

UNITED STATES DISTRICT COURT  
FOR THE EASTERN DISTRICT OF ARKANSAS

UNITED STATES

- against -

WORTHEN BANK & TRUST COMPANY,  
FRANK LYON COMPANY, FRANK LYON,  
NEW YORK LIFE INSURANCE CO.

No. \_\_\_\_\_

The grand jury charges:

COUNT ONE  
(Conspiracy)

BACKGROUND

The Pertinent Persons, Entities and Defendants

At all times relevant to this Indictment:

1. WORTHEN BANK & TRUST COMPANY (“WORTHEN BANK”), a defendant herein, was a banking institution chartered under Arkansas law and subject to regulation by the Arkansas State Bank Department and the Federal Reserve System. As part of its business, WORTHEN BANK regularly engaged in complex financial transactions and thus well knew the nature and effect of the transaction involved in this Indictment.

2. FRANK LYON CO., a defendant herein, was a closely held corporation incorporated in the state of Arkansas and engaged in the distribution of home furnishings, primarily Whirlpool and RCA electrical products. FRANK LYON CO. did not regularly engage in complex financial transactions, but through advice rendered to it by its experience counsel FRANK LYON CO. was fully advised as to the nature and effect of the transaction involved in this Indictment.

3. FRANK LYON, a defendant herein, was:

- a. an individual citizen and resident of Little Rock, Arkansas, United States of America. (In spite of all temptations to belong to other nations, he remained an American.);
- b. the majority shareholder and board chairman of the Corporation;
- c. a member of the board of directors of WORTHEN BANK; and

d. although not regularly engaged in complex financial transactions, through advice rendered to it by its experience counsel FRANK LYON was fully advised as to the nature and effect of the transaction involved in this Indictment.

4. CC 1, a co-conspirator not named in this indictment, was the general counsel for WORTHEN BANK, with responsibility that included handling significant legal matters for the bank. In that capacity, CC 1 had substantial experience in complex financial arrangements. CC 1 was involved in the transaction described in this Indictment and fully understood the nature and effect of the transaction.

5. LAW FIRM 1 was the law firm that, based on gross fees paid, was the principal law firm representing WORTHEN BANK and was the firm which generally represented WORTHEN BANK with respect to its banking regulatory, financing and tax matters. LAW FIRM 1, through one or more of its partners, including CC 1, CC 2 and CC 3 described below, was involved in the transaction described in this Indictment and fully understood the nature and effect of the transaction.

6. CC 1 was the engagement partner of LAW FIRM 1 with respect to the WORTHEN BANK's relationship with LAW FIRM 1. In that capacity, CC 1 was familiar with WORTHEN BANK's business and legal affairs and had substantial experience in complex financial arrangements entered by WORTHEN BANK on its own behalf and for others. CC 1 was involved in the transaction described in this Indictment and fully understood the nature and effect of the transaction.

7. CC 2 was the partner of LAW FIRM 1 that provided WORTHEN BANK tax advice as consulted by WORTHEN BANK. CC 2 has substantial experience in the tax aspects of complex financial arrangements and well knew the tax effects of the transaction described herein. CC 2 was involved in the transaction described in this Indictment and fully understood the nature and effect of the transaction.

8. CC 3 was the partner of LAW FIRM 1 that provided WORTHEN BANK financial transaction advice as consulted by WORTHEN BANK. CC 3 has substantial experience in the complicated lending and financial aspects of complex financial arrangements and well knew the economic effects of the transaction described herein. CC 3 was involved in the transaction described in this Indictment and fully understood the nature and effect of the transaction.

9. LAW FIRM 2 was the law firm that generally represented FRANK LYON CO. and FRANK LYON with respect to their business and financial affairs. LAW FIRM 2, through one or more of its partners, including CC 4 described below, was involved in the transaction described in this Indictment and fully understood the nature and effect of the transaction.

10. CC 4 was the engagement partner at Law Firm 2 with respect to its relationships with FRANK LYON CO. and FRANK LYON and was also the tax partner who generally represented FRANK LYON CO. and FRANK LYON with respect to the tax aspects of their business and financial affairs. Based on CC 4's experience generally and with respect to FRANK LYON CO. and

FRANK LYON specifically, CC 4 understood and advised clients generally and FRANK LYON CO. and FRANK LYON specifically as to the differences between a lending and an ownership relationship for tax purposes in complex financial transactions. CC 4 was involved in the transaction described in this Indictment and fully understood the nature and effect of the transaction.

11. At all times relevant to this indictment, NEW YORK LIFE INSURANCE COMPANY (“NEW YORK LIFE”), a defendant herein, was a life insurance company incorporated in New York. Among its activities as a life insurance company was participation in structured financial transactions in which it and others acted as lenders but in which their relationships may have been disguised and concealed as some relationship other than lenders. NEW YORK LIFE had substantial experience in structuring such transactions and recognizing the underlying economics and realities of such transactions. At times, NEW YORK LIFE willfully falsified documentation as to its and other participants’ roles in transactions, one of which is at issue in this Indictment.

12. At all times relevant to this indictment, CC 5 and CC 6, co-conspirators not named in this indictment and who are cooperating witnesses for the Government, were attorneys in the general counsel’s office for NEW YORK LIFE, and, in that capacity, had substantial expertise in structured financial transactions. Based on their expertise, CC 5 and CC 6 understood the underlying economics and realities of such transactions. At times, CC 5 and CC 6, acting in part to achieve higher financial compensation for themselves and in part under the belief that NEW YORK LIFE desired them to do so, willfully described and thus falsified documentation as to NEW YORK LIFE’s and other participants’ roles in transactions, one of which is at issue in this Indictment.

13. At all times relevant to this indictment, CC 7, a co-conspirator not named in this indictment, was employed as a vice-president in charge of NEW YORK LIFE’S structured financing transactions and, in that capacity, had substantial experience in structuring such transactions and recognizing the underlying economics and realities of such transactions. At times, CC 7 acting in part to achieve higher financial compensation for himself and others in his group and in part under the belief that NEW YORK LIFE desired him to do so, willfully described and thus falsified documentation as to NEW YORK LIFE’s and other participants’ roles in transactions, one of which is at issue in this Indictment.

14. At all times relevant to this indictment, Law Firm 3 was the principal law firm engaged by NEW YORK LIFE to provide legal advice with respect to its structured financial transactions. Partners in Law Firm 2 assisted NEW YORK LIFE and others in the planning and documentation of transactions in which the participating parties’ roles were misdescribed in the legal documentation, including specifically the transaction involved in this Indictment..

15. At all times relevant to this indictment, CC 8 and CC 9 were partners in Law Firm 2 involved in rendering advice to NEW YORK LIFE on its structured financial transactions. CC 8 and CC 9, among others in Law Firm 2 not named herein, assisted NEW YORK LIFE and others in the planning and documentation of transactions in which the participating parties’ roles were

misdescribed in the legal documentation and specifically were involved in the legal documentation of the transaction involved in this Indictment.

16. The term CONSPIRATORS hereafter refers to each and all of WORTHEN BANK, FRANK LYON CO., FRANK LYON, NEW YORK LIFE LAW FIRM 1, LAW FIRM 2, LAW FIRM 3, CC 1, CC 2, CC 3, CC 4, CC 5, CC 6 , CC 7, CC 8, and CC 9 and others known and unknown to the grand jury.

#### Tax Fraud

17. In 1965, for good and sufficient business reasons, WORTHEN BANK decided that it would acquire prestigious corporate headquarters in Little Rock, Arkansas, its principal place of business.

18. To that end, WORTHEN BANK acquired real property and drew up plans to construct and finance a prestigious headquarters building on the property.

19. For regulatory reasons relating to financial solvency, federal and state banking authorities declined to approve WORTHEN BANK's direct ownership in a manner that would require WORTHEN BANK to report the asset and related mortgage liability on its balance sheet.

20. Because of the characteristics of the federal tax regime applying to banks, WORTHEN BANK would have been unable to achieve full tax benefits for the tax items (such as depreciation and interest) of ownership of such improvements if it owned the improvements directly. For this reason, WORTHEN BANK was willing to enter into a transaction in which it appeared to concede ownership and thus the tax benefits of ownership to another taxpayer and instead appear in the role of a tenant, thereby claiming the tax benefits of tenant.

21. The CONSPIRATORS conceived, drafted, approved and entered a complex sale-leaseback transaction with FRANK LYON CO. and with New York Life. The key terms of the sale-leaseback transaction were:

a. WORTHEN BANK would nominally lease the underlying unimproved real property to FRANK LYON CO.

b. WORTHEN BANK would acquire the improvements seriatim during construction and immediately assign them to FRANK LYON CO., so that the cost of the improvements did not as WORTHEN BANK's asset for regulatory purposes.

c. Under this arrangement, FRANK LYON CO. appeared as the nominal owner of the improvements.

d. The improvements, the substantial and prestigious headquarters WORTHEN BANK desired, would cost \$7,500,000, the cost of which would be funded by \$500,000 from

FRANK LYON CO. and \$7,000,000 from NEW YORK LIFE. NEW YORK's \$7,000,000 commitment was as a loan nominally made to FRANK LYON CO. and FRANK LYON CO.'s commitment of \$500,000 as a nominal equity contribution to the acquisition of ownership of the improvements.

e. NEW YORK LIFE's advance of \$7,000,000 was secured by a mortgage on the real property, the improvements and the lease.

f. FRANK LYON CO. had no material economic relationship to the arrangement other than supplying the \$500,000, which indeed it had borrowed from WORTHEN BANK. In order to conceal his relationship and give the appearance of qualifying for tax benefits, however, FRANK LYON CO. appeared in the documentation as owner of the improvements, lessor of the improvements to WORTHEN BANK and debtor with respect to the construction financing supplied by NEW YORK LIFE.

g. WORTHEN BANK's nominal lease from FRANK LYON CO. was a triple-net lease, imposing on WORTHEN BANK all economic costs related to the real property, the improvements and the NEW YORK LIFE loan through net lease payments, dedicated to NEW YORK LIFE designed to amortize principal and accruing interest on NEW YORK LIFE's lending.

h. Through a series of related provisions giving WORTHEN BANK (i) an option to purchase the property for an amount reduced by the Bank's lease payments economically attributable to the principal reduction and (ii) an option to renew the lease for substantially beyond the practical economic life of the improvements for a reduced lease rate, FRANK LYON CO.'s economic return was practically limited to return of its outlay of \$500,000 plus a reasonable interest rate.

i. The net effect of this arrangement, recognized by all of the CONSPIRATORS and concealed by the documentation they prepared and approved and signed, was that FRANK LYON CO.'s economic role in the complex transaction was that of lender and not of owner.

j. Notwithstanding the foregoing, the CONSPIRATORS participated in a scheme to conceal the nature of the transaction through complex and false documents naming FRANK LYON CO. as the owner and borrower from NEW YORK LIFE, thus concealing the true economic fact that FRANK LYON CO. was a lender and not an owner or debtor.

k. All of the CONSPIRATORS (i) knowingly and willfully participated in some important feature of designing and approving the arrangements whereby the true nature of the transaction and, most prominently, FRANK LYON CO.'s and WORTHEN BANK'S real roles in the transaction, thereby concealing their true nature, and (ii) knew that, as a result of so concealing the true nature of the transaction and FRANK LYON CO.'s and WORTHEN BANK's roles, FRANK LYON CO. and WORTHEN BANK expected to and would falsely reporting on their respective federal tax returns tax attributes for roles that it did not in fact occupy with respect to the transaction.

22. One of the purposes for concealing and mischaracterizing the true nature of the parties' relationships was to impede, impair, defeat and obstruct the lawful functions of the IRS to differentiate between lending and ownership arrangements.

23. FRANK LYON CO. did in fact falsely claim on its federal income tax return (Form 1120) for 1969 depreciation, interest and other expense in net amount of \$497,219.18 related to or arising from the transaction which it was not entitled to claim, thereby fraudulently underreporting its tax liability by \$236,596.36.

24. WORTHEN BANK did in fact falsely claim on its federal income tax return for 1969 rental deductions for its purported rent payments to FRANK LYON CO. when in fact WORTHEN BANK knew that the payments were not rent but instead payment on the amortization the loan with respect to its economic ownership of the improvements.

#### Objects of the Conspiracy

25. It was a part and an object of the conspiracy that the CONSPIRATORS willfully and knowingly would and did defraud the United States of America and the IRS by impeding, impairing, defeating and obstructing the lawful governmental functions of the IRS in the ascertainment, evaluation, assessment, and collection of income taxes.

26. It was further a part and an object of the conspiracy that FRANK LYON CO. willfully and knowingly would and did attempt to evade and defeat a substantial part of the income taxes due and owing to the United States by tax shelter clients and others, in violation of Title 26, United States Code, Section 7201.

27. It was further a part and an object of the conspiracy that WORTHEN BANK unlawfully, wilfully and knowingly would and did make and subscribe its federal tax returns which returns contained and were verified by written declarations that they were made under the penalties of perjury, and that the defendants and their co-conspirators did not believe to be true and correct as to every material matter, in violation of Title 26, United States Code, Section 7206(1).

#### Means and Methods of the Conspiracy

28. Among the means and methods by which the CONSPIRATORS would and did carry out the conspiracy were the following:

a. The CONSPIRATORS would and did concoct complex and false documents and false and fraudulent factual scenarios to support them so that FRANK LYON CO. would report and pay less tax than it owed.

b. The CONSPIRATORS would and did concoct complex and false documents and false and fraudulent factual scenarios to support them so that WORTHEN BANK falsely report its payments under the transactions on its tax returns.

c. The CONSPIRATORS would and did prepare false and fraudulent documents to deceive the IRS, including but not limited to, transactional documents, representation letters, and opinion letters.

d. The CONSPIRATORS would and did prepare and cause to be prepared tax returns that were false and fraudulent because, among other things, they claimed phony deductions for depreciation, interest and related expenses of ownership and therefore substantially understated the tax due and owing by FRANK LYON CO.

e. The CONSPIRATORS would and did fail to report to the IRS the true nature of the transaction as a lending arrangement.

f. The CONSPIRATORS would and did impede the IRS audit of the tax returns of FRANK LYON CO. and WORTHEN BANK by presenting to the IRS false and fraudulent documents and by making factual representations as to the nature of the parties to the transaction involved in this Indictment which they knew to be false and fraudulent.

#### Overt Acts

29. In furtherance of the conspiracy and to effect the illegal objects thereof, the CONSPIRATORS committed the following overt acts, among others, in the Eastern District of Arkansas and elsewhere:

a. In or around June 1968, the CONSPIRATORS, in their respective roles, conducted negotiations leading to the transaction described herein wherein the subject of mischaracterizing the relationships of FRANK LYON CO. and WORTHEN BANK as owner and lessee, respectively, to the underlying transaction was specifically discussed, despite the fact that the CONSPIRATORS then and there well knew that FRANK LYON CO. was not the owner of the improvements and WORTHEN BANK was not the lessee.

b. In 1969, the CONSPIRATORS drafted, approved and executed a series of complex documents designed to conceal the true nature of relationship of FRANK LYON CO. AND WORTHEN BANK to and with respect to the property, stating that FRANK LYON CO. was the owner of the property when they then well knew that, in economic and actual fact, FRANK LYON CO.'s relationship with respect to the property was lender and not owner.

c. In 1970, FRANK LYON CO., through, among others, FRANK LYON, presented the false documentation to its tax return preparers and falsely represented to its tax return preparers that it was the owner of the improvements entitled to claim depreciation on the improvements and interest with respect to the financing of the improvements.

d. In or around June 15, 1970, FRANK LYON CO. filed false and fraudulent income tax returns wherein it claimed deductions for depreciation, interest and related expense with respect to its claimed ownership interest in the property which it, and the officer subscribing the return, knew were false and fraudulent.

e. In or around May 10, 1970, WORTHEN filed false income tax returns wherein it reported its financial transactions with respect to the property as rental deductions rather than the depreciation, interest and related deductions that were proper for its relationship to the property, which it, and the officer subscribing the return, knew were false and fraudulent.

f. In or around March 1971, acting as representative for FRANK LYON CO. in the IRS audit of its 1969 return, CC 4 presented the false documents alleged herein to the agent in support of the false return positions for depreciation and interest with respect to the transaction and further made false representations to the agent with respect to the nature of the relationships created by such false documents.

g. In or around September 1971, acting as representative for WORTHEN BANK in the IRS audit of its 1969 return, CC 2 presented the false documents alleged herein to the agent in support of the false deductions for lease payments with respect to the improvements claimed by WORTHEN BANK on its return and further made false representations to the agent with respect to the nature of the relationships created by such false documents.

(Title 28, Section 371, United States Code; Title 26, Section 7212, United States Code.)

COUNT TWO  
(Tax Evasion)

30. On or about June 15, 1970, FRANK LYON CO. signed and filed a false and fraudulent income tax return for the year 1969 falsely claiming the deductions for depreciation on the improvements and interest with respect to the financing of the improvements, thereby underreporting its tax liability and evading tax in the amount underreported.

(Title 26, Section 7201, United States Code.)

COUNT THREE  
(Tax Perjury)

31. On or about June 15, 1970, FRANK LYON CO. signed and filed a false and fraudulent income tax return for the year 1969 falsely claiming the deductions for depreciation on the improvements and interest with respect to the financing of the improvements, thereby underreporting its tax liability and evading tax in the amount underreported.

(Title 26, Section 7206(1) United States Code.)

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FOREPERSON

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UNITED STATES ATTORNEY