

IN THE UNITED STATES DISTRICT COURT FOR THE
SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

UNITED STATES OF AMERICA,)	
)	
Plaintiff,)	
)	
v.)	Civil No.
)	
ERIC J. PETERSON, individually and d/b/a)	
ELEC-ME ENTERPRISES,)	
)	
Defendants.)	

COMPLAINT FOR PERMANENT INJUNCTION

Plaintiff, the United States of America complains as follows against defendant Eric J. Peterson, individually and doing business as Elec-Me Enterprises:

1. This action has been requested by the Chief Counsel of the Internal Revenue Service (IRS), a delegate of the Secretary of the Treasury, and commenced at the direction of a delegate of the Attorney General, pursuant to 26 U.S.C. ("I.R.C.") §§ 7402, 7407, and 7408.

2. The United States brings this complaint to enjoin Peterson, and anyone in active concert or participation with him, from directly or indirectly:

- (a) Organizing, promoting, or selling the Mining Interest Development Action Strategy (MIDAS) program associated with Merendon Mining, Inc. and its subsidiary corporations;
- (b) Making false or fraudulent statements, in connection with the organization or sale of a tax shelter, plan, or other arrangement, about the allowability of any deduction or credit, the excludability of any income, or the securing of any other tax benefit by reason of participating in the tax shelter, plan, or other arrangement;
- (c) Organizing, promoting, selling, or advising participation in any other tax shelter, plan, investment, business venture, or arrangement and in connection therewith

making false or fraudulent statements about federal tax benefits of participating in such tax shelter, plan, investment, business venture, or arrangement;

- (d) Causing or assisting other persons and entities to understate their federal tax liabilities and avoid paying federal taxes;
- (e) Preparing, filing, or helping others to prepare or file federal income tax returns, or any other tax-related documents or forms for any entity or person other than himself;
- (f) Engaging in any other conduct subject to penalty under I.R.C. § 6700, including making or furnishing, in connection with the organization or sale of a shelter, plan, or arrangement, a statement that he knows or has reason to know to be false or fraudulent as to any material federal tax matter, or by making a gross valuation overstatement;
- (g) Engaging in conduct subject to penalty under I.R.C. § 6701, including preparing or helping others prepare documents likely to be used in connection with any material matter arising under the internal revenue laws that he knows will (if so used) result in understating another person's tax liability;
- (h) Engaging in any conduct subject to penalty under I.R.C. § 6694, including preparing tax returns for customers where there is no reasonable belief that the position would be more likely than not be sustained on its merits, and asserting a claimed deduction under I.R.C. § 616 with respect to which the customer has not made any mining development investment;
- (i) Engaging in any conduct subject to any other penalty under the I.R.C.;
- (j) Representing anyone before the Internal Revenue Service; and
- (k) Engaging in any other conduct that interferes with the administration or enforcement of the internal revenue laws.

3. An injunction is warranted based on Peterson's continual and repeated violations of the internal revenue laws, including engaging in conduct subject to penalty under I.R.C. §§ 6700, 6701, and 6694.

Jurisdiction and Venue

4. Jurisdiction is conferred on this Court by 28 U.S.C. §§ 1340 and 1345 and I.R.C. §§ 7402(a), 7407 and 7408.
5. Venue is proper in this Court pursuant to 28 U.S.C. § 1391 because a substantial part of the events giving rise to this claim occurred within this jurisdiction.
6. Defendant Eric Peterson is an accountant and resident of Channelview, Texas. Peterson does business as ELEC-ME Accounting Services, LLC and ELEC-ME Enterprises, LLC out of an office in Houston, Texas.

Overview of Peterson's Activities

7. Peterson is a tax return preparer who prepares federal income tax returns in affiliation with Merendon Mining (Colorado), Inc. (hereinafter Merendon), a company that purports to redevelop disused gold mines in Colorado and elsewhere for a profit. Peterson promotes a tax-fraud scam called Mining Interest Development Action Strategy (MIDAS) through Merendon in which customers purportedly “invest” in the development of mines in Colorado, Arizona, and California. In promoting the MIDAS scheme, Peterson and other Merendon promoters tell customers that the mines contain viable gold, platinum, and other mineral reserves that customers should claim federal income tax deductions for not-yet-paid “mining development expenses,” and that customers should give to Merendon as their purported “investment” the tax refunds that they obtain as a result of taking those deductions. To entice customers to give these ill-gotten refunds to Merendon, Merendon promises a 34-51% return on the so-called “investment.”

8. Beginning in 2003, Merendon promoters advised potential MIDAS customers that in order to participate in the scheme, the participants would have to sign agreements promising to invest up to \$10 million for the extraction of minerals from Merendon's mines over a ten-year period. These agreements were shams. After signing them, most customers did not pay any of their own money to Merendon for mining development. Nevertheless, the promoters falsely told customers that they could file amended federal income tax returns for previous years and claim large deductions for "mining development investments" based on the sham agreements. These bogus deductions yielded claims for large tax refunds.

9. Promoters referred Merendon customers to Peterson to prepare the fraudulent tax returns and amended tax returns claiming those bogus mining-development deductions. Peterson contacted the Merendon customers, often explaining how the purported investment and tax-refund scheme worked, and falsely assuring customers it was legal. In many cases, Peterson falsely told customers that the IRS or federal government had approved the investments and that the amended tax returns he prepared and filed for them were legal. Peterson prepared amended tax returns for at least 21 MIDAS customers claiming total fraudulent deductions under I.R.C. § 616 exceeding \$27 million mostly over tax years 1997 through 2002, and Merendon customers received fraudulent refunds exceeding \$1 million before the IRS detected the fraudulent scheme.

10. The great majority of MIDAS scheme participants for whom Peterson prepared returns never contributed any money to Merendon for mining development before obtaining tax refunds. Moreover, the participants were otherwise not eligible for the claimed deductions because: (1) the mines did not contain commercially marketable quantities of ore or minerals; (2) customers did not contribute money or have any actual risk of their money being spent for mine

development; (3) any money customers contributed was not paid in 2002, as reported; and (4) any claimed net operating loss deductions are properly deductible only against a customer's passive, rather than earned, income. Peterson nevertheless prepared returns, and in some cases secured refunds for customers, fraudulently reporting that customers had no tax liability for up to seven years because of the purported mining investments.

The Merendon Mining Tax Scheme Promotion

11. Merendon Mining (Colorado), Inc. (hereinafter "Merendon") is a Nevada subsidiary of Merendon Mining (Nevada), Inc. Both are controlled by Milo Brost of Calgary, Alberta. Brost operates both Merendon corporations in conjunction with his umbrella organization, the Institute for Financial Learning (hereinafter IFFL), headquartered in Canada. Merendon is directed and operated by Ward Capstick of Snohomish, Washington. Generally in its promotional materials, IFFL identifies Capstick and other persons who promote various IFFL "investment" schemes as "structurists."

12. On information and belief, Peterson became affiliated with Merendon in or after 2003, and prepares tax returns for many Merendon customers in Texas. Peterson is an accountant and experienced tax return preparer who claims to have formerly worked for H&R Block.

13. From 2003 through 2006, Peterson promoted the MIDAS scheme for Merendon and IFFL in conjunction with Capstick and other structurists. In many cases, Merendon structurists recruited prospective customers through existing customers, their family members, and co-workers. In these situations, the promoters or customers told other prospective customers about the MIDAS scheme, and referred prospective customers to Capstick or other promoters for them

to provide the details and further explanation about MIDAS. Several of Peterson's customers are family members of, co-workers of, or otherwise affiliated with other MIDAS scheme participants.

14. After making an initial contact with potential customers, Merendon structurists, including Peterson, explained details of the MIDAS scheme during individual meetings, over the telephone, and at information sessions IFFL sponsored in the state of Washington and elsewhere. Structurists, including Peterson, gave customers copies of the MIDAS and Merendon prospectus, a "Mining Agreement," and other documents explaining the MIDAS tax scheme.

15. At presentations and in promotional materials they furnished to potential customers, Merendon promoters including Peterson stated that Merendon owned two disused gold mines in Colorado and one in Arizona. They falsely told customers that with new technology, these mines could begin producing gold and other minerals again. The MIDAS prospectus that Peterson provided to Merendon customers advised them that the mines contained commercially marketable quantities of ore.

16. In fact, Merendon's properties contained no commercially marketable quantities of ore and no mining has taken place at these mines. In some cases, Merendon had not obtained mining permits to allow any development on the properties. Instead, the purported investment scheme was a sham, used for the sole purpose of helping customers obtain fraudulent income tax refunds and then inducing the customers to turn over those funds to Merendon.

17. Merendon promoters including Peterson falsely told customers that the federal government had set up a program that allowed taxpayers to receive tax refunds and use this money for investing in Merendon's redevelopment of disused mines. In fact, the federal

government has not created any such program and the internal revenue laws do not allow deductions for amounts not actually paid or incurred in the year for which the deduction is claimed.

18. Capstick falsely told potential customers that by signing Mining Agreements with Merendon, they would be able to take full advantage of the mining development tax deductions under I.R.C. § 616. He further told prospective customers that after signing the agreements, the customers were required to amend their tax returns for the previous five years in order to claim the deductions, and that Peterson could prepare and file these amended tax returns for them.

19. Merendon promoters including Peterson persuaded potential customers to participate in MIDAS by promising they would earn returns of up to 51% on their “investments.” In addition, promoters told customers they would not have to pay their entire investment until they received tax refunds that would be used to fund the mineral development and production.

20. Merendon promoters including Peterson told customers that to participate in the MIDAS scheme they first had to become IFFL members for an initial fee of approximately \$1,450 plus an additional \$350 annual fee.

21. Once customers joined IFFL, Merendon promoters including Peterson advised them to sign the Mining Agreement created and distributed by Merendon, whereby customers agreed to invest a certain amount of funds towards the development of mines purportedly owned and operated by Merendon. The amount of the purported investment was designated as a “developmental expenditure payment” and ranged from several hundred thousand dollars up to \$10 million. According to the Agreement, customers purportedly incurred an obligation to pay Merendon the full amount of their “investment” over ten years.

22. Merendon would purportedly use this ten-year period to fund the development of gold mines the company claimed to own. According to the Mining Agreement, customers were to continue making payments for the entire ten-year period regardless of the amount of ore or minerals actually mined. The Agreement also purported to require MIDAS participants to pay Merendon a “reservation fee” of between one and ten percent of the participants’ total purported investment.

23. Despite the language in the Mining Agreement, Peterson told potential MIDAS participants that the future investments ostensibly required by the Mining Agreement were not true debts or obligations, and that the participants were required only to pay Merendon the tax refunds they would receive as a result of their amended tax returns.

24. Merendon distributed to participants a memorandum stating that participants were allowed to postpone payment of their reservation fees until after they received tax refunds resulting from the purported mining development deductions.

25. Based on Peterson’s and other promoters’ advice and recommendations, most MIDAS participants paid no money towards their “investment” before they received their tax refunds. Only in isolated instances did customers actually pay any money towards the purported development expenses, but these amounts were well below the total amounts claimed as deductions on these customers’ amended income tax returns.

26. When questioned by customers about the MIDAS scheme’s validity, Peterson falsely told them that it was legal to claim these tax deductions in order to obtain refunds, even though the customers spent little or none of their own money for mining development.

27. Peterson often falsely assured customers that the MIDAS scheme and filing of amended tax returns was “perfectly legal.” He told one customer that he was a pastor and would not think of doing anything illegal. He told another that the worst possible consequence of claiming the MIDAS deductions was that the customer would be denied the refunds. Peterson did not tell customers that they could be subject to penalties or criminal prosecution for failing to accurately report their income and deductions.

28. Peterson told customers that he had studied the law regarding the mining development deductions for more than a year and falsely claimed that the scheme was legal under the tax code. He referred customers with questions about the scheme’s legality to I.R.C. § 616 and told the customers that this statute specifically allowed schemes such as MIDAS.

29. One IFFL structurist told a customer that the actual purpose of the MIDAS scheme was simply to obtain large tax refunds based on their purported investment and to “re-invest” 50% of the refund in Merendon. In some cases, structurists admitted to customers that the mines did not actually exist and would never produce any gold or other mineral or ores.

30. The Merendon promotional materials that promoters such as Capstick and Peterson distributed to customers stated that the gold mines existed and that they contained ore or minerals in commercially marketable quantities. The Mining Agreement also provided that Merendon either owned mines or mining interests in Colorado and Arizona. In some instances, promoters showed customers pictures or video falsely purporting to depict mining activity at Merendon’s mining sites.

31. In actuality, throughout 2002 and at the time when many of the Mining Agreements were signed, Merendon did not own some of the mines listed in promotional materials, and had

not secured mining interests in those properties. On information and belief, Merendon had not begun developing mines in any location for the purposes of extracting minerals or ores in commercially marketable quantities. In 2002, Merendon also had not obtained the required mining permits for development in some of its locations.

32. Merendon promoters advised some customers that they would need to show “active participation” in order to take advantage of the tax deductions to which the promoters claimed the customers were entitled. In order to create the appearance that customers were “actively participating” in mine development, Capstick advised customers that they needed to visit the mines on trips arranged by Merendon.

33. Throughout 2004, 2005, and 2006, Merendon arranged and conducted “investor” mine visits to Broomfield, Colorado and Las Vegas, Nevada. These meetings and site visits typically occurred over a weekend, and were attended by Merendon promoters and customers.

34. Although several customers did visit the mines and viewed some gold, Merendon officials did not show customers gold in commercially marketable quantities being either mined or processed at Merendon’s sites. One MIDAS participant described the purported “processing center” at the Jamestown, Colorado mining site as “dilapidated” and “covered in rat droppings.”

Peterson’s Tax Return Preparation and Statements

35. Peterson continued to promote the MIDAS scheme to customers throughout 2003 and 2004, and maintained contact with customers throughout 2006 when he represented them during IRS examinations. In some cases, customers did not even receive the full MIDAS prospectus until 2006.

36. In order to bolster their false claims that MIDAS was legal, Peterson and other promoters provided some customers with copies of tax opinion letters. The letters, written by persons affiliated with Merendon, advised that the purported development expenses paid by customers were deductible. But the letters made no mention of how customers would be eligible to legitimately claim the I.R.C. § 616 deduction merely by signing the Mining Agreement, or how the deductions would be valid in 2002 when the Agreements were not signed until 2003 or later.

37. A common feature of tax-fraud schemes is the promoters' desire to have customers use tax return preparers who are in on the scheme and will therefore prepare returns consistent with the scheme and not raise questions about its illegality. Capstick and other structurists explained to customers that Merendon recommended accountants such as Peterson who were familiar with the details of the tax deductions claimed by MIDAS participants. In some instances, structurists told customers that they were required to use either Peterson or William Camp, another tax return preparer, to prepare tax returns claiming the MIDAS mining deduction.

38. Peterson asked MIDAS participants to send him copies of their 1997 through 2002 federal income tax returns so that he could prepare amended returns for those years claiming the MIDAS deductions. Because many customers had not specified an amount of their purported investment when agreeing to participate in the MIDAS scheme, or had not yet signed the Mining Agreement, Peterson in many instances simply made up the amount of the purported investment using the total amount of income customers had received for 1997 through 2002.

39. Although Peterson was well aware that customers had not paid any money for mining development, and he had even advised customers that they did not need to make any up-

front payments, Peterson prepared amended and original tax returns for those customers falsely reporting I.R.C. § 616 deductions. Instead of reporting deductions based on amounts customers had actually invested in the mining scheme – which would have been zero in many cases – Peterson reported deductions based on the entire amount of customers’ purported ten-year contractual investment. For each customer, Peterson prepared an amended 2002 income tax return claiming the total amount of the customer’s purported investments as an ordinary deduction.

40. Peterson also prepared and filed amended income tax returns for years before 2002, carrying back the “excess losses” for up to five years. In the vast majority of cases, the bogus losses eliminated customers’ tax liabilities for several years. In some cases, Peterson prepared amended and filed amended 2003 income tax returns carrying forward the bogus losses.

41. Peterson falsely reported the § 616 deductions as occurring in tax year 2002. Peterson reported all deductions for 2002 because he hoped to take advantage of I.R.C. § 172(b)(1)(H), which allowed net operating losses incurred in 2001 or 2002 to be carried back to each of the five years preceding the loss, rather than the two- or three-year carryback period that would otherwise apply.

42. In interviews with the IRS, which was investigating the MIDAS scheme, Peterson claimed that MIDAS participants were entitled to the deduction for 2002 because Merendon had “left its books open” and would not close its books until a future date. But under I.R.C. § 616 taxpayers cannot take a deduction for tax year 2002 for money invested in 2003 and 2004, even if they have actually made such expenditures in the later years.

43. Two Peterson customers in Texas, a former NFL football player and his wife, paid over \$2 million in federal income tax for the years 1997 through 2002 based on total income of over \$7 million reported on their federal income tax returns. After this couple signed up for the MIDAS scheme, Peterson, in January 2005, prepared an amended 2002 income tax return for them claiming a \$6.9 million mining deduction for bogus MIDAS expenses. Because the deduction exceeded the couple's income for 2002, Peterson prepared amended returns carrying the resulting loss back to previous years, eliminating the vast majority of the couple's income tax liability for 1997 through 2002, and claiming large refunds for those years. Peterson determined the amount of the couple's purported MIDAS investment based on the amount of income they reported and the taxes they paid in previous years. In actuality, the couple had not paid the \$6.9 million in reported "mining development expenses" in 2002 or any other year. The IRS detected the fraudulent amended returns before it issued the claimed refunds to the couple.

44. When one customer inquired about a \$10 million loss Peterson had reported on the customer's amended federal income tax return for 2002, but that the customer had not actually incurred, Peterson falsely told the customer that by participating in the MIDAS investment program, he became part of a large group that had invested that sum in 2002.

45. Peterson prepared amended income tax returns for at least 21 MIDAS participants. On each return, Peterson fraudulently reported that customers had made mining development investments and reported deductions based on I.R.C. § 616 for the year 2002. For the majority of customers, Peterson reported investments exceeding customers' taxable income for the year 2002, and carried back the resulting "excess losses" from the purported 2002 investment to tax

years 1997 through 2001. Peterson failed to apply these “excess losses” strictly to passive income and instead applied them to his customers’ combined passive and non-passive income.

46. Peterson charged customers several thousand dollars to prepare their returns and amended returns. In one instance, Peterson charged an NFL football player from Georgia \$5,000 to prepare five amended tax returns to claim tax refunds under the MIDAS scam.

47. Peterson also acted as a Power of Attorney for Merendon customers. Peterson submitted IRS Forms 2848 on behalf of several customers for whom he had prepared false tax returns. He also participated in meetings with Camp on behalf of several customers, during which he attested to the correctness of the tax returns he prepared.

48. Peterson prepared at least 144 amended income tax returns for 21 customers reporting fraudulent deductions related to MIDAS. Of Peterson’s 21 MIDAS customers, at least seven are current or former NFL football players.

Peterson’s Interference with IRS Investigations

49. In 2004 the IRS discovered suspicious amended returns claiming I.R.C. § 616 deductions for the MIDAS scheme. The IRS issued summonses to several MIDAS participants, requiring that they provide documents and testimony regarding the purported expenses. In addition, the IRS began investigating the MIDAS scheme itself.

50. Between 2004 and 2006, when they received notice that the IRS was investigating their claimed MIDAS deductions, several MIDAS participants contacted Peterson. When contacted, Peterson falsely told the participants that the scheme was legal and said that the IRS investigations were not unusual.

51. Starting in 2004, several customers, at Peterson's suggestion, signed forms authorizing him to represent them before the IRS in connection with IRS audits of their tax returns.

52. In a December 7, 2004 meeting the IRS requested in connection with its audit of three MIDAS participants, Peterson admitted that he prepared a number of federal income tax returns claiming mining deductions, but he refused to name other customers for whom he prepared similar returns. Only on formal request by an IRS Area Director did Peterson later supply to the IRS a list of some customers for whom he had prepared tax returns. Peterson was joined in the meeting by Camp, another Merendon return preparer and promoter, who claimed that Merendon had asked him to appear at the interviews in order to explain the transaction and facilitate acceptance of the claims.

53. In the same meeting, Peterson claimed that he had researched I.R.C. § 616 extensively and was knowledgeable about preparing amended income tax returns. He falsely stated that the MIDAS program and the federal tax returns he prepared were correct and complied with internal revenue laws regarding mining development investment deductions. He contended that Merendon Mining had "left its books open" for 2002, allowing customers to continue to invest in the program through 2004 and indefinitely into the future.

54. As a result of its audits, the IRS has determined that all of the amended federal income tax returns Peterson prepared for MIDAS participants contain fraudulent deductions based on the mining development scheme.

55. Peterson and other Merendon promoters continue to advise customers not to agree with the IRS disallowances of their mining expense deductions. On a conference call in late

2006, Capstick and Peterson convinced a customer not to agree to the IRS's determination. From that conversation, the customer received the impression that Capstick and Peterson would not refund the fees he had paid them if he did not follow their advice and disagree with the IRS's determination.

56. As a result of Peterson and other promoters' advice, the IRS's investigations of Merendon customers have been significantly delayed and customers have been further injured by the accrual of additional interest and penalties.

57. In spite of Peterson's advice, several customers, after being investigated by the IRS, have acknowledged that they did not make the mining "investments" that Peterson reported on their tax returns, and have agreed they are not eligible for the deductions or refunds claimed. When these customers informed Peterson of this intention, he expressed strong concern.

58. Although the Merendon Mining Agreement provided that if customers did not make their agreed investment, the unpaid amount would be reported as cancellation-of-debt income, on information and belief Merendon has not actually reported to the IRS any such cancellation-of-debt income to its customers.

Harm to the United States

59. Peterson's promotion of the MIDAS scam and his preparation of false and fraudulent tax returns for MIDAS participants has resulted in significant understatements of customers' tax liabilities.

60. Before the IRS became aware that the tax returns Peterson prepared were fraudulent, the IRS inadvertently issued refunds to several Merendon customers totaling over \$1 million. The IRS is now spending significant resources attempting to recover the erroneous refunds and

ensure that no other erroneous refunds relating to returns prepared by Peterson with false mining deductions are issued.

61. For the 21 customers for whom Peterson prepared tax returns that the IRS has identified to date, Peterson reported false claims for refund of over \$27 million. The IRS estimates that the average fraudulent refund claim per customer is about \$1.3 million.

Count I - Injunction under I.R.C. § 7408

62. The United States incorporates by reference the allegations in paragraphs 1 through 61.

63. I.R.C. § 7408 authorizes a district court to enjoin any person from further engaging in conduct subject to penalty under either I.R.C. § 6700 or § 6701, if injunctive relief is appropriate to prevent recurrence of that conduct.

64. I.R.C. § 6700 provides that a penalty will be imposed against any person who (a) organizes or assists in the organization of a partnership or other investment plan or arrangement, or participates directly or indirectly in the sale of an interest in an entity or plan, and (b) makes, or causes to be made, a statement as to the allowability of a deduction or credit, the excludability of any income, or the securing of another tax benefit, because of an interest held in the entity or because of his participation in the plan, that the person knows or has reason to know to be false or fraudulent as to any material matter.

65. Peterson, in promoting the MIDAS scheme, and advising potential customers that the scheme was legal, made materially false or fraudulent statements to customers regarding the allowability of tax deductions for mining development expenses and the tax benefits of participating in the scheme. In addition, he made materially false or fraudulent statements

regarding customers' liability for personal income taxes. As an accountant and experienced tax return preparer, Peterson knew or had reason to know that his statements were false or fraudulent.

66. I.R.C. Section 6701 imposes a penalty on any person who aids or assists in, procures, or advises with respect to the preparation or presentation of a federal tax return, refund claim, or other document, while knowing or having reason to believe that such document will be used in connection with any material matter arising under the tax laws, and knowing that if so used it would result in an understatement of another person's tax liability.

67. Peterson falsely advised customers that the MIDAS tax scheme was legal under I.R.C. § 616 although he knew no participant risked their own money or paid mining development expenditures before taking the deductions.

68. Peterson also prepared and filed customers' federal income tax returns on which he included inapplicable and fraudulent deductions for mining development expenses. Peterson did so knowing that customers would file the amended tax returns and that the filing would result in understatements of customers' correct tax liabilities.

69. Peterson engaged in conduct subject to penalty under I.R.C. §§ 6700 and 6701, and is subject to an injunction under I.R.C. § 7408.

70. I.R.C. §§ 7408 and 7402 authorize a court to issue orders of injunction as may be necessary or appropriate for the enforcement of the internal revenue laws. Peterson, through the actions described above, has engaged in conduct that substantially interferes with the enforcement of the internal revenue laws.

Count II - Injunction under I.R.C. § 7407

71. The United States incorporates by reference the allegations in paragraphs 1 through 70.

72. I.R.C. Section 7407 authorizes a court to enjoin a tax return preparer from engaging in conduct subject to penalty under I.R.C. §§ 6694 or 6695 or engaging in any other fraudulent or deceptive conduct which substantially interferes with the proper administration of the internal revenue laws, if a court finds that injunctive relief is appropriate to prevent the recurrence of such conduct.

73. In addition, if a court finds that a defendant has continually or repeatedly engaged in such misconduct and that a narrower injunction prohibiting only that specific conduct would not be sufficient to prevent the person's interference with the proper administration of the internal revenue laws, a court may enjoin the person engaged in such prohibited conduct from acting as an income tax return preparer.

74. I.R.C. Section 6694, as in effect at the time Camp prepared the MIDAS-related returns for customers, provided that a tax return preparer was subject to penalty if he prepared a return or claim for refund understating a customer's tax liability based on a position for which there was no realistic possibility of the position being sustained on its merits, and the preparer knew or should have known of the position. A return preparer is subject to a larger penalty if the understatement of liability is due to the preparer's willful attempt to understate the liability or the reckless or intentional disregard of rules or regulations.

75. Peterson willfully and recklessly prepared customers' tax returns containing understatements of liability based on tax deductions that had no realistic possibility of being

sustained on the merits. Peterson's claiming those deductions was a willful attempt to understate customers' liabilities based on reckless or intentional disregard of statutes, rules, and regulations.

76. Peterson prepared amended income tax returns for customers unlawfully claiming mining development expense deductions pursuant to I.R.C. § 616(a) and carried claimed losses back to other tax years.

77. I.R.C. Section 616(a) generally allows the deduction of mining development expenses as ordinary expenses rather than as capital expenditures. It provides that a deduction shall be allowed for all expenditures in a given year made for the development of a mine after ores or minerals in commercially marketable quantities have been disclosed.

78. A mining development deduction may be taken only if certain requirements are met:

- a. before the investment is made, the ore or minerals must exist in commercially marketable quantities sufficient to reasonably justify commercial exploitation; and
- b. the primary objective of the mining venture must be to make a profit; and
- c. the taxpayer must have in fact paid or incurred the expenditures for which the deduction is claimed, I.R.C. § 461(h); and
- d. the investment must be for development expenditures rather than production expenditures; and
- e. the expenses paid or incurred towards mining development expenses must have occurred during the taxable year; and
- f. for passive investment activity, losses are only deductible against passive income, I.R.C. § 469; and
- g. losses are limited to the aggregate amount for which the taxpayer is at risk of real economic loss, I.R.C. § 465.

79. The tax deductions Peterson reported on customers' returns for purported expenditures do not meet any of the above requirements. Further, the deductions he reported had no realistic possibility of being sustained on the merits. Thus, Peterson engaged in conduct subject to penalty under I.R.C. § 6694.

80. Peterson prepared customers' amended federal income tax returns by fraudulently reporting deductions for mining investments with Merendon when ore and minerals were not disclosed at the Merendon sites in commercially marketable quantities sufficient to reasonably justify commercial exploitation.

81. The Merendon prospectus Peterson provided to customers contained two valuations, dated 1994 and 1989, of the lands Merendon claimed to have rights to mine. The 1994 report stated that the maximum gross value of the recoverable minerals or ores was approximately \$528 million, even though Merendon claimed to seek a total participant investments of \$1 billion. Mineral quantities of only \$528 million are not sufficient to reasonably justify commercial expenditures of \$1 billion for development and extraction.

82. Furthermore, though the 1989 report showed that the properties contained a "possible" gross value of various minerals totaling \$2.1 billion, the Merendon report disclosed that the properties contained "probable" reserves of only \$18.6 million and \$4.5 million of "proven" reserves. Because possible reserves cannot be used in the direct evaluation of a mineral deposit, the total value of the potentially recoverable minerals in the 1989 report was \$23.1 million. Neither the 1994 nor 1989 prospectus disclosed ore or minerals in commercially marketable quantities sufficient to justify exploitation. On information and belief, no further mineral deposits have been disclosed at Merendon's properties.

83. The deductions Peterson claimed on customers' returns were also not valid under I.R.C. § 616 because the MIDAS scheme's primary objective was not to generate profits, but to recover fraudulent tax refunds. As discussed above, Merendon's claimed expected recovery was unrealistic and was in any event only slightly more than half of the total capital it sought from

investors. At least one structurist candidly told customers that the entire MIDAS scheme was to be funded by tax refunds received based on customers submitting amended federal income tax returns with false deductions for mining expenses.

84. Peterson engaged in I.R.C. § 6694 penalty conduct by reporting deductions for amounts that were never actually paid or incurred. In 2003 or 2004, Peterson's customers signed sham Mining Agreements purportedly obligating them to pay amounts over ten years. In reality, the vast majority of Peterson's customers never actually paid any money to Merendon, much less the entire agreed amount. Most amounts customers paid to Merendon were for membership or tax preparation fees, or to buy other Merendon products unrelated to the MIDAS scheme.

85. MIDAS participants similarly did not incur any losses from their purported investments. Pursuant to I.R.C. § 461(h), economic performance must have occurred before an expense will be considered "incurred." Economic performance occurs when a service or property is provided to the taxpayer. Merendon customers were not provided a service because Merendon never notified customers of any development actions taken towards the extraction of ores or minerals. Specifically, they did not notify customers that any economic performance had occurred.

86. In some cases, Merendon could not even have taken any development actions because it did not own the land or possess the necessary permits to conduct any mining development or extraction. On information and belief, Merendon did not acquire several mining permits until December 30, 2003, and could not have legally delivered any mining development services before then. As of October 2005, all of Merendon's mining permits had been revoked or terminated. Further, while Merendon did purchase two parcels identified as Buena Lode and

New Rival Lode (Black Rose) for purported mining, the purchases took place on January 20, 2005.

87. Merendon has failed to provide to the IRS evidence supporting any actual services or properties that would substantiate the purported mining expenses Peterson falsely reported that Merendon customers had incurred.

88. Peterson fraudulently reported that customers were eligible for the I.R.C. § 616 deduction for the year 2002, and carried back the reported losses to previous tax years, and forward to future years in some cases. Yet, none of their Merendon customers made any payments or even entered into the MIDAS contracts until 2003 and 2004. A deduction under I.R.C. § 616 is valid only for expenses incurred during the taxable year for which they were claimed.

89. The mining deductions Peterson reported were also invalid because the deductions concerned funds that, if actually committed, would be properly characterized as production expenses, rather than development expenses. A development expenditure is one made to attain an intended output whereas a production expenditure is one made to maintain an output. Development expenditures, which are deductible under I.R.C. § 616, are intended to relate to an entire mineral deposit or a large area of a deposit such that they provide benefits extending over relatively long periods of extraction of the ore or mineral. Production costs, which are not deductible under I.R.C. § 616, are directly related to the mining and extraction of a particular increment of the mineral or ore.

90. Merendon sought investment for disused mines for which many of the development costs had already been incurred by the previous purchaser. Thus, any “investments” MIDAS

participants made would have been applied to the production of minerals and ores, rather than site development.

91. Peterson prepared tax returns unlawfully offsetting customers' non-passive income using the claimed I.R.C. § 616 deductions, rather than applying the net-operating losses relating to the purported mining development expense strictly to similarly passive income. Losses from a business in which a taxpayer does not materially participate cannot be used to reduce non-passive income, pursuant to I.R.C. § 469. Merendon customers did not participate in the operation or functioning of Merendon Mining, the IFFL, or the purported gold mines, other than to sign the "Mining Agreements." Although some customers did visit mine sites, they did not work on a regular, continuous, and substantial basis for or on behalf of Merendon, as required to show material participation in an activity.

92. Finally, Peterson unlawfully reported deductions and refunds exceeding the amounts for which customers were actually "at risk." Pursuant to I.R.C. § 465(b)(1)(B), investors can only claim deductions if they are personally liable on the debt or have pledged property to secure a debt. Peterson's customers were not at risk because Merendon never intended to and has never sought to collect amounts customers purported to contract to pay, but never actually paid. In fact, structurists provided Merendon customers with letters advising them not to pay the contracted amounts until customers received the claimed federal income tax refunds. Although the Mining Agreements purported to obligate customers to pay the amounts listed on the contracts, promoters told customers that they were not required to make any payments other than the amounts received as tax refunds. Peterson's customers were not at risk of real economic loss

because they did not actually pay money to the Merendon investment scheme, and at the time the deductions were claimed, Merendon did not actually intend for customers to make any payments.

93. The mining deductions promoted and reported by Peterson on at least 144 federal income tax returns were not valid under I.R.C. § 616(a) for numerous reasons. Peterson, as an accountant and professional tax preparer, knew or had reason to know that the deductions were invalid because he knew the customers had not made any payments, that sufficient quantities of minerals and ores had not been disclosed, and knew that no development activities had taken place in 2002. Furthermore, Peterson knew or should have known that any such investments by customers would be considered passive activities not usable to offset customers' non-passive incomes.

94. Peterson is subject to penalty under I.R.C. § 6694 because he knew or had reason to know that the tax positions taken on his customers' amended tax returns had no realistic possibility of being sustained on their merits. Peterson has interfered with the administration of the internal revenue laws by preparing false tax returns and fraudulent claims for refunds. Peterson is subject to an injunction under I.R.C. § 7407.

95. An injunction is necessary to prevent Peterson from further engaging in violations of I.R.C. § 6694 because he has prepared numerous returns containing the same fraudulent claims for refund. He has exacerbated his unlawful conduct by advising customers not to agree to the IRS' position and to maintain that the tax returns were valid.

96. An injunction prohibiting only Peterson's preparation of returns understating taxpayers' liabilities and including unrealistic positions is not sufficient to prevent him from

further interfering with the proper administration of the internal revenue laws. Rather, he should be permanently enjoined from acting as a tax preparer.

WHEREFORE, the Plaintiff, United States of America, respectfully prays for the following:

A. That the Court find that Peterson has continually and repeatedly engaged in conduct subject to penalty under I.R.C. §§ 6700 and 6701, and has engaged in conduct that interferes with the administration and enforcement of the internal revenue laws;

B. That the Court find that Peterson has continually and repeatedly engaged in conduct subject to penalty under I.R.C. § 6694;

C. That the Court find that injunctive relief is appropriate under I.R.C. §§ 7402, 7407, and 7408 to prevent Peterson, and anyone acting in concert with him, from further recurrence of such conduct;

D. That the Court enter a permanent injunction pursuant to I.R.C. §§ 7402 and 7408, prohibiting Peterson from directly or indirectly:

- (a) Organizing, promoting, or selling the Mining Interest Development Action Strategy (MIDAS) program associated with Merendon Mining, Inc. and its subsidiary corporations;
- (b) Making false or fraudulent statements, in connection with the organization or sale of any tax shelter, plan, or other arrangement, about the allowability of any deduction or credit, the excludability of any income, or the securing of any other tax benefit by reason of participating in the tax shelter, plan, or other arrangement;
- (c) Organizing, promoting, selling, or advising participation in any other tax shelter, plan, investment, business venture, or arrangement that makes false or fraudulent representations about federal tax benefits or treatment

because of participation in such tax shelter, plan, investment, business venture, or arrangement;

- (d) Causing or assisting other persons and entities to understate their federal tax liabilities and avoid paying federal taxes;
- (e) Engaging in any other conduct subject to penalty under I.R.C. § 6700, including making or furnishing, in connection with the organization or sale of a shelter, plan, or arrangement, a statement that he knows or has reason to know to be false or fraudulent as to any material federal tax matter, or by making a gross valuation overstatement; and
- (f) Engaging in conduct subject to penalty under I.R.C. § 6701, including preparing or assisting others in the preparation of any tax forms or other documents to be used in connection with any material matter arising under the internal revenue laws and which he knows will (if so used) result in the understatement of another person's tax liability.

E. That the Court enter a permanent injunction pursuant to I.R.C. § 7407 prohibiting Peterson from directly or indirectly:

- (a) Preparing or assisting others in the preparation of any tax forms or documents on behalf of any other person or entity including a claimed deduction under I.R.C. § 616 for which the taxpayer has not made any mining development investment;
- (b) Engaging in any conduct subject to penalty under I.R.C. § 6694, including preparing tax returns for customers where there is no reasonable belief that the position would more likely than not be sustained on its merits; and
- (c) Preparing or filing, or helping others to prepare or file, federal tax returns, amended returns, or any other tax-related documents or forms for anyone other than himself.

F. That the Court order Peterson to turn over to counsel for the United States a list of the names, addresses, e-mail addresses, phone numbers, and Social Security numbers of all customers:

- (a) To whom he promoted, sold, or marketed the MIDAS scheme;

- (b) For whom he created, prepared, or filed a federal tax return claiming an I.R.C. § 616 deduction; and
- (c) Affiliated with Merendon whom he advised, counseled, or otherwise assisted regarding the preparation of federal tax returns or advised regarding their tax liability.

G. That the Court order Peterson to inform all persons described in paragraph F above of the entry of the Court's findings and injunction, that their tax returns are likely false, that they may be subject to penalties because of the fraudulent tax returns;

H. That the Court order Peterson to complete the requirements listed in paragraphs F and G within 20 days of the Court's permanent injunction and file a certificate of compliance signed under penalties of perjury, along with evidence of compliance, within 20 days of the Court's permanent injunction;

I. That the Court allow the United States full post-judgment discovery to monitor compliance with the injunction;

J. That the Court retain jurisdiction over this action for purposes of implementing and enforcing the final judgment and any additional orders necessary and appropriate to the public interest; and

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K. That the Court grant the United States such other and further relief, including costs, as the Court deems appropriate.

Respectfully submitted,

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