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U.S. DISTRICT COURT
DISTRICT OF COLORADO

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IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLORADO

GREGORY C. LANGHAM
CLERK

BY _____ DEP. CLK

Civil Action No.

03-M-1310 (CWS)

UNITED STATES OF AMERICA,

Plaintiff,

v.

COLORADO MUFFLERS UNLIMITED, INC., a Colorado corporation,
RICHARD D. RUDD, SR.,
DOLORES RUDD,
SHERILYN GALLEGOS,
RICHARD D. RUDD, JR., and
GEORGE GALLEGOS, III,

Defendants.

Complaint for Permanent Injunction

Plaintiff, the United States of America, complains and alleges as follows:

I. Jurisdiction and Venue

1. This Court has jurisdiction over this action for permanent injunctive relief under 28 U.S.C. §§ 1340 and 1345 and 26 U.S.C. (Internal Revenue Code) § 7402(a).

2. Venue is proper under 28 U.S.C. § 1391(b) because a substantial part of the events or omissions giving rise to the United States' claim occurred, and continues to occur, within this judicial district and because most of the defendants may be found within this judicial

district. Venue is also proper under 28 U.S.C. § 1396 because the taxpayer, Colorado Mufflers Unlimited, Inc., resides within this judicial district.

3. This action is commenced at the request of the Chief Counsel of the Internal Revenue Service, a delegate of the Secretary of the Treasury, and at the direction of a delegate of the Attorney General.

II. Defendants

4. Defendant Colorado Mufflers Unlimited, Inc., ("Colorado Mufflers"), is a Colorado corporation that sells, installs, and services automobile exhaust systems. It is located at 11450 N. Huron Street, Unit R, Northglenn, Colorado, its principal place of business. It has elected to be treated as a "Subchapter S" (or "small business") corporation for federal income tax purposes.

5. Defendant Richard D. Rudd, Sr., is Colorado Mufflers's president and majority shareholder.

6. Defendant Dolores Rudd is Richard D. Rudd, Sr.'s wife and Colorado Mufflers's vice president.

7. Defendant Sherilyn Gallegos is Richard and Dolores Rudd's daughter. She is Colorado Mufflers's secretary and treasurer and a minority shareholder.

8. Defendant Richard D. Rudd, Jr., is Richard and Dolores Rudd's son. He is a minority shareholder of Colorado Mufflers. Upon information and belief, Richard D. Rudd, Jr., is currently an employee of Colorado Mufflers.

9. Defendant George Gallegos, III, is Sherilyn Gallegos's husband. He is also a

minority shareholder of Colorado Mufflers. Upon information and belief, George Gallegos, III, is currently an employee of Colorado Mufflers.

**III. Claim for Relief:
Permanent Injunction under I.R.C. § 7402(a)**

10. The United States seeks a permanent injunction requiring Colorado Mufflers and the other defendants, as well as anyone else acting in concert with them, to resume (a) withholding federal employment taxes from its employees' wages; (b) filing timely and accurate federal employment and unemployment tax returns (Forms 941 and 940); (c) filing timely and accurate wage and tax statements (Forms W-2); and (d) making timely and full payroll tax deposits and payments.

11. This suit is brought under Internal Revenue Code (26 U.S.C.) Section 7402(a), which authorizes the district court to issue, among other things, orders of injunction as may be necessary or appropriate for the enforcement of the internal revenue laws. To obtain injunctive relief under Section 7402(a), the United States need only to satisfy the requirements thereunder.

Employers' Withholding and Filing Obligations

12. Under Internal Revenue Code Sections 3102(a) and 3402(a), employers are required to withhold federal income and Federal Insurance Contributions Act ("FICA") taxes from their employees' wages as and when wages are paid. Under Internal Revenue Code Section 7501(a), employers are to hold these withheld taxes in trust for the United States.

13. In addition to withholding their employees' share of FICA taxes, under Internal Revenue Code Section 3111, employers are required to pay their own share of FICA taxes.

14. Under Internal Revenue Code Section 6302 and the Treasury Regulations (26 C.F.R.) promulgated thereunder, employers are generally required to deposit the withheld income taxes and the FICA taxes either monthly or semi-weekly.

15. Under Internal Revenue Code Sections 6011(a) and 6071(a) and the Treasury Regulations promulgated thereunder, employers are required to file Forms 941 (Employer's Quarterly Federal Tax Returns) quarterly to report the income and FICA taxes withheld from their employees' wages and their own share of FICA taxes.

16. In addition to FICA taxes, under Internal Revenue Code Section 3301, employers are required annually to pay Federal Unemployment Tax Act ("FUTA") taxes.

17. Under Internal Revenue Code Sections 6011(a) and 6071(a) and the Treasury Regulations promulgated thereunder, employers are required to file annual Forms 940 (Employer's Annual Federal Unemployment Tax Returns) to report their FUTA taxes.

18. Under Internal Revenue Code Section 6151(a), employers are required to pay any taxes due on their Forms 941 and 940 without assessment or notice and demand from the Internal Revenue Service and pay them no later than the time they are required to file the returns.

19. Under Internal Revenue Code Section 6041 and Treasury Regulation Section 1.6041-2, employers are required to file with the Internal Revenue Service an annual Wage and Tax Statement (Form W-2) for each employee and to issue the employee a copy of his or her form.

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Colorado Mufflers's Defiance of the Internal Revenue Laws

20. At the behest of the individual defendants, Colorado Mufflers has not complied with any of the above withholding and filing obligations, nor has it paid the required taxes, for any periods since the first quarter of 2000.

21. Since 1999, Colorado Mufflers has had at least nine employees.

22. For tax periods ending on or before December 31, 1999, Colorado Mufflers timely filed its Forms 941 and 940 and paid the taxes due. For these periods, Colorado Mufflers also filed Forms W-2 and issued copies to its employees.

23. Nevertheless, Colorado Mufflers has not filed valid Forms 941 for any periods since the first quarter of 2000. Although Colorado Mufflers filed Forms 941 for the first and second quarters of 2000, it falsely reported zero wages and taxes due on those returns.

24. Colorado Mufflers also has not filed any Forms 940 after the 1999 return.

25. Colorado Mufflers has not filed any Forms W-2 or issued them to its employees for years after 1999.

26. Moreover, in August and September 2000, Colorado Mufflers filed "Amended and Corrected" Forms 941 and Forms 940-EZ for all quarters of 1997, 1998, and 1999, falsely reducing all previously reported wages and tax liabilities to zero.

27. Colorado Mufflers also filed Forms W-3c (Transmittal of Corrected Wage and Tax Statements) and Forms W-2c (Corrected Wage and Tax Statements) for at least 1996 and 1999, falsely reducing all previously reported wages to its employees to zero.

28. As a result of these "Amended and Corrected" Forms 941 and 940-EZ, the

Internal Revenue Service issued erroneous refunds of over \$88,768.70 to Colorado Mufflers for periods in 1997 and 1998. On June 28, 2002, the United States instituted an action in this Court (Civil Action No. 02-BB-1231 (CBS)) to recover these erroneous refunds. On May 19, 2003, the Court granted the United States' motion for summary judgment against Colorado Mufflers.

29. For over two years, the Internal Revenue Service has repeatedly warned Colorado Mufflers and its officers that Colorado Mufflers is required to withhold payroll taxes from its employees' wages, file accurate returns, and pay any taxes due.

30. Colorado Mufflers, acting at the behest of the individual defendants, has refused to resume withholding payroll taxes, filing accurate returns, and paying employment and unemployment taxes. The individual defendants have professed their intention to continue to flout the internal revenue laws.

Colorado Mufflers's Frivolous "Section 861" Argument

31. Colorado Mufflers and its officers attempt to justify their illegal conduct by the patently frivolous "Section 861" argument. Relying on a misreading of Internal Revenue Code Section 861 and the Treasury Regulations promulgated thereunder, they assert that U.S. citizens' wages are not taxable and that employers, therefore, have no obligation to withhold payroll taxes from their employees' wages or to pay the withheld taxes.

32. Courts have uniformly rejected the Section 861 argument as frivolous and have imposed penalties on its proponents.

33. This Court, in granting the United States' motion for summary judgment in the erroneous refund case, similarly rejected Colorado Mufflers's Section 861 argument as

“frivolous.”

Irreparable Harm to the United States

34. The Internal Revenue Service estimates that for the eight quarters in 2000 and 2001 Colorado Mufflers has accrued Form 941 tax liabilities and penalties (exclusive of interest) in the amount of \$25,443 per quarter (except the fourth quarter of 2000, for which the estimate is \$23,688). This totals \$201,789 for these eight quarters.

35. The Internal Revenue Service estimates that, for 2000 and 2001, Colorado Mufflers has accrued Form 940 tax liabilities and penalties (excluding interest) in the respective amounts of \$4,840 and \$4,339.

36. Based on the above estimates and not including interest, Colorado Mufflers has accrued Forms 941 and 940 tax liabilities and penalties for 2000 and 2001 in the amount of over \$210,000.

37. Not only has Colorado Mufflers accrued tax liabilities that have likely surpassed its ability to repay, it continues to accumulate Form 941 taxes of over \$25,000 per quarter and Form 940 taxes of over \$4,000 per year.

38. While the Internal Revenue Service has statutory enforcement procedures by which it may seek administratively to collect past tax liabilities, these administrative procedures are inadequate to prevent Colorado Mufflers from continuing to accumulate further tax liabilities, and are also inadequate to force Colorado Mufflers to resume its tax withholding, filing, and payment obligations as an employer.

39. Colorado Mufflers's flouting of the internal revenue laws, unless enjoined, will

continue to interfere with the enforcement and administration of the internal revenue laws.

40. Colorado Mufflers's flouting of the internal revenue laws, unless enjoined, will continue to cause irreparable harm to the United States Treasury, both in terms of loss in tax revenue and of additional tax enforcement expenditures, neither of which will be fully recovered.

41. Colorado Mufflers's flouting of the internal revenue laws, unless enjoined, will continue to cause irreparable harm to the United States.

42. Colorado Mufflers's flouting of the internal revenue laws, unless enjoined, will continue to cause hardship on its employees, who must determine their own tax liabilities without the benefit of Forms W-2 and income and FICA taxes withholding, and who require proper employer reporting of wages in order to obtain the Social Security and Medicare benefits to which they are entitled.

43. Neither Colorado Mufflers nor the individual defendants will be harmed by a permanent injunction compelling them to obey the internal revenue laws.

44. A permanent injunction against Colorado Mufflers and the individual defendants, therefore, is necessary and appropriate for the enforcement of the internal revenue laws, and, thus, is in the public interest.

Wherefore, the United States respectfully prays that:

A. This Court enter a permanent injunction under I.R.C. § 7402(a) against the individual defendants, Colorado Mufflers, and its officers, agents, servants, employees, attorneys, and persons in active concert or participation with them, ordering that, for periods beginning on or after January 1, 2000:

(1) they resume withholding and paying over to the Internal Revenue Service all required income, FICA, and FUTA taxes;

(2) they resume (a) filing timely and accurate Forms 941, 940, and W-2 and (b) send a copy of the returns and forms to the United States' counsel for the first two years after entry of the injunction;

(3) they (a) make all income, FICA, and FUTA tax deposits with Colorado Mufflers's bank within three days of making each payroll and (b) fax a receipt for each tax deposit and a completed worksheet showing the calculation for each deposit to the revenue officer or agent designated by the United States;

(4) they serve, within thirty days from the entry of the injunction, a copy of the Court's findings and permanent injunction on all current employees and any former employees employed at any time since January 1, 2000; and

(5) they post for two years a copy of the Court's findings and permanent injunction in conspicuous places at the business premises where notices to employees are customarily posted; and

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- B. This Court retain jurisdiction over this case to ensure compliance with the injunction; and
- C. This Court award the United States its costs and such other relief as is just and proper.

Respectfully submitted,

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