividends paid on certain preferred stock of public utilities			
19	Total dividends. Add lines 1 through 17. Enter here and on page 1, line 4 ▶			
20	Total special deductions. Add lines 9, 10, 11, 12, and 18. Enter here and on page 1, line 29b ▶			

Form 1120 (2014)

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Schedule J Tax Computation and Payment (see instructions)

Part I-Tax Computation

1	Check if the corporation is a member of a controlled group (attach Schedule O (Form 1120)). ▶ ☐			
2	Income tax. Check if a qualified personal service corporation (see instructions). ▶ ☐		2	
3	Alternative minimum tax (attach Form 4626)		3	NONE
4	Add lines 2 and 3		4	NONE
5a	Foreign tax credit (attach Form 1118)	5a		
b	Credit from Form 8834 (see instructions)	5b		
c	General business credit (attach Form 3800)	5c		
d	Credit for prior year minimum tax (attach Form 8827)	5d		
e	Bond credits from Form 8912	5e		
6	Total credits. Add lines 5a through 5e		6	
7	Subtract line 6 from line 4		7	NONE
8	Personal holding company tax (attach Schedule PH (Form 1120))		8	
9a	Recapture of investment credit (attach Form 4255)	9a		
b	Recapture of low-income housing credit (attach Form 8611)	9b		
c	Interest due under the look-back method - completed long-term contracts (attach Form 8697)	9c		
d	Interest due under the look-back method - income forecast method (attach Form 8866)	9d		
e	Alternative tax on qualifying shipping activities (attach Form 8902)	9e		
f	Other (see instructions - attach statement)	9f		
10	Total. Add lines 9a through 9f		10	
11	Total tax. Add lines 7, 8, and 10. Enter here and on page 1, line 31		11	NONE

Part II-Payments and Refundable Credits

12	2013 overpayment credited to 2014		12	
13	2014 estimated tax payments		13	
14	2014 refund applied for on Form 4466		14	( )
15	Combine lines 12, 13, and 14		15	
16	Tax deposited with Form 7004		16	
17	Withholding (see instructions)		17	
18	Total payments. Add lines 15, 16, and 17		18	
19	Refundable credits from:			
a	Form 2439	19a		
b	Form 4136	19b		
c	Form 8827, line 8c	19c		
d	Other (attach statement - see instructions)	19d		
20	Total credits. Add lines 19a through 19d		20	
21	Total payments and credits. Add lines 18 and 20. Enter here and on page 1, line 32		21	

Schedule K Other Information (see instructions)

		Yes	No
1	Check accounting method: a ☐ Cash b ☒ Accrual c ☐ Other (specify) ▶		
2	See the instructions and enter the:		
a	Business activity code no. ▶ 454390		
b	Business activity ▶ DIRECT SALES		
c	Product or service ▶ COMMUNICATIONS		
3	Is the corporation a subsidiary in an affiliated group or a parent-subsidiary controlled group?		X
	If "Yes," enter name and EIN of the parent corporation ▶		
4	At the end of the tax year:		
a	Did any foreign or domestic corporation, partnership (including any entity treated as a partnership), trust, or tax-exempt organization own directly 20% or more, or own, directly or indirectly, 50% or more of the total voting power of all classes of the corporation's stock entitled to vote? If "Yes," complete Part I of Schedule G (Form 1120) (attach Schedule G)		X
b	Did any individual or estate own directly 20% or more, or own, directly or indirectly, 50% or more of the total voting power of all classes of the corporation's stock entitled to vote? If "Yes," complete Part II of Schedule G (Form 1120) (attach Schedule G)	X	

TELEXFREE, LLC [redacted]

Form 1120 (2014) Page 4

Schedule K Other Information *continued* (see instructions)

		Yes	No
5	At the end of the tax year, did the corporation:		
a	Own directly 20% or more, or own, directly or indirectly, 50% or more of the total voting power of all classes of stock entitled to vote of any foreign or domestic corporation not included on Form 851, Affiliations Schedule? For rules of constructive ownership, see instructions. If "Yes," complete (i) through (iv) below.	X	

(i) Name of Corporation	(ii) Employer Identification Number (if any)	(iii) Country of Incorporation	(iv) Percentage Owned in Voting Stock
TELEXFREE FINANCIAL, INC	[redacted]	US	100.000

b	Own directly an interest of 20% or more, or own, directly or indirectly, an interest of 50% or more in any foreign or domestic partnership (including an entity treated as a partnership) or in the beneficial interest of a trust? For rules of constructive ownership, see instructions. If "Yes," complete (i) through (iv) below.		X

(i) Name of Entity	(ii) Employer Identification Number (if any)	(iii) Country of Organization	(iv) Maximum Percentage Owned in Profit, Loss, or Capital

6	During this tax year, did the corporation pay dividends (other than stock dividends and distributions in exchange for stock) in excess of the corporation's current and accumulated earnings and profits? (See sections 301 and 316.) If "Yes," file Form 5452, Corporate Report of Nondividend Distributions. If this is a consolidated return, answer here for the parent corporation and on Form 851 for each subsidiary.		X
7	At any time during the tax year, did one foreign person own, directly or indirectly, at least 25% of (a) the total voting power of all classes of the corporation's stock entitled to vote or (b) the total value of all classes of the corporation's stock? For rules of attribution, see section 318. If "Yes," enter:	X	
	(i) Percentage owned ▶ 30.000 and (ii) Owner's country ▶ BR		
	(c) The corporation may have to file Form 5472, Information Return of a 25% Foreign-Owned U.S. Corporation or a Foreign Corporation Engaged in a U.S. Trade or Business. Enter the number of Forms 5472 attached ▶		
8	Check this box if the corporation issued publicly offered debt instruments with original issue discount ▶ ☐ If checked, the corporation may have to file Form 8281, Information Return for Publicly Offered Original Issue Discount Instruments.		
9	Enter the amount of tax-exempt interest received or accrued during the tax year ▶ $		
10	Enter the number of shareholders at the end of the tax year (if 100 or fewer) ▶ 2		
11	If the corporation has an NOL for the tax year and is electing to forego the carryback period, check here ▶ ☐ If the corporation is filing a consolidated return, the statement required by Regulations section 1.1502-21(b)(3) must be attached or the election will not be valid.		
12	Enter the available NOL carryover from prior tax years (do not reduce it by any deduction on line 29a.) ▶ $		
13	Are the corporation's total receipts (page 1, line 1a, plus lines 4 through 10) for the tax year and its total assets at the end of the tax year less than $250,000? If "Yes," the corporation is not required to complete Schedules L, M-1, and M-2. Instead, enter the total amount of cash distributions and the book value of property distributions (other than cash) made during the tax year ▶ $		X
14	Is the corporation required to file Schedule UTP (Form 1120), Uncertain Tax Position Statement (see instructions)? If "Yes," complete and attach Schedule UTP.		X
15a	Did the corporation make any payments in 2014 that would require it to file Form(s) 1099?	X	
b	If "Yes," did or will the corporation file required Forms 1099?	X	
16	During this tax year, did the corporation have an 80% or more change in ownership, including a change due to redemption of its own stock?		X
17	During or subsequent to this tax year, but before the filing of this return, did the corporation dispose of more than 65% (by value) of its assets in a taxable, non-taxable, or tax deferred transaction?		
18	Did the corporation receive assets in a section 351 transfer in which any of the transferred assets had a fair market basis or fair market value of more than $1 million?		X

Form 1120 (2014)

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TELEXFREE, LLC [redacted]

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Schedule L Balance Sheets per Books

Assets	Beginning of tax year (a)	Beginning of tax year (b)	End of tax year (c)	End of tax year (d)
1 Cash		37,640,973.		
2a Trade notes and accounts receivable				
b Less allowance for bad debts	( )		( )	
3 Inventories				
4 U.S. government obligations				
5 Tax-exempt securities (see instructions)				
6 Other current assets (attach statement)	STMT 4	29,951,194.		NONE
7 Loans to shareholders		91,257.		NONE
8 Mortgage and real estate loans				
9 Other investments (attach statement)		27,368,369.		NONE
10a Buildings and other depreciable assets	258,495.		NONE	
b Less accumulated depreciation	(38,550.)	219,945.	(NONE)	NONE
11a Depletable assets				
b Less accumulated depletion	( )		( )	
12 Land (net of any amortization)				
13a Intangible assets (amortizable only)				
b Less accumulated amortization	( )		( )	
14 Other assets (attach statement)	STMT 4	107,368.		NONE
15 Total assets		95,379,106.		NONE
Liabilities and Shareholders' Equity				
16 Accounts payable				
17 Mortgages, notes, bonds payable in less than 1 year				
18 Other current liabilities (attach statement)	STMT 4	54,512,623.		NONE
19 Loans from shareholders		50.		NONE
20 Mortgages, notes, bonds payable in 1 year or more				
21 Other liabilities (attach statement)	STMT 4	61,335,098.		NONE
22 Capital stock: a Preferred stock				
b Common stock				
23 Additional paid-in capital				
24 Retained earnings - Appropriated (attach statement)				
25 Retained earnings - Unappropriated		-20,468,665.		NONE
26 Adjustments to shareholders' equity (attach statement)				
27 Less cost of treasury stock		( )		( )
28 Total liabilities and shareholders' equity		95,379,106.		NONE

Schedule M-1 Reconciliation of Income (Loss) per Books With Income per Return

Note: The corporation may be required to file Schedule M-3 (see instructions).

1 Net income (loss) per books	-552,373,891.	7 Income recorded on books this year not included on this return (itemize): Tax-exempt interest $	
2 Federal income tax per books			
3 Excess of capital losses over capital gains			
4 Income subject to tax not recorded on books this year (itemize):		8 Deductions on this return not charged against book income this year (itemize):	
5 Expenses recorded on books this year not deducted on this return (itemize):		a Depreciation $	
a Depreciation $		b Charitable contributions $	NONE
b Charitable contributions $			
c Travel and entertainment $ 529.			
SEE STATEMENT 5	16,779,214.	9 Add lines 7 and 8	NONE
6 Add lines 1 through 5	-535,594,148.	10 Income (page 1, line 28) - line 6 less line 9	-535,594,148.

Schedule M-2 Analysis of Unappropriated Retained Earnings per Books (Line 25, Schedule L)

1 Balance at beginning of year	-20,468,665.	5 Distributions: a Cash	
2 Net income (loss) per books	-552,373,891.	b Stock	
3 Other increases (itemize):		c Property	
		6 Other decreases (itemize):	
SEE STATEMENT 5	572,842,556.	7 Add lines 5 and 6	
4 Add lines 1, 2, and 3	NONE	8 Balance at end of year (line 4 less line 7)	NONE

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Form 1120 (2014)

4C1140 2.000

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SCHEDULE G (Form 1120)
(Rev. December 2011)
Department of the Treasury
Internal Revenue Service

Information on Certain Persons Owning the Corporation's Voting Stock

▶ Attach to Form 1120.
▶ See instructions on page 2.

OMB No. 1545-0123

Name

TELEXFREE, LLC
C/O STEPHEN DARR, BANKRUPTCY TRUSTEE

Employer identification number (EIN)

[redacted]

Part I **Certain Entities Owning the Corporation's Voting Stock.** (Form 1120, Schedule K, Question 4a). Complete columns (i) through (v) below for any foreign or domestic corporation, partnership (including any entity treated as a partnership), trust, or tax-exempt organization that owns directly 20% or more, or owns, directly or indirectly, 50% or more of the total voting power of all classes of the corporation's stock entitled to vote (see instructions).

(i) Name of Entity	(ii) Employer Identification Number (if any)	(iii) Type of Entity	(iv) Country of Organization	(v) Percentage Owned in Voting Stock

Part II **Certain Individuals and Estates Owning the Corporation's Voting Stock.** (Form 1120, Schedule K, Question 4b). Complete columns (i) through (iv) below for any individual or estate that owns directly 20% or more, or owns, directly or indirectly, 50% or more of the total voting power of all classes of the corporation's stock entitled to vote (see instructions).

(i) Name of Individual or Estate	(ii) Identifying Number (if any)	(iii) Country of Citizenship (see instructions)	(iv) Percentage Owned in Voting Stock
CARLOS WANZELER	[redacted]	US	50.000
JAMES MERRILL		US	50.000

For Paperwork Reduction Act Notice, see the instructions for Form 1120.
1472KP 1592

4C2720 1.000 JSA

[redacted]

Schedule G (Form 1120) (Rev. 12-2011)
6

Form **4626** — Department of the Treasury, Internal Revenue Service

Alternative Minimum Tax - Corporations

▶ Attach to the corporation's tax return.
▶ Information about Form 4626 and its separate instructions is at www.irs.gov/form4626.

OMB No. 1545-0123

2014

Name: TELEXFREE, LLC
C/O STEPHEN DARR, BANKRUPTCY TRUSTEE

Employer identification number: [redacted]

Note: *See the instructions to find out if the corporation is a small corporation exempt from the alternative minimum tax (AMT) under section 55(e).*

1	Taxable income or (loss) before net operating loss deduction		1	-535594148.
2	**Adjustments and preferences:**			
a	Depreciation of post-1986 property		2a	
b	Amortization of certified pollution control facilities		2b	
c	Amortization of mining exploration and development costs		2c	
d	Amortization of circulation expenditures (personal holding companies only)		2d	
e	Adjusted gain or loss		2e	
f	Long-term contracts		2f	
g	Merchant marine capital construction funds		2g	
h	Section 833(b) deduction (Blue Cross, Blue Shield, and similar type organizations only)		2h	
i	Tax shelter farm activities (personal service corporations only)		2i	
j	Passive activities (closely held corporations and personal service corporations only)		2j	
k	Loss limitations		2k	
l	Depletion		2l	
m	Tax-exempt interest income from specified private activity bonds		2m	
n	Intangible drilling costs		2n	
o	Other adjustments and preferences SEE STATEMENT 6		2o	NONE
3	Pre-adjustment alternative minimum taxable income (AMTI). Combine lines 1 through 2o		3	-535594148.
4	**Adjusted current earnings (ACE) adjustment:**			
a	ACE from line 10 of the ACE worksheet in the instructions	4a: -535594148.		
b	Subtract line 3 from line 4a. If line 3 exceeds line 4a, enter the difference as a negative amount (see instructions)	4b:		
c	Multiply line 4b by 75% (.75). Enter the result as a positive amount	4c:		
d	Enter the excess, if any, of the corporation's total increases in AMTI from prior year ACE adjustments over its total reductions in AMTI from prior year ACE adjustments (see instructions). **Note:** *You must enter an amount on line 4d (even if line 4b is positive)*	4d:		
e	ACE adjustment. • If line 4b is zero or more, enter the amount from line 4c • If line 4b is less than zero, enter the smaller of line 4c or line 4d as a negative amount		4e	
5	Combine lines 3 and 4e. If zero or less, stop here; the corporation does not owe any AMT		5	-535594148.
6	Alternative tax net operating loss deduction (see instructions)		6	
7	**Alternative minimum taxable income.** Subtract line 6 from line 5. If the corporation held a residual interest in a REMIC, see instructions		7	-535594148.
8	**Exemption phase-out** (If line 7 is $310,000 or more, skip lines 8a and 8b and enter -0- on line 8c):			
a	Subtract $150,000 from line 7 (If completing this line for a member of a controlled group, see instructions). If zero or less, enter -0-	8a: NONE		
b	Multiply line 8a by 25% (.25)	8b: NONE		
c	Exemption. Subtract line 8b from $40,000 (If completing this line for a member of a controlled group, see instructions). If zero or less, enter -0-		8c	40,000.
9	Subtract line 8c from line 7. If zero or less, enter -0-		9	
10	Multiply line 9 by 20% (.20)		10	
11	Alternative minimum tax foreign tax credit (AMTFTC) (see instructions)		11	
12	Tentative minimum tax. Subtract line 11 from line 10		12	
13	Regular tax liability before applying all credits except the foreign tax credit		13	
14	**Alternative minimum tax.** Subtract line 13 from line 12. If zero or less, enter -0-. Enter here and on Form 1120, Schedule J, line 3, or the appropriate line of the corporation's income tax return		14	NONE

For Paperwork Reduction Act Notice, see separate instructions. Form 4626 (2014)

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4X2400 2.000
1472KP 1592 [redacted] 7

TELEXFREE, LLC [redacted]

Adjusted Current Earnings (ACE) Worksheet

Keep for Your Records

▶ See ACE Worksheet Instructions.

1	Pre-adjustment AMTI. Enter the amount from line 3 of Form 4626					1	-535594148.
2	ACE depreciation adjustment:						
a	AMT depreciation			2a	NONE		
b	ACE depreciation:						
	(1) Post-1993 property	2b(1)	NONE				
	(2) Post-1989, pre-1994 property	2b(2)					
	(3) Pre-1990 MACRS property	2b(3)					
	(4) Pre-1990 original ACRS property	2b(4)					
	(5) Property described in sections 168(f)(1) through (4)	2b(5)					
	(6) Other property	2b(6)					
	(7) Total ACE depreciation. Add lines 2b(1) through 2b(6)			2b(7)	NONE		
c	ACE depreciation adjustment. Subtract line 2b(7) from line 2a					2c	NONE
3	Inclusion in ACE of items included in earnings and profits (E&P):						
a	Tax-exempt interest income			3a			
b	Death benefits from life insurance contracts			3b			
c	All other distributions from life insurance contracts (including surrenders)			3c			
d	Inside buildup of undistributed income in life insurance contracts			3d			
e	Other items (see Regulations sections 1.56(g)-1(c)(6)(iii) through (ix) for a partial list)			3e			
f	Total increase to ACE from inclusion in ACE of items included in E&P. Add lines 3a through 3e					3f	
4	Disallowance of items not deductible from E&P:						
a	Certain dividends received			4a			
b	Dividends paid on certain preferred stock of public utilities that are deductible under section 247			4b			
c	Dividends paid to an ESOP that are deductible under section 404(k)			4c			
d	Nonpatronage dividends that are paid and deductible under section 1382(c)			4d			
e	Other items (see Regulations sections 1.56(g)-1(d)(3)(i) and (ii) for a partial list)			4e			
f	Total increase to ACE because of disallowance of items not deductible from E&P. Add lines 4a through 4e					4f	
5	Other adjustments based on rules for figuring E&P:						
a	Intangible drilling costs			5a			
b	Circulation expenditures			5b			
c	Organizational expenditures			5c			
d	LIFO inventory adjustments			5d			
e	Installment sales			5e			
f	Total other E&P adjustments. Combine lines 5a through 5e					5f	
6	Disallowance of loss on exchange of debt pools					6	
7	Acquisition expenses of life insurance companies for qualified foreign contracts					7	
8	Depletion					8	
9	Basis adjustments in determining gain or loss from sale or exchange of pre-1994 property					9	
10	Adjusted current earnings. Combine lines 1, 2c, 3f, 4f, and 5f through 9. Enter the result here and on line 4a of Form 4626					10	-535594148.

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4X2410 2.000
1472KP 1592 [redacted] 8

Form **1125-A**
(Rev. December 2012)
Department of the Treasury
Internal Revenue Service

Cost of Goods Sold

▶ Attach to Form 1120, 1120-C, 1120-F, 1120S, 1065, or 1065-B.
▶ Information about Form 1125-A and its instructions is at *www.irs.gov/form1125a*.

OMB No. 1545-2226

Name: TELEXFREE, LLC
C/O STEPHEN DARR, BANKRUPTCY TRUSTEE

Employer identification number: [redacted]

1	Inventory at beginning of year	1	
2	Purchases	2	
3	Cost of labor	3	
4	Additional section 263A costs (attach schedule)	4	
5	Other costs (attach schedule) SEE STATEMENT 7	5	1,563,042.
6	Total. Add lines 1 through 5	6	1,563,042.
7	Inventory at end of year	7	
8	Cost of goods sold. Subtract line 7 from line 6. Enter here and on Form 1120, page 1, line 2 or the appropriate line of your tax return (see instructions)	8	1,563,042.

9a Check all methods used for valuing closing inventory:
- (i) ☐ Cost
- (ii) ☐ Lower of cost or market
- (iii) ☐ Other (Specify method used and attach explanation.) ▶

b Check if there was a writedown of subnormal goods ▶ ☐
c Check if the LIFO inventory method was adopted this tax year for any goods (if checked, attach Form 970) ▶ ☐
d If the LIFO inventory method was used for this tax year, enter amount of closing inventory computed under LIFO | 9d |
e If property is produced or acquired for resale, do the rules of section 263A apply to the entity (see instructions)? ☐ Yes ☐ No
f Was there any change in determining quantities, cost, or valuations between opening and closing inventory? If "Yes," attach explanation ☐ Yes ☐ No

Section references are to the Internal Revenue Code unless otherwise noted.

General Instructions

Purpose of Form

Use Form 1125-A to calculate and deduct cost of goods sold for certain entities.

Who Must File

Filers of Form 1120, 1120-C, 1120-F, 1120S, 1065, or 1065-B, must complete and attach Form 1125-A if the applicable entity reports a deduction for cost of goods sold.

Inventories

Generally, inventories are required at the beginning and end of each tax year if the production, purchase, or sale of merchandise is an income-producing factor. See Regulations section 1.471-1. If inventories are required, you generally must use an accrual method of accounting for sales and purchases of inventory items.

Exception for certain taxpayers. If you are a qualifying taxpayer or a qualifying small business taxpayer (defined below), you can adopt or change your accounting method to account for inventoriable items in the same manner as materials and supplies that are not incidental.

Under this accounting method, inventory costs for raw materials purchased for use in producing finished goods and merchandise purchased for resale are deductible in the year the finished goods or merchandise are sold (but not before the year you paid for the raw materials or merchandise, if you are also using the cash method).

If you account for inventoriable items in the same manner as materials and supplies that are not incidental, you can currently deduct expenditures for direct labor and all indirect costs that would otherwise be included in inventory costs. See the instructions for lines 2 and 7.

For additional guidance on this method of accounting, see Pub. 538, Accounting Periods and Methods. For guidance on adopting or changing to this method of accounting, see Form 3115, Application for Change in Accounting Method, and its instructions.

Qualifying taxpayer. A qualifying taxpayer is a taxpayer that, (a) for each prior tax year ending after December 16, 1998, has average annual gross receipts of $1 million or less for the 3 prior tax years and (b) its business is not a tax shelter (as defined in section 448(d)(3)). See Rev. Proc. 2001-10, 2001-2 I.R.B. 272.

Qualifying small business taxpayer. A qualifying small business taxpayer is a taxpayer that, (a) for each prior tax year ending on or after December 31, 2000, has average annual gross receipts of $10 million or less for the 3 prior tax years, (b) whose principal business activity is not an ineligible activity, and (c) whose business is not a tax shelter (as defined in section 448(d)(3)). See Rev. Proc. 2002-28, 2002-18, I.R.B. 815.

Uniform capitalization rules. The uniform capitalization rules of section 263A generally require you to capitalize, or include in inventory, certain costs incurred in connection with the following.

- The production of real property and tangible personal property held in inventory or held for sale in the ordinary course of business.
- Real property or personal property (tangible and intangible) acquired for resale.
- The production of real property and tangible personal property by a corporation for use in its trade or business or in an activity engaged in for profit.

See the discussion on section 263A uniform capitalization rules in the instructions for your tax return before completing Form 1125-A. Also see Regulations sections 1.263A-1 through 1.263A-3. See Regulations section 1.263A-4 for rules for property produced in a farming business.

TELEXFREE, LLC [redacted]

FORM 1120, PAGE 1 DETAIL

LINE 17 - TAXES AND LICENSES

TELECOM TAX EXPENSE	46,808.
PAYROLL TAX EXPENSE	14,483.
TOTAL	61,291.

TELEXFREE, LLC [redacted]

FORM 1120, PAGE 1 DETAIL

LINE 19 - CONTRIBUTIONS DEDUCTION

1.	TAXABLE INCOME (EXCLUDING CONTRIBUTIONS AND DOMESTIC PRODUCTION ACTIVITIES DEDUCTION)	-535,594,148.
2.	LESS: NOL CARRYOVER	
3.	PLUS: CAPITAL LOSS CARRYBACK	
4.	TAXABLE INCOME WITHOUT REGARD TO CONTRIBUTIONS, SPECIAL DEDUCTIONS, DOMESTIC PRODUCTION ACTIVITIES DEDUCTION, NOL CARRYBACKS, AND CAPITAL LOSS CARRYBACKS	-535,594,148.
5.	CONTRIBUTION DEDUCTION LIMITATION (TAXABLE INCOME X 10%)	NONE
6.	AMOUNT OF DEDUCTIBLE CONTRIBUTIONS	7,500.
7.	CONTRIBUTION DEDUCTION (LESSER OF LINE 5 OR LINE 6)	NONE

LINE 19 - 5 YEAR CONTRIBUTION CARRYOVER

YEAR ENDING	AMOUNT AVAILABLE	AMOUNT UTILIZED	CONVERTED TO NOL CARRYOVER	CARRYOVER TO NEXT YEAR
12/31/2013	7,500.	NONE		7,500.
TOTAL	7,500.	NONE		7,500.

TELEXFREE, LLC [redacted]

FORM 1120, PAGE 1 DETAIL

LINE 26 - OTHER DEDUCTIONS

TRAVEL, MEALS AND ENTERTAINMENT		34,021.
BANK CHARGES		3,629.
EVENTS		6,668.
FILING AND REGISTERED AGENT FEES		269,145.
LEGAL AND PROFESSIONAL FEES		2,140,637.
165 LOSS SEC ASSET SEIZURE		148,000,000.
ACCRUED ADMINISTRATIVE EXPENSES		3,271,988.
MERCHANT FEES		313,623.
OFFICE EXPENSES		11,482.
PAYROLL FEES		9,144.
PAYROLL EXPENSES		12,306.
PERSONNEL		47,344.
POSTAGE AND DELIVERY		90.
CONSULTING EXPENSE		3,896,209.
SOFTWARE EXPENSE		51,684.
SMALL ITEMS NOT CAPITALIZED		1,749.
SUBCONTRACTOR		283,642.
TOTAL TECHNOLOGY CONSULTANT		257,663.
WEBSITE DOMAIN		60.
GROSS CREDIT LIABILITY ACCRUAL	SEE STATEMENT 3A FOR DETAIL	2,442,705,607.
TOTAL		2,601,316,691.

21,450

Taxpayer: TelexFree, LLC
EIN: [redacted]
Tax Period: December 31, 2014

2014 Statement Regarding Gross Credit Liability Accrual

The credits deposited in Ponzi scheme users' accounts during 2014 (i.e., $2,442,705,606) were used by participants to satisfy invoices and redeemed for cash as shown below:

$61,335,098	Credits outstanding BOY
$2,442,705,606	2014 Credits issued to users (deduction claimed on line 26)
($1,866,795,376)	Credits redeemed by users to satisfy invoices (included in gross receipts in line 1a)
($83,212,109)	Credits redeemed by users for cash
$554,033,219	Credits outstanding EOY

STATEMENT 3A

TELEXFREE, LLC [redacted]

FORM 1120, PAGE 5 DETAIL

SCH L, LINE 6 - OTHER CURRENT ASSETS	BEGINNING	ENDING
PROPERTY ON HOLD	16,222,365.	NONE
LOAN TO TELEXELECTRIC LLP	2,022,329.	NONE
LOAN TO TELEXFREE FINANCIAL	4,105,475.	NONE
LOAN TO TELEXMOBILE	500,870.	NONE
PREPAID EXPENSES	1,709,402.	NONE
LOAN TO TELEXFREE LLC	5,390,753.	NONE
TOTAL	29,951,194.	NONE

SCH L, LINE 14 - OTHER ASSETS		
ORGANIZATIONAL COSTS	3,475.	NONE
SOFTWARE	97,949.	NONE
SECURITY DEPOSITS	5,944.	NONE
TOTAL	107,368.	NONE

SCH L, LINE 18 - OTHER CURRENT LIABILITIES		
ACCRUED FEDERAL INCOME TAX	19,964,029.	NONE
ACCRUED STATE TAX	3,812,940.	NONE
BRAZILLIAN HELP INC	2,672.	NONE
LOAN TO/FROM TELEXFREE LLC	5,390,753.	NONE
OTHER CURRENT LIABILITIES	17,676,275.	NONE
TELECOM TAXES PAYABLE	23,404.	NONE
COMMISSIONS PAYABLE	7,642,550.	NONE
TOTAL	54,512,623.	NONE

SCH L, LINE 21 - OTHER LIABILITIES		
ACCRUED ADVERTISING CREDITS	61,335,098.	NONE
TOTAL	61,335,098.	NONE

TELEXFREE, LLC [redacted]

FORM 1120, PAGE 5 DETAIL

SCH M-1, LINE 5 - EXPENSES RECORDED ON BOOKS NOT DEDUCTED ON RETURN

PENALTIES & SETTLEMENTS	638.
FEDERAL & STATE TAXES	16,778,576.
TOTAL	16,779,214.

SCH M-2, LINE 3 - OTHER INCREASES

SEE ATTACHMENT A	572,842,556.
TOTAL	572,842,556.

TELEXFREE, LLC [redacted]

FORM 4626 DETAIL

LINE 20 - OTHER ADJUSTMENTS - CONTRIBUTIONS DEDUCTION

1. AMTI (EXCLUDING CONTRIBUTIONS AND DOMESTIC PRODUCTION ACTIVITIES DEDUCTION)	-535,594,148.
2. LESS: NOL CARRYOVER	
3. PLUS: CAPITAL LOSS CARRYBACK	
4. AMTI WITHOUT REGARD TO CONTRIBUTIONS, SPECIAL DEDUCTIONS, DOMESTIC PRODUCTION ACTIVITIES DEDUCTION, NOL CARRYBACKS, AND CAPITAL LOSS CARRYBACKS	-535,594,148.
5. CONTRIBUTION DEDUCTION LIMITATION (AMTI X 10%)	NONE
6. AMOUNT OF DEDUCTIBLE CONTRIBUTIONS	7,500.
7. CONTRIBUTION DEDUCTION (LESSER OF LINE 5 OR LINE 6)	NONE

5 YEAR CONTRIBUTIONS CARRYOVER

YEAR ENDING	AMOUNT AVAILABLE	AMOUNT UTILIZED	CARRYOVER TO NEXT YEAR
12/31/2013	7,500.	NONE	7,500.
TOTAL	7,500.	NONE	7,500.

LINE 20 - CONTRIBUTIONS ADJUSTMENT

REGULAR CONTRIBUTIONS	NONE
AMT CONTRIBUTIONS	NONE
CONTRIBUTION ADJUSTMENT	NONE

TELEXFREE, LLC [redacted]

FORM 1125-A DETAIL

LINE 5 - OTHER COSTS

TELECOM & DATABASE NETWORK EXPENSE	57,886.
TERMINATION	1,505,156.
TOTAL	1,563,042.



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Internet www.us.kpmg.com

BY ELECTRONIC MAIL ONLY

December 3, 2018

Christine DeRosa
Internal Revenue Service
LB&I Team 1472
JFK Federal Building
15 New Sudbury St.
Boston, MA 02203

Re: **In re TelexFree, LLC**
U.S. Bankruptcy Court for the District of Massachusetts
Docket No. 14-40987
Response to NOPA Issue No. 004

Dear Christine:

I write on behalf of TelexFree, LLC ("Taxpayer") in response to Form 5701, *Notice of Proposed Adjustment* ("NOPA"), dated November 13, 2018. The NOPA disallows the Taxpayer's $148 million section 165[1] loss deduction for funds frozen by a court order and later ordered to be distributed by the Trustee as restitution to victims.

The NOPA should be withdrawn because the U.S. district court ordered the frozen funds to be distributed by the Trustee as restitution to victims. The Trustee and all but one of the federal officials and agencies involved in this matter have tried to maximize funds available for restitution to victims, as the facts developed below illustrate.

The Internal Revenue Service is the lone outlier agency pulling in the opposite direction, contrary to the goals of the Trustee, the SEC, the Department of Justice, and the U.S. Attorney, among others. With this NOPA, the Service makes another strained argument that, if indulged, would strip restitution funds away from victims in favor of the IRS.

Facts

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

On April 15, 2014, the Securities and Exchange Commission filed a complaint under seal against TelexFree seeking a preliminary injunction freezing assets held by TelexFree in an effort to, among other

[1] All references to "section" "§" or "I.R.C." refer to the Internal Revenue Code of 1986, as amended to 2014 unless otherwise noted.

KPMG LLP, a U.S. limited liability partnership, is the U.S. member firm of KPMG International, a Swiss cooperative.

things, "preserve any remaining assets for defrauded investors."[2] On April 16, 2014, the U.S. District Court in Boston issued an *ex parte* temporary restraining order freezing TelexFree's assets.[3] According to the SEC, the temporary restraining order "secured millions of dollars of funds and prevented the potential dissipation of investor assets."[4]

More precisely, the temporary restraining order issued by the U.S. district court froze $140 million in the Taxpayer's domestic bank accounts and payment processor reserve accounts. On April 17, 2014, government agents raided TelexFree's offices. As part of that raid, the government seized cash, real property, and personal property worth $8 million, also pursuant to the temporary restraining order.[5] For the remainder of this letter, we refer to these assets collectively as "Frozen Assets."

The SEC, U.S. Attorney's Office, Homeland Security, and the Trustee carefully coordinated the best way to provide as much restitution as possible to the victims of the TelexFree scheme.

On September 8, 2016, a federal grand jury returned a seventeen-count superseding indictment against James Merrill, a former officer of TelexFree. The indictment contained forfeiture allegations. The defendant pleaded guilty to several of the counts in the indictment and agreed and consented to the asset forfeiture allegations with respect to the assets specified in Exhibit A of the plea agreement, which included the Frozen Assets described above.

On March 22, 2017, the U.S. district court issued a preliminary order of forfeiture in Merrill's criminal case that covered the Frozen Assets, among others.[6] Merrill's rights in the Frozen Assets were forfeited under the order, and the court ordered the United States to publish notice to enable any person with interest in the Frozen Assets the right to file a petition to assert their interest in the Frozen Assets. In close consultation with the U.S. Attorney, the SEC, and others, the Trustee chose not to file any petitions on behalf of TelexFree in response to the preliminary forfeiture order based upon the government's stated intention to have the funds turned over to the Trustee for distribution and restitution to victims.

On July 11, 2017, the U.S. district court entered a restitution order in Merrill's criminal case. The parties sought "to avoid duplication of effort and inconsistent findings, reduce administration costs, conserve judicial resources, and enable better accounting of funds received by victims of the fraud."[7] Because of

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[2] Complaint at 6, *Securities and Exchange Commission v. TelexFree, Inc. et al*, Case no. 1:14-cv-11858-DJC, Doc. 2 (Apr. 15, 2014), **Exhibit A.**

[3] Temporary Restraining Order, *Securities and Exchange Commission v. TelexFree, Inc. et al*, Case no. 1:14-cv-11858-NMG, Doc. 13 (Apr. 16, 2014), **Exhibit B.**

[4] Press Release, SEC, SEC Halts Pyramid Scheme Targeting Dominican & Brazilian Immigrants (Apr. 17, 2014), **Exhibit C.**

[5] Subsequently, on January 4, 2017, the government seized approximately $19 million in cash generated by the Taxpayer's Ponzi scheme, but that seizure does not affect the 2014 tax return.

[6] Preliminary Order for Forfeiture, *United States of America v. James Merrill*, Case no. 4:14-cr-40028-TSH, Doc. 347 (Mar. 22, 2017), **Exhibit D.**

[7] Restitution Order, *United States of America v. James Merrill*, Case no. 4:14-cr-40028-TSH, Doc. 367 (Jul. 11, 2017), **Exhibit E.**

the volume and complexity of restitution payments in this case, the district court ordered restitution to be administered and paid by the Trustee.[8]

On June 14, 2018, the U.S. district court ordered the Frozen Assets to be turned over to the Trustee as partial payment of restitution.[9] On that same day, the district court entered a partial final order of forfeiture, ordering that all of Merrill's right, title or interest in the forfeited property be forfeited to the United States.[10] The Federal Rules of Criminal Procedure provide that the preliminary order became final as to Merrill at the time of his sentencing, became part of his criminal sentence, and was included in the criminal judgment entered against him.[11] Those two orders were entered together as part of a closely coordinated plan.

On March 12, 2018, the Chapter 11 Trustee filed an amended 2014 tax return claiming a section 165 casualty loss deduction for assets seized by the SEC in 2014. In the NOPA, the IRS proposes to disallow this deduction.

Law

Section 165(a) allows a deduction for any loss not compensated for by insurance or otherwise. Section 165 loss deductions are limited to three types of losses: (1) losses incurred in a trade or business; (2) losses incurred in any transaction entered into for profit, though not connected with a trade or business; and (3) casualty losses from fire, storm, shipwreck, or other casualty, or from theft.[12]

Courts have disallowed deductions under section 165 where "the allowance of a deduction would 'frustrate sharply defined national or state policies proscribing particular types of conduct.'"[13] Known as the public policy doctrine, this limitation was imposed by courts on certain illegal activities. Specifically, the doctrine prevented taxpayers from taking deductions for government-imposed fines or penalties, or for payments that are themselves illegal acts.[14]

In 1969, Congress codified and circumscribed the common-law public policy doctrine by enacting section 162(f). Since the enactment of section 162(f), courts generally now look to the "all inclusive" public policy standards set by section 162(f) and its regulations when interpreting the scope of permissible loss deductions under section 165.[15] Section 162(f) disallows a deduction for any fine or

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[8] *Id.*
[9] Order to Apply Certain Assets to Restitution, *United States of America v. James Merrill*, Case no. 4:14-cr-40028 TSH, Doc. 398 (Jun. 14, 2018), **Exhibit F.**
[10] Partial Final Order of Forfeiture, ¶ 3, *United States of America v. James Merrill*, Case no. 4:14-cr-40028 TSH, Doc. 400 (Jun. 14, 2018), **Exhibit G.**
[11] *Id.* ¶ 10.
[12] *See* I.R.C. § 165(c).
[13] *Commissioner v. Tellier*, 383 U.S. 687, 694 (1966). *See also Stephens v. Commissioner*, 905 F.2d 667 (2d Cir. 1990).
[14] *Tank Truck Rentals, Inc. v. Commissioner*, 356 U.S. 30, 35 (1958).
[15] *E.g., Medeiros v. Commissioner*, 77 T.C. 1255, 1262 n. 8 (1981); *Stephens v. Commissioner*, 905 F.2d 667, 672 (2d Cir. 1990) "[P]ublic policy considerations embodied in section 162(f) are highly relevant in determining whether the payment . . . was deductible under section 165."); *Nacchio v. United States*, 824 F.3d 1370, 1375

similar penalty paid to the government for the violation of any law or the investigation or inquiry into the potential violation of any law.

Congress explained its purpose for enacting section 162(f) in the Senate Finance Committee Report:

> This provision is to apply in any case in which the taxpayer is required to pay a fine because he is convicted of a crime (felony or misdemeanor) in a full criminal proceeding. ... The provision for the denial of the deduction for payments in these situations which are deemed to violate public policy is intended to be all inclusive. Public policy, in other circumstances, generally is not sufficiently clearly defined to justify the disallowance of deductions.[16]

Treas. Reg. section 1.162-21(b) provides that compensatory damages paid to a government do not constitute a fine or penalty and, therefore, should be deductible. Accordingly, when deciding whether losses in this context should be deductible, courts look to whether the losses are primarily compensatory or punitive.[17] Labels are not necessarily definitive—courts have held that some payments labeled civil penalties are nevertheless deductible if imposed to encourage prompt compliance with a requirement of the law or as a remedial measure to compensate another party.[18]

In *Stephens v. Commissioner*, the Second Circuit allowed the taxpayer to take a section 165 loss deduction for a restitution payment made in connection with his participation in a scheme to defraud and embezzle funds from his employer, Raytheon.[19] The taxpayer was subject to fines, sentenced to 5 years in prison, and sentenced to an additional, consecutive 5-years in prison, which was suspended on the condition that he make restitution to his former employer. The taxpayer sought to deduct his restitution payment but not the separate amount of fines he paid to the government. At the beginning of its discussion, the court acknowledged that "the federal income tax is a tax on net income, not a sanction against wrongdoing."[20]

In allowing the deduction for the restitution payment, the Second Circuit found that the primary purpose of the restitution order was compensatory rather than punitive. In its analysis of the public policy doctrine, the *Stephens* court observed that "[c]learly, no public policy would be frustrated if a restitution payment unrelated to a criminal prosecution [of the defendant] were at issue.... The Commissioner, however, argues that because Stephens made the restitution payment in lieu of punishment, the deduction should be disallowed." In support of its holding that the restitution payment was deductible, the court

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(Fed. Cir. 2016) "Although the amendments to section 162 did not explicitly affect section 165, the 'frustration of public policy' doctrine has continuing vitality with respect to section 165." *But see* Rev. Rul. 77-126.

[16] S. Rep. No. 552, 91st Cong., 1st Sess. (1969).

[17] *See Southern Pacific Transportation Co. v. Commissioner*, 75 T.C. 497 (1980). *See also Waldman v. Commissioner*, 88 T.C. 1384 (1987), *aff'd without opinion*, 850 F.2d 611 (9th Cir. 1988), in which the Ninth Circuit noted that when a payment serves both law enforcement and compensatory functions, one must determine which purpose the payment was designed to serve.

[18] CCA 201748008 (collecting cases). *See also Fresenius Medical Care Holdings. Inc. v. United States*, 763 F.3d 64 (1st.Cir. 2014).

[19] 905 F.2d 667 (2d Cir. 1990).

[20] *Id.* at 671 (quoting *Commissioner v. Tellier*, 383 U.S. 687).

referred back to statements made by the sentencing judge, which suggested the judge was primarily concerned with the employer recovering its money, not further punishment for the taxpayer.[21]

Courts apply the compensatory-versus-punitive analysis taken in *Stephens* in similar situations. For example, in *Spitz v. United States*, the district court held that a restitution payment made in satisfaction of a condition of probation was deductible.[22] The taxpayer was convicted in state court of misappropriating funds a client had paid to a construction firm the taxpayer co-owned. The state court ordered the taxpayer to pay the stolen funds back to the client. In holding that the taxpayer was entitled to a deduction, the district court stated that the repayment "is not a fine. Neither is it a penalty since it was payment of an amount due and owing."[23] On the other hand, in *Colt Industries, Inc. v. United States*, the Claims Court denied deductions for penalties relating to violations of the Clean Water Act and Clean Air Act because they were not compensatory in nature.[24] The Claims Court stated "compensatory payments generally return the parties to the status quo ante."[25]

In *Nacchio v. United States*, the Federal Circuit undertook a similar analysis, holding that the individual taxpayer's criminal forfeiture as a result of his embezzlement conviction was a fine or similar penalty, and thus not deductible.[26] The court offered several reasons for its holding. First, the use of the forfeited funds was left to the discretion of the Attorney General: it was not clear at the time of forfeiture that the funds would be used to compensate victims. Rather, the choice to use the funds as restoration to victims was a post-hoc decision by the Attorney General.[27] A second and related point was that the forfeited amount was unrelated to the amount of losses suffered by the victims. In fact, the specific forfeiture amount was pegged to the taxpayer's profits and not to the victims' losses.[28] The court observed that the forfeited funds "wended their way to Nacchio's victims, [however] the forfeited amount is unrelated to the amount of losses suffered by the victims."[29] Furthermore, the court noted that the forfeiture was ordered as part of Nacchio's criminal sentence, and that it served a distinct punitive purpose to punish Nacchio. In that case, the sentencing order specifically noted the amount of restitution was zero. The court distinguished *Stephens* on this point, noting that in the *Stephens* case the court-ordered restitution was clearly remedial as it focused on the restoration of embezzled funds to the injured party.

Analysis

The Taxpayer is entitled to a section 165 loss deduction with respect to the Frozen Assets. The $148 million of Frozen Assets are not subject to the public policy exception because the Frozen Assets were ordered to be turned over to the Trustee to be distributed to victims as a remedial measure designed to

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[21] *Id.* at 673 (noting the sentencing judge's statements, including that "Raytheon must get its money back.").
[22] 432 F. Supp. 148 (E.D. Wis. 1977).
[23] *Id.* at 150.
[24] 11 Cl. Ct. 140 (1986).
[25] *Id.* at 146.
[26] 824 F.3d 1370 (5th Cir. 2016).
[27] *Id.* at 1380. "The Attorney General's post-hoc decision to use the forfeited funds for remission did not transform the character of the forfeiture so that it was no longer a 'fine or similar penalty' under section 162(f)."
[28] *Id.* at 1381.
[29] *Id.*

compensate the victims directly. As discussed above, the standards established under section 162(f) set the contours of the public policy exception for section 165 purposes.

As an initial matter, the simplest way to resolve this issue is to recognize that the U.S. district court ordered that the Frozen Assets be distributed to the Trustee, not to the government. Before last year's tax reform, 162(f) only disallowed deductions for penalties and fines paid *to the government*.[30] Because the Frozen Assets were required to be distributed to the Trustee for the benefit of victims (and not to the government), the all-inclusive public policy exception established by section 162(f) does not affect the deductibility of the loss.

Even assuming the funds were paid to the government, section 1.162-21(b) of the Treasury Regulations and the cases provide that compensatory losses and payments do not constitute a fine or penalty. As outlined above, in this case all parties intend for the Frozen Assets to be used fully as restitution payments to compensate victims. The Sentencing Memorandum, the Restitution Order, the Order to Apply Certain Assets to Restitution, and the Forfeiture Order all provide for the forfeited funds to be distributed to victims in compensation for their losses. Those forfeited assets do not constitute a fine or penalty but, rather, restitution.[31]

The district court's orders in the Merrill criminal case implemented the carefully designed plan to transfer the Frozen Assets to the Trustee as restitution.[32] Regardless of the references to "forfeiture" in the Merrill criminal case, the substance, rather than the form of the orders, governs in this context. In substance, the Frozen Assets will compensate TelexFree victims for their outstanding losses, as ordered by the court.

This case is much more like *Stephens* than *Nacchio*. Like the *Stevens* case, in this case the district court ordered the Frozen Assets turned over to the Trustee for distribution to the victims as restitution. In contrast to *Nacchio*, the government seized the Frozen Assets to obtain any of the Taxpayer's available assets for the purpose of compensating victims. In this case, it was always the government's intention to use the Frozen Assets for restitution of the victims of the TelexFree fraud, unlike in *Nacchio* where the Attorney General made a post-hoc decision. Additionally, in *Nacchio*, the forfeited amount was a specified amount linked to the taxpayer's profits. Here, the government seized any assets it could for the purpose of restitution.

The Bankruptcy Court has entered an order establishing a methodology for the allowance of victim claims based upon the "Net Equity" method, meaning that claims are computed based upon amounts contributed by a victim into the TelexFree program, reduced by amounts received by the victim. The Trustee is in the process of resolving disputed victim claims. The funds to be distributed by the Trustee

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[31] Sentencing Memorandum at 32, *United States of America v. James Merrill*, Case no. 14-CR-40028-TSH, Doc. 332 (Mar. 16. 2017), **Exhibit H**. *See Stephens v. Commissioner,* 905 F.2d 667 (2d Cir. 1990) (court ordered restitution served remedial purpose).

[32] *See* Sentencing Memorandum at 37. A plain reading of the orders as well as the U.S. Attorney's Sentencing Memorandum indicates that the seized assets to be disbursed during the bankruptcy claims process constitute restitution, while any restitution beyond that amount is impracticable. While the U.S. Attorney explained that restitution is impracticable under the Mandatory Victims Restitution Act ("MVRA"), the Sentencing Memorandum specifically states that the MVRA applies only to potential restitution measures beyond the Trustee's claim process.

as restitution, *pro rata* to holders of allowed victim claims, is remedial in nature and not intended to be punitive or "pegged" to the taxpayer's profits as in *Nacchio*.

Conclusion

Here, just like in *Stephens*, the court-ordered restitution was remedial as it restored the ill-gotten funds to the Trustee to distribute to the injured parties. TelexFree declined to press any claims it might have had under the preliminary forfeiture order as part of the carefully orchestrated restitution plan described above. That plan conserved as much of the Frozen Assets as possible for distribution to the victims without squandering any of them on wasteful deadweight litigation. The fact that the restitution doesn't completely restore the victims is sad, but that fact does not undermine the compensatory nature of the plan.

The NOPA tries to impose a tax punishment on the Taxpayer by disallowing a properly claimed deduction. But the Taxpayer is entitled to a section 165 loss deduction with respect to the Frozen Assets for the reasons explained above. The Trustee's primary purpose in this case is to conserve assets in order to maximize restitution for the victims in this case. These victims should not be punished by the IRS. For all these reasons, we respectfully suggest that the NOPA be withdrawn. If you have any questions or need additional information, please call me.

Very Truly Yours,
KPMG LLP



Thomas Greenaway
Principal

Enclosures

cc: Stephen Darr, Trustee
Harry Murphy, Counsel to the Trustee
Andy Lizotte, Counsel to the Trustee