

---

---

MEMORANDUM

---

---

RE: U.S. SENATE (8/1/06 REPORT) TAX HAVEN ABUSE: (WYLY CASE) (SUMMARY)

DATE: MAY 8, 2008

---

**The 8/1/06 Report: United States Senate (Permanent Subcommittee on Investigations/Committee on Homeland Security and Governmental Affairs) described Wyly Case History (see excerpted pages 7,8) :**

**Wyllys: 58 Offshore Trusts and Corporations.**

The sixth, and final, case history comprises the most elaborate offshore operations reviewed by the Subcommittee. Over a thirteen-year period from 1992 to 2005, two U.S. citizens, Sam and Charles Wyly, assisted by an army of attorneys, brokers, and other professionals, transferred over 17 million stock options and warrants representing approximately \$190 million in compensation to a complex array of 58 trusts and shell corporations. The offshore trusts had either been established by the Wyllys or named them as beneficiaries; the trusts owned the shell corporations that took possession of the stock options and warrants. In return, the Wyllys obtained private annuity agreements from the offshore corporations. The Wyllys took the position, on the advice of counsel, that because they had exchanged their stock options for annuities of equivalent value, no tax was due on their stock option compensation, until they received actual annuity payments years later. The first annuity payment was made ten years later in 2003. To date, about \$124 million in stock option compensation remains offshore and untaxed.

From 1992 through 2004, the Wyllys and their representatives directed the offshore entities on exercising the stock options and warrants, and engaging in a wide range of securities trades and other transactions. The Wyllys and their representatives conveyed their

decisions to two individuals the Wyllys had selected, called “trust protectors,” who communicated the decisions, worded as “recommendations,” to the offshore trustees, who implemented them. In addition to cashing in many of the options, the offshore entities used the cash and shares to generate substantial investment gains. The Wyllys did not pay taxes on these gains, on advice from counsel, even though the U.S. tax code generally requires that income earned by a trust controlled by a U.S. person who funded or is a beneficiary of the trust be attributed to that U.S. person for tax purposes. The Wyly legal position was that the offshore trusts were independent entities. Over the thirteen years examined in this Report, the offshore entities used more than \$600 million from untaxed stock sales and other investment gains to issue substantial loans to Wyly interests, finance Wyly-related business ventures, and acquire U.S. real estate, furnishings, art, and jewelry for the personal use of Wyly family members. The offshore entities placed nearly \$300 million of these offshore dollars in two hedge funds and an investment fund established by the Wyllys.

The stock options exercised by the offshore entities came from three publicly traded corporations with which the Wyllys were associated, Michaels Stores Inc., Sterling Software Inc., and Sterling Commerce Inc. In addition to the tax issues, a key concern is whether, by sending millions of company stock options and warrants to offshore entities whose investments they directed, the Wyllys were using offshore secrecy laws to circumvent basic U.S. principles intended to ensure fair and transparent capital markets, including disclosure requirements for major shareholders, trading restrictions on privately acquired shares, and prohibitions against trading on nonpublic information. For most of the thirteen years examined in this Report, U.S. securities regulators and the investing public were not informed of the extent of the Wyly-related offshore stock holdings and trading activity.

The Wyly transactions also raise issues related to compliance with anti-money laundering laws. Over the years, the 58 offshore trusts and corporations opened securities accounts at three prominent U.S. financial institutions, Credit Suisse First Boston

("CSFB"), Lehman Brothers, and Bank of America. All three financial institutions knew that the offshore entities were associated with the Wyly family, but never required the offshore entities to identify their beneficial owners. By 2003, when Bank of America had the accounts, the law was clear that the Bank had to identify the beneficial owners. Despite being pressed for nearly a year by its clearing broker to do so, Bank of America allowed the accounts to operate without obtaining the information required by law. In addition, when for tax purposes, the Wyly-related offshore entities submitted forms representing they were independent foreign entities not subject to IRS 1099 reporting requirements for U.S. taxpayers, Bank of America accepted the forms, despite knowing the Wylys were directing the offshore entities' investments and benefitting from their account income. Had the offshore entities acknowledged that the Wylys were the beneficial owners of the offshore trusts and corporations for purposes of complying with the anti-money laundering laws, and allowed their connection to the Wylys be documented at Bank of America, it would have been harder for the Wylys to deny a connection to these entities for tax and securities purposes.

Many of the offshore mechanisms used in this case history raise serious tax, securities, or other concerns, including the stock option-annuity swaps; pass-through loans using an offshore vehicle; securities traded by offshore entities associated with corporate insiders; and the use of hedge funds and other investment vehicles to control use of funds placed offshore. Sam and Charles Wyly reaped a number of benefits from their offshore activities, including attempted deferral of taxes on their stock option compensation, nonpayment of taxes on hundreds of millions of dollars in offshore capital gains by entities they directed, a ready source of capital for their business ventures in the United States, and a ready source of funds to finance their personal interests. Among those impacted by the Wyly offshore activities are the U.S. Treasury, U.S. taxpayers who have to make up the lost revenue, and the investing public who were kept in the dark about the offshore stock holdings and trading activity of entities controlled by the directors of three publicly traded corporations.

May 8, 2008

Page 4

Gary S. Wolfe  
A PROFESSIONAL LAW CORPORATION  
9100 Wilshire Blvd., Suite 505 East  
Beverly Hills, CA, 90212  
Tel: 310-274-3116 Fax: 310-274-3118  
<http://www.gswlaw.com>  
email: [gsw@gswlaw.com](mailto:gsw@gswlaw.com)