Billion-dollar Bankruptcy Trial of Sam and Dee Wyly Starts this Week

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By Mark Curriden

(Jan. 5) – Most individual bankruptcy trials last a few hours – maybe a couple days at most.

But the bankruptcies of famed Dallas entrepreneur Sam Wyly and his sister-in-law Dee Wyly are not like most. Billions of dollars are at stake. Each side plans to call three-dozen witnesses. The Internal Revenue Service says it will introduce 1,270 exhibits. Lawyers for the Wylys plan to submit another 837 memos, financial statements, emails and letters.

U.S. Bankruptcy Chief Judge Barbara Houser has set aside four weeks to allow lawyers for the Wylys and the federal government to argue over how much, if any, the former owner of Michaels Stores and Bonanza restaurants owes in back taxes, fines and penalties for hiding hundreds of millions of dollars in trusts on the Isle of Man.

"This is a one-of-a-kind bankruptcy trial," says Hunton & Williams bankruptcy partner Greg Hesse, who is not involved in the litigation. "Everything about this trial is unusual – from how it is structured to its extraordinary length. I've never seen anything like it."

The unique bankruptcy trial officially starts Wednesday morning, when lawyers for the Wylys and the IRS give brief opening statements to Judge Houser.

Sam Wyly and Dee Wyly, who is the wife of deceased Charles Wyly, filed bankruptcy in 2014 after a New York jury ruled that the brothers violated federal securities laws by setting up off-shore trusts designed to protect their income from income taxes.

A federal judge ordered the Wylys to pay $299 million.

Lawyers for the Wylys filed for protection under Chapter 11 of the U.S. Bankruptcy code in hopes that the government claims could be resolved through a global settlement agreement, according to Josiah Daniel, a Vinson & Elkins partner who represents Sam Wyly.

Last April, the IRS sent the already high-profile case into the stratosphere when it filed its own claim against the Wylys. The agency claimed that Sam Wyly owes $2 billion in back taxes, penalties and interest from income hidden in the trusts between 1992 and 2012. The IRS also said that the estate of Charles Wyly, who died in 2011 in a car crash in Aspen, Colo., owes another $1.2 billion. Dee Wyly is Charles' surviving wife.

Last month, the IRS reduced its demand to $1.4 billion from Sam Wyly and $800 million from Dee Wyly.

"These two cases involve one of the largest tax frauds in the history of the United States," Assistant U.S. Attorney Cynthia Messersmith wrote in a 157-page brief filed on Dec. 23.

Messersmith said the Wylys used "a maze of offshore entities in the Isle of Man" to hide hundreds of millions of dollars of income and avoid paying income and gift taxes on the money.

"The entities were structured solely for the purpose of using offshore assets to benefit the Wyly family, while attempting to avoid the tax consequences of those transactions," Messersmith said in court documents. "Examining the actual beneficiaries of these transactions show a gift made by Sam Wyly to his children.

"The children selected the real property, oversaw the properties' improvements and had full use and enjoyment of the property," she said. "No rent was paid and no loans were repaid."

Messersmith points out that the Isle of Man, a chilly, rainy, self-governing republic of 85,000 residents in the sea between England and Ireland, is a known haven for hiding money from taxing authorities.

Lawyers for the Wylys say the government's case is one of the worst examples of overreach and abuse they have ever witnessed.

"The scope of this case is staggering," Daniel wrote in his reply brief, which is 132 pages. "The Wylys have been subjected to what is undoubtedly one of the largest, longest and most thorough government investigations of a family in history.

"The volume of information available to the government on the interworkings of the Wyly family and their advisers [is] unprecedented," he said.

Sam Wyly, who is 82, will be the first witness in the trial, says Daniel, who notes that his client just wants the entire litigation resolved.

"The IRS figures are baloney," Sam Wyly told The Texas Lawbook in an interview last March. "I paid $160 million in taxes in the last 22 years, and my brother, Charles, paid $80 million. We firmly believe we have paid all the taxes we owe.

"We believe the IRS figures are so absurd as to undermine the credibility of the IRS," he said.

The trusts were created in the early 1990s for the purpose of converting equity wealth the brothers earned from their various business interests into a fixed annual income stream, Wyly said.

Court records show the trusts are worth about $382 million and pay Wyly about $16 million a year.

A key element in the Wylys case is that they set up the trusts only after receiving professional advice to do so from financial and legal experts.

"Filings were made with the SEC and IRS by knowledgeable and honest CPAs and lawyers who had to deal with legalese sometimes defined in different ways in different parts of the regulations written by the same agency or the other agencies," Wyly said in his interview.

"So, we respectfully disagree with the claim filed by the IRS and look forward to our hearing in the Bankruptcy Court," he said.

Wyly founded University Computing Co. in 1963 with only $1,000 in the bank and grew it into a multimillion-dollar computer services company. In 1967, Sam and Charles purchased the Bonanza Steakhouse chain and expanded it to 600 stores before selling it in 1989. In 1982, the Wylys bought the controlling interest in Michaels, the craft store chain. It grew from a $10 million in revenue private company in 1982 to $1.2 billion public company in 2006.

Lawyers involved in the case say all efforts to settle the matter before trial were unfruitful.

Sidney Scheinberg

"This is one of those cases in which the IRS wants to make a high-profile public statement," says Sid Scheinberg, a bankruptcy partner at the Godwin law firm in Dallas. "These numbers are just so large that the IRS may feel it cannot settle. The IRS would rather be told by the judge that their claims are too outrage than to set a bad precedent by settling for a much lower, more reasonable amount."

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