IN THE UNITED STATES DISTRICT COURT FOR THE
MIDDLE DISTRICT OF FLORIDA
FORT MYERS DIVISION

UNITED STATES OF AMERICA Plaintiff, v. FRED J. ANDERSON, RICHARD ALAN WALTERS, AND DEBORAH A. MARTIN, and TAX STRATEGIES, INC., Defendants.	)	Case No.

UNITED STATES' BRIEF IN SUPPORT OF MOTION FOR PRELIMINARY INJUNCTION

Expedited Hearing Requested

INTRODUCTION

Defendants Fred J. Anderson, Richard Alan Walters, Deborah A. Martin, and Tax Strategies, Inc. have helped their customers defraud the United States of an estimated $7.5 million in taxes so far. In furtherance of the schemes, Martin prepares federal tax returns for defendants' customers claiming improper deductions and exclusions. The defendants' customers face possible civil and criminal penalties for using the defendants' tax scams. Consequently, the United States requests an expedited hearing and entry of a preliminary injunction to prevent the defendants from further promoting their illegal schemes and to bar Martin from preparing federal tax returns for others.

Because the statutory requirements for injunctions under 26 U.S.C. ("I.R.C.") Sections 7402, 7407, and 7408 are satisfied, the United States is entitled to injunctive relief. Moreover,

the traditional equitable factors applicable to non-statutory injunctions are also established here.[1]

STATEMENT OF FACTS

DEFENDANTS' ABUSIVE TAX SCHEMES

Defendants promote and market tax scams through seminars, the Internet, and promotional literature. The schemes involve the creation and use of sham entities — trusts, limited liability companies, and private foundations — to purport to eliminate or reduce federal income and self-employment tax liabilities.[2] Abusive-trust schemes have been identified as one of the IRS's "Dirty Dozen" tax scams.[3] They have mushroomed in the last few years.[4] Although many variations exist, most abusive trusts share several common characteristics:

a. claimed tax benefits based on purported transfers of income and assets to trusts with no meaningful change in the taxpayer's relationship to his income or assets.

b. Promoters promise reduction or elimination of taxable income, deductions for non-deductible personal expenses, the reduction or elimination of self-employment taxes, and the reduction or elimination of gift and estate taxes.

Abusive-trust schemes have been universally rejected by courts,[5] and the IRS has publicly

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[1] *See United States v. Ernst & Whinney*, 735 F.2d 1296, 1301 (11th Cir. 1984).

[2] Declaration of Revenue Agent George Ventura ("Ventura Declaration") at ¶¶ 4 and 10.

[3] Ventura Declaration at ¶ 10.

[4] United States Treasury, *Summary of Abusive Trust Schemes* (Sept. 4, 2001), *available at* http://www.ustreas.gov/irs/ci/factsheets/docabusivetrustschemes.htm. Attached as Exhibit A; *see also* Lucy May, *Locals Duped by Tax Schemes, IRS Says*, Cincinnati Business Courier, July 8, 2002. Attached as Exhibit B.

[5] *See, e.g., Muhich v. Commissioner*, TC Memo 1999-192 (U.S. Tax Ct.). Attached as Exhibit C; *United States v. Muhich*, 238 F.3d 860 (7th Cir. 2001). Attached as Exhibit D; Federal Income Taxation of Estates and Trusts, ¶ 17.06[2]. Attached as Exhibit E.

announced their invalidity.[6]

Defendants charge customers an "initial planning fee" of $2,000 and a monthly fee of $325 for, among other things, accounting and tax-return preparation for their customers using their "private foundation strategy." Those customers also pay "third party legal fees" of $2,000 to $5,000 for the creation of a limited liability company ("LLC"), non-grantor trust, and private foundation.[7] Customers pay a "third party implementation cost" of $5,000 to $15,000 to have documentation completed for the scheme involving the sham business trust and private foundation. Defendants also charge those customers $325 a month for purported tax accounting, tax-return preparation, and trust administration and management services.[8]

The defendants formerly recommended to their customers that they retain Thomas J. Davis Jr., an attorney and certified public accountant, to prepare the papers creating the sham entities, with defendant Anderson named as a trustee of all trusts.[9] Thereafter, defendant Martin handled the "bookkeeping" and tax-return preparation for the customers and their sham entities.[10]

David and Amy Anthony were the first customers to purchase the defendants' abusive schemes.[11] On the advice of defendants Anderson and Walters, in late 1997 or early 1998, the Anthonys had Davis prepare the documents for their business trust and charitable foundation

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[6] IRS Notice 97-24, 1997-1 C.B. 409. Attached as Exhibit F.

[7] Ventura Declaration at ¶ 9.

[8] Ventura Declaration at ¶¶ 12 and 13.

[9] Ventura Declaration at ¶ 14.

[10] Ventura Declaration at ¶ 16.

[11] Declaration of David Anthony ("Anthony Declaration") at ¶ 9.

trust. Anderson was the trustee of those two trusts.[12] Later in 1998, the Anthonys set up an LLC through the defendants, which the defendants told the Anthonys they had to do in order to "be legal."[13] The Anthonys paid the defendants between $30,000 to $40,000 for services related to the use of their sham business trust, private foundation, and LLC, which included federal-tax-return preparation by defendant Martin.[14]

1. Defendants' Promotion Involving Sham Business Trusts and Sham Private Foundations

The defendants advise and assist their customers to reduce or eliminate reported federal tax liabilities using a fraudulent scheme involving sham business trusts and sham private foundations. Defendants start by helping a customer set up a purported business trust that "contracts" with the customer's existing business to provide "facilities" and "management" for that business. Some of the customer's personal assets, including his house, are transferred to the business trust. The business trust uses the house as the business headquarters, and the business trust deducts the cost of "operating and maintaining" the house.

The customer becomes the "director" of the business trust, and the trust enters into an "employment contract" with the director/customer. As part of the employment contract, the director/customer "agrees" to manage the business for the trust and to protect, maintain, and improve the assets of the business, including caring for the business headquarters (the customer's house), in exchange for compensation and benefits.

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[12] Anthony Declaration at ¶¶ 4-6.

[13] Anthony Declaration at ¶ 11.

[14] Anthony Declaration at ¶¶ 13 and 19.

The business trust provides housing and meals at the "business headquarters" for the director/customer. The business trust pays the director/customer for the cost of lodging, food, and transportation while on "company business," health care, insurance premiums, educational expenses for the director/customer and his or her descendants, director's fees, and incidental expenses purportedly associated with operating the business trust.

The defendants further advise their customers that they can eliminate the tax on any remaining income after the above-described costs are paid by having the business trust "donate" that income to the customer's purported charitable foundation. They tell their customers that the business trust can "contribute" up to 100 percent of its taxable income to the foundation, thereby, eliminating or reducing the business trust's income tax liability, and any "donations" received by the foundation is "invested" by its trustees. The defendants also advise that an amount equal to 5 percent of the private foundation's "net investment assets" are to be used for "charitable" purposes and a 1 to 2 percent excise tax should be paid on the private foundation's "net investment income."[15] The net result of all of the customer's supposed transactions with his or her sham entities is that all or virtually all income magically disappears for federal-income-tax-reporting purposes, yet remains available for the customer to use as he did before participating in the scheme.

The defendants gave the Anthonys similar advice. The defendants told David Anthony that funds generated through his chiropractic business were put in his trust, and the trust invested

[15]Ventura Declaration at ¶ 7 and attached Exhibit 4 (Tab A).

those funds.[16] Defendant Walters advised the Anthonys that they were employees of their trust, and as a result, the trust could buy their groceries. He also advised them that because their residential address was the trust's permanent address, the trust could pay for their household personal expenses.[17]

2. Defendants' Promotion of the "Private Foundation Strategy" Scheme

The defendants' "private foundation strategy" involves customers using an existing LLC or creating a new one to conduct their existing business. The defendants advise customers that if they are currently conducting business through an S corporation or a C corporation, they should execute a "consulting agreement" between the newly created LLC and their corporation and an "employment agreement" between themselves and the LLC.

The defendants tell their customers to create a non-grantor trust and the trust in turn should create a private foundation. The customers are told to "transfer" 99 percent of their ownership interest in the LLC to the non-grantor trust and keep the remaining 1 percent. They are also advised that as a result of the transfer: (1) 99 percent of the LLC's taxable income flows through to the non-grantor trust; (2) the non-grantor trust can give all of that taxable income to the foundation as a "charitable contribution" and the foundation does not pay a tax on that income; (3) the foundation need pay only a 2 percent "federal exercise [sic] tax" on its "net investment income" and "contribute" 5 percent of its "net investment assets" to public charities

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[16]Anthony Declaration at ¶ 7.

[17]Anthony Declaration at ¶ 8.

or other private foundations each year.[18]

The defendants advised the Anthonys to set up an LLC. The defendants gave the Anthonys a bank card for the LLC with defendant Anderson's name on it. Defendants Anderson or Martin told the Anthonys that they had to use the card to pay for their groceries and expenses for their vehicles and residence.[19]

3. The False or Fraudulent Statements Defendants made in Promoting their Schemes

The defendants have made the following false or fraudulent statements in the course of promoting their scheme involving the sham business trust and sham private foundation:

- Selected assets of the customer, including the residence, can be transferred to a business trust. The business trust can use the residence as the business headquarters, and the business trust can deduct the cost of "operating and maintaining" the residence;

- The customer can become a director of the business trust, and the business trust can enter into an "employment contract" with the customer. As part of the employment contract, the customer can "agree" to "manage" his or her own business and "protect, maintain, and improve" the assets of the businesses, including caring for the business headquarters, which is the customer's residence, in exchange for compensation and benefits;

- The customer's business trust may provide tax deductible housing and meals for the customer as the director at the business headquarters, which is the customer's residence;

- The customer's business trust may make tax deductible payments to the customer as director for the costs of the following: lodging, food, and transportation while on "company business," health care, insurance premiums, educational expenses for the director and his or her descendants, director's fees, and incidental expenses associated with operating the business trust;

- To avoid a tax on any remaining income after the above costs are paid, the customer's business trust may "donate" that income to the customer's private foundation. The business trust may "contribute" up to 100 percent of its taxable income to the private

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[18]Ventura Declaration at ¶ 5 and attached Exhibit 2.

[19]Anthony Declaration at ¶¶ 11-12.

foundation, thereby, eliminating or reducing the business trust's income tax liability;

- The donations received by the private foundation can be "invested" by its trustee. An amount equal to 5 percent of the private foundation's "net investment assets" can be used for "charitable purposes" and only a 1 to 2 percent excise tax should be paid on the private foundation's "net investment income;" and

- The customer's use of the business trust and private foundation will "legally" reduce their income and self-employment taxes.[20]

The defendants have made false or fraudulent statements in the course of promoting their "private foundation strategy" scheme. They have falsely stated that:

The customer can transfer 99 percent of his or her business interest to a LLC created by the customer and keep the remaining 1 percent, and the LLC can transfer its interest to the customer's non-grantor trust. As a result of the LLC's transfer of business interest to the customer's non-grantor trust, 99 percent of the business's taxable income flows through to the non-grantor trust. The non-grantor trust can give all of that taxable income to a private foundation" as a "charitable contribution" and the foundation does not pay a tax on that income. The private foundation only has to pay a 2 percent "federal exercise [sic] tax" on its "net investment income" and "contribute" 5 percent of its "net investment assets" to public charities or other private foundations each year. [21]

The above false and fraudulent statements were implemented on the returns of the defendants' customers.[22]

4. Defendant Martin's Return Preparation for those Using the Abusive Schemes

Martin prepares federal tax returns for those customers using the schemes described above. On those returns, she claims non-deductible personal living expenses, such as "rent" and repairs for the customers' residence, medical expenses, groceries, utilities, and travel. She also

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[20]Ventura Declaration at ¶ 8.

[21]Ventura Declaration at ¶ 6.

[22]Ventura Declaration at ¶ 15.

improperly claims deductions for sham management fees and sham charitable contributions. The "charitable contributions" are paid to the customers' foundations, which are partially controlled by the customer. Most of the funds in the foundations are used to pay customer fees to Tax Strategies and to make investments for the benefit of the customers and not used for charity.[23] As a result of the above, those customers' federal taxes are understated on their federal-income-tax returns.[24]

The IRS examined the Martin-prepared returns of fifteen Tax Strategies' customers. Audit adjustments were made to all of them. To date, eight of those fifteen customers have agreed to the adjustments. All of the audit adjustments resulted from the customers' Martin-prepared returns improperly claiming deductions.[25] The total tax understatements on the audited returns alone exceed $1,300,000.[26]

Two of the customers, the Anthonys, agreed to an adjustment for four tax years that increased their tax by $162,064. The deficiency was caused by Martin improperly claiming deductions for, among other things, (1) nondeductible personal expenses, such as "rent" and repairs for their residence, medical expenses, groceries, and utilities; (2) sham charitable contributions; and (3) a sham management fee.[27]

Another customer agreed to IRS proposed adjustments that increased his tax for four

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[23]Declaration of Revenue Agent Arthur Brake ("Brake Declaration") at ¶ 6.

[24]Ventura Declaration at ¶ 16; Brake Declaration at ¶¶ 3-7.

[25]Brake Declaration at ¶¶ 2-3, 10.

[26]Brake Declaration at ¶ 10.

[27]Brake Declaration at ¶ 8; Anthony Declaration at ¶¶ 13-19.

years by more than $149,601. As with the above two customers, Martin prepared returns which claimed deductions for, among other things, (1) nondeductible personal expenses, such as "rent" and repairs for his residence, medical expenses, groceries, utilities, and travel; (2) sham charitable contributions; and (3) a sham management fee.[28]

Defendants' Purported Tax Knowledge and Experience

All three of the individual defendants claim to have tax knowledge and experience. Before forming Tax Strategies in 1997, Anderson owned an H&R Block franchise in LeHigh Acres, Florida. Anderson describes himself as a tax and financial consultant. He claims to have a college degree.[29]

Walters, who purchased Tax Strategies from Anderson in April of 2001, also describes himself as a tax and financial consultant. Walters is the former vice president and current president of that business. He is an IRS enrolled agent. He claims to have a Master's degree. He also claims to be a 25-year member of the Institute of Management Accountants and a member of the International Association of Financial Planners.[30] Anderson and Martin refer to Walters as "the tax law specialist."[31]

Martin is currently the Vice President of Tax Strategies. She holds herself out to be a

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[28]Brake Declaration at ¶ 9.

[29]Ventura Declaration at ¶¶ 22 and 24.

[30]Ventura Declaration at ¶¶ 23 and 24.

[31]Ventura Declaration at ¶ 23.

bookkeeper and tax return preparer. She recently passed the test to be an IRS enrolled.[32]

Defendants' promotional materials include discussions of the tax code and regulations and contains case citations.[33] Indeed, the defendants led the Anthonys to believe that the defendants had done the research to support their schemes.[34] And the defendants told the Anthonys that their trust arrangements "were completely legal."[35]

Harm to the United States

The United States is harmed because the defendants and their customers are fraudulently under-reporting and under-paying the correct amount of taxes. To date, Martin is known to have prepared federal tax returns for at least 30 customers between 1998 and June of 2003.[36] Based on IRS audits of the defendants' customers to date, the IRS has estimated that the defendants' misconduct has so far caused a loss of more than $7.5 million in tax revenue.[37] The monetary harm is even greater because the IRS is forced to devote its limited resources to identifying and recovering this lost revenue from the defendants' customers. Moreover, it may be impossible to identify and audit all of the erroneous federal tax returns prepared by Martin. Consequently, some of these taxes may never be collected, resulting in a permanent loss to the United States Treasury. In addition to the harm caused by the defendants' promotions and fraudulent tax-return

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[32]Ventura Declaration at ¶ 25.

[33]Ventura Declaration at ¶ 11.

[34]Anthony Declaration at ¶ 17.

[35]Anthony Declaration at ¶ 10.

[36]Ventura Declaration at ¶ 17.

[37]Id.

preparation, their activities undermine the integrity of the federal tax system and encourage noncompliance with the internal revenue laws.

Defendants' Recent Activities

The IRS is conducting an investigation of the defendants' illegal activity involving their abusive tax schemes and return preparation. The defendants are aware of the investigation.[38] To date, the defendants continue to provide services relating to their schemes to their current customers, including defendant Anderson's "trustee services" for the customers' sham entities and defendant Martin's return preparation.[39] Although defendant Walters claims that he, Anderson, and Martin are not actively recruiting new customers, he has stated that they will resume promotion of those schemes as soon as the IRS's investigation has ended.[40]

ARGUMENT

A. Standards for Granting a Preliminary Injunction.

Due to the urgent need to halt irreparable harm, "a preliminary injunction is customarily granted on . . . procedures that are less formal and on evidence that is less complete than in a trial on the merits. A party thus is not required to prove his case in full" at the preliminary injunction stage.[41] In a statutory-injunction action such as this, the moving party must demonstrate that the

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[38]Ventura Declaration at ¶¶ 18-20.

[39]Ventura Declaration at ¶ 21.

[40]Ventura Declaration at ¶ 20.

[41] *University of Tex. v. Camenisch*, 451 U.S. 390, 395 (1981). *See Asseo v. Pan Am. Grain Co.*, 805 F.2d 23, 26 (1st Cir. 1986) ("Affidavits and other hearsay materials are often received in preliminary injunction proceedings."). "[I]nasmuch as the grant of preliminary injunction is discretionary, the trial court should be allowed to give even inadmissible evidence some weight

(continued...)

statute has been violated and that "there is a reasonable likelihood of future violations."[42] Because I.R.C. Sections 7407 and 7408 set forth the criteria for injunctive relief, the United States need only meet those criteria, without reference to the traditional equitable factors, for a court to issue a preliminary injunction under these sections.[43] For a preliminary injunction under Section 7402, however, the United States must meet the traditional four-factor test for an injunction by showing that: (1) it is likely that the United States will suffer irreparable injury if the defendant's conduct continues; (2) it is unlikely that the defendant will be harmed by the injunction; (3) the United States is likely to prevail on the merits; and (4) an injunction will serve the public interest.[44]

B. The evidence demonstrates that an injunction should issue under IRC Section 7408.

Section 7408 authorizes a court to enjoin persons from further engaging in conduct

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[41](...continued)
when it is thought advisable to do so in order to serve the primary purpose of preventing irreparable harm before a trial can be held." 11 C. Wright & A. Miller, *Federal Practice & Procedure* § 2949 at 471. *See also Asseo.*, 805 F.2d at 26 ("Affidavits and other hearsay materials are often received in preliminary injunction proceedings. The dispositive question is not their classification as hearsay but whether, weighing all the attendant factors, including the need for expedition, this type of evidence was appropriate given the character and objectives of the injunctive proceeding.").

[42] *S.E.C. v. Holschuh*, 694 F.2d 130, 144 (7th Cir. 1982).

[43] *See United States v. Estate Pres. Servs.*, 202 F.3d 1093, 1098 (9th Cir. 2000) ("The traditional requirements for equitable relief need not be satisfied since Section 7408 expressly authorizes the issuance of an injunction."); *United States v. Rosile*, No. 8:02-CV-466-T-17MSS, 2002 WL 1760861, at *1 (M.D. Fla. June 10, 2002) (issuing a preliminary injunction based on a showing of the statutory requirements under Sections 7407 and 7408).

[44] *Ernst & Whinney*, 735 F.2d at 1301 ("[T]he decision to issue an injunction under § 7402(a) is governed by the traditional factors shaping the . . . use of the equitable remedy.").

subject to penalty under I.R.C. Sections 6700 and 6701 if the court finds that injunctive relief is appropriate to prevent recurrence of such conduct. The record submitted with this motion establishes that the defendants engaged in conduct subject to penalty under I.R.C. Sections 6700 and 6701 in connection with the organization and promotion of their abusive tax schemes described above and Martin's preparation of the tax returns of those customers using the schemes. The record also shows that the defendants will continue to violate I.R.C. Sections 6700 and 6701 absent injunctive relief.

1. Defendants engaged in conduct subject to penalty under Section 6700.

Section 6700 imposes a penalty on a person who organizes or participates in the sale of any plan or arrangement and, in connection therewith, makes or furnishes a statement with respect to the excludability of any income that the person knows or has reason to know is false or fraudulent as to any material matter.[45] The evidence submitted with this motion establishes that the defendants organize and promote abusive tax schemes that advise their customers to create and use sham entities — trusts, LLCs, and private foundations — to eliminate or reduce their federal income and/or self-employment tax liability.

In promoting their schemes, the defendants have made false statements about the tax consequences of the customers' business income and the deductibility of personal expenses, sham charitable contributions, and sham management fees. They falsely advise the customers that taxable business income is nontaxable if: (1) 99 percent of the business interest is "transferred" to the customer's LLC, (2) the LLC "transfers" that interest to the customer's non-grantor trust (which the defendants advise results in 99 percent of the business's taxable income

[45]I.R.C. Section 6700.

flowing through to the trust), and (3) the trust gives all of the business income to the customer's private foundation as a "charitable contribution."

The defendants falsely advise the customers that nondeductible personal living expenses, such as improvements to their residences, meals, and transportation costs, are deductible if the customers: (1) "transfer" their assets, including the residence, to their business trust, (2) become a director of that trust, (3) enter into an "employment contract" with the trust and "agree" to "manage" the business and care for the business assets, which includes the residence, in exchange for compensation and benefits. The defendants further falsely advise that the customer's business trust may eliminate or reduce its income tax by "contributing" up to 100 percent of that income to its sham private foundation.

Martin does "bookkeeping" and prepares returns for Tax Strategies' customers based upon the above advice, and those returns result in substantial understatements of income. Consequently, those customers are subject to large deficiency assessments of tax, penalties, and interest when audited by the IRS.

Courts consider three factors in determining whether the Government has established Section 6700's "knew or had reason to know" standard: (1) the extent of the defendants' reliance on knowledgeable professionals; (2) the defendants' level of sophistication and education; and (3) the defendants' familiarity with tax matters.[46]

Each of the three individual defendants "knew or had reason to know" within the meaning of Section 6700. Anderson has a bachelors degree and describes himself as a tax and financial consultant. He formerly owned and operated a H&R Block franchise. He also formed

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[46] *Estate Pres. Servs.*, 202 F.3d at 1103.

and previously owned Tax Strategies.

Walters currently owns Tax Strategies and serves as its president. He claims to have a Master's degree and holds himself out to be a tax and financial consultant. Indeed, Anderson and Martin refer to him as the "tax law specialist." Walters claims to be a 25-year member of the Institute of Management Accountants and a member of the International Association of Financial Planners.

Martin holds herself out to be a tax return preparer and bookkeeper. She has prepared numerous returns for customers, including the erroneous returns described in this action. She recently passed the test to be an IRS enrolled agent. She serves as Tax Strategies' vice president.

Also, the promotional literature involving the defendants' abusive schemes include discussions of the tax code and regulations and case citations, which demonstrate the defendants' familiarity with tax matters. Additionally, the defendants persuaded the Anthonys that there was a legal basis for their schemes. Because of the claimed educational level of Anderson and Walters and all of the defendants' claimed familiarity with and substantial experience in tax, the defendants knew or had reason to know that their promotional statements concerning the tax consequences of using their schemes were false.

Furthermore, the defendants' false statements made in the course of their promotion were material. A matter is considered to be material if it would have a substantial impact on the decision-making process of a reasonably prudent investor.[47] As evident from the number of Martin-prepared returns audited by the IRS, it is clear that the defendants have been very successful in marketing their abusive schemes. Undoubtedly, their false claims about the tax

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[47] S.Rep. No. 97-494, Vol. 1 at 267 (1982).

benefits obtainable through participation in those schemes have a substantial impact on whether customers participate.

2. Defendants engaged in conduct subject to penalty under Section 6701.

Section 6701 imposes a penalty when a person prepares or assists in the preparation of "any portion of a return, affidavit, claim, or other document" that he "knows (or has reason to believe) will be used in connection with any material matter" under the Internal Revenue Code and that he knows will "result in an understatement of the liability for tax."[48] Martin prepared numerous returns claiming unallowable deductions.[49] She knew that those returns would "be used in connection with [a] material matter." Indeed, she submitted them to report customers' tax liability.[50] Because of Martin's substantial tax preparation experience, she also knew those returns would result in an understatement of liability. Consequently, Martin's conduct is subject to a Section 6701 penalty.

B. The Evidence demonstrates that an Injunction should Issue under IRC Section 7407.

Section 7407 authorizes a court to enjoin a person from acting as a return-preparer if that person has continually or repeatedly: (1) violated Section 6694, which prohibits preparation or submission of a return containing an unrealistic position, or (2) engaged in any other fraudulent or deceptive conduct substantially interfering with the proper administration of the tax laws. In addition, Section 7407 requires the court to find that an injunction prohibiting only specific

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[48] I.R.C. Section 6701.

[49]Brake Declaration at ¶¶ 2-7.

[50]Id.

misconduct would be insufficient to prevent further interference.

1. Defendant Martin engaged in conduct subject to penalty under Section 6694.

The Internal Revenue Code imposes a penalty on an income-tax-return preparer who knows or reasonably should know that a return she prepared understated liability due to a frivolous position for which there was not a realistic possibility of being sustained on the merits. A return preparer is anyone who, for compensation, prepares federal income tax returns, employs someone who prepares federal income tax returns, or "[renders] . . . advice directly relevant to the determination of the existence, characterization, or amount of an entry [on a federal tax return]."[51]

Martin prepared and filed returns for approximately 30 customers claiming improper deductions. Because Martin has substantial tax preparation experience, she knew or should have known that the deductions she was claiming on the customers' returns were frivolous and would result in understatement of liabilities. Moreover, Martin's awareness of the IRS's investigation of herself, Anderson, Walters, and Tax Strategies and the audits of their customers are more than reasonable indications to her that the positions taken on those returns lacked merit. Thus, Martin's violation of Section 6694 warrants an injunction under Section 7407.

2. Injunctive relief is appropriate to prevent recurrence of such conduct.

Martin continues to prepare the returns of current customers reflecting the same frivolous positions for which she is under investigation. Moreover, she vowed to continue preparing returns for those customers and anyone who walks through Tax Strategies' doors. Defendant

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[51] *United States v. Savoie*, 594 F. Supp. 678, 683-84 (W.D.La. 1984)(citing 26 C.F.R. § 301.7701-15(b)(1). *See also* 26 U.S.C. Section 7701(a)(36); *Goulding v. United States*, 957 F.2d 1420, 1424-25 (7th Cir. 1992).

Walters has stated that once the IRS's investigation of him, Anderson, and Martin has ended, they will continue to promote their abusive tax schemes. Consequently, the number of frivolous returns prepared by Martin will increase. Because the IRS does not have the resources needed to monitor all future returns that Martin prepares and files, a narrow injunction only prohibiting Martin from preparing frivolous returns will not be sufficient to prevent further violations of Section 6694. Therefore, broader injunctive relief is necessary to prevent Martin from preparing returns for any third party.

C. The Evidence demonstrates that an Injunction should Issue under I.R.C. Section 7402 (a).

Section 7402(a) of the I.R.C. authorizes this Court to issue an injunction "as may be necessary or appropriate for the enforcement of the internal revenue laws." Section 7402(a) confers upon district courts "a broad range of powers to necessary compel compliance with the tax laws" even in instances "when such interference does not violate any particular tax statute."[52] For a preliminary injunction under Section 7402(a) to issue, the Eleventh Circuit requires a showing that: (1) it is likely that the United States will suffer irreparable injury if the defendant's conduct continues; (2) it is unlikely that the defendant will be harmed by the injunction; (3) the United States is likely to prevail on the merits; and (4) an injunction will serve the public interest.[53]

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[52] *Ernst & Whinney*, 735 F.2d at 1300.

[53] *Id.* at 1301 ("[T]he decision to issue an injunction under § 7402(a) is governed by the traditional factors shaping the . . . use of the equitable remedy."); *Am. Red Cross v. Palm Beach Blood Bank, Inc.*, 143 F.3d 1407, 1410 (11th Cir. 1998) (listing the equitable factors for a preliminary injunction).

1. The United States will suffer irreparable harm absent an injunction.

The defendants have promoted and marketed abusive tax schemes, which resulted in false and fraudulent statements being made to the public. Defendant Martin has prepared erroneous returns for those customers who purchased the abusive schemes. As shown earlier, the defendants' conduct has caused significant revenue losses to the United States Treasury — estimated to be more than $7.5 million dollars. The IRS will have to devote substantial time and resources simply to detect future customers' returns, and it may be unable to detect all of them. The IRS will also have to devote resources to audit these federal tax returns and to collect deficiencies from the defendants' customers.

Defendant Walters has said that he, Anderson, and Martin will continue promoting their abusive schemes. Likewise, defendant Martin made it clear that she currently does and will persist in preparing returns for the customers using the schemes. And defendant Anderson vowed to continue providing "trustee services" to the customers' sham entities. Therefore, absent an injunction, the Government will continue losing money as a result of the defendants' promotions and fraudulent tax-return preparation. Additionally, the defendants' activities undermine the integrity of the federal tax system and encourage noncompliance with the internal revenue laws. Thus, the only adequate and effective remedy would be enjoining the defendants' conduct.

2. Any harm to defendants is slight compared to United States' harm.

The need to remedy the sizeable injury suffered by the United States outweighs any harm the defendants may suffer if an injunction is issued. The requested injunction is tailored to prevent the defendants from causing further irreparable injury. Additionally, an injunction would

prevent the defendants from further violating the law, which benefits them long term. Preliminary injunctions of this nature are typically granted.[54]

3. The United States is likely to prevail on the merits.

The defendants' customers use the abusive tax schemes to deduct sham charitable contributions, sham management fees, and such clearly non-deductible personal living expenses as "rent" and repairs for the customers' residence, medical expenses, groceries, utilities, and travel. The IRS has audited several of those customers, who have agreed to pay the United States Treasury over $500,000 in back taxes based on the defendants' abusive schemes. Thus, the United States is very likely to prevail on the merits of this case.

4. An injunction will serve the public interest.

If a preliminary injunction is granted, it will help to stem the spread of the defendants' abusive schemes and the preparation of defendant Martin's tax returns based on their schemes. A preliminary injunction will help protect people from paying significant sums for harmful tax advice and from paying tax penalties resulting from filing frivolous returns—by halting their promotion at its source. And the "collection of taxes certainly serves the public interest."[55]

D. Other Requested Affirmative Relief under Section 7402(a)

Under the broad powers of Section 7402(a), the Court should grant affirmative relief to remedy the harm the defendants have caused as a result of their promotions and fraudulent tax-return preparation. This Court has not hesitated to grant various types of affirmative relief under

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[54] *Dunlop v. Davis*, 524 F.2d 1278, 1281 (5th Cir. 1975) (stating that injunctions requiring people to follow the law do not cause hardship).

[55] *United States v. Mathewson*, No. 92-1054-CIV, 1993 WL 113434, at *2 (S.D. Fla. Feb. 25, 1993).

this provision.[56]

In accordance with Section 7402(a), the United States requests the Court to order the defendants to contact by mail all customers who have purchased their current and any former abusive tax promotions, inform those customers of the Court's findings in this case, and attach a copy of the preliminary injunction against them. This type of affirmative relief is necessary to inform the defendants' current customers of the illegality of the defendants' abusive tax schemes. This will provide the current customers an opportunity to voluntarily correct any tax returns submitted to the IRS. In turn, the IRS will not be forced to use its limited resources to detect and audit these frivolous returns. In addition, the current customers will be discouraged from any further participation in the defendants' tax schemes.

The United States also asks the Court to order that the defendants produce to the United States any records in their possession or to which they have access, identifying by name, taxpayer-identification number, address, telephone number, and e-mail address all individuals and entities: (1) to whom they sold or distributed, either directly or indirectly, their current or

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[56] *See United States v. Bosse*t, No. 8:01-CV-2154-T-17TBM, 2003 WL 1735481, at *3 (M.D. Fla. Feb. 27, 2003) (ordering promoter of abusive tax scheme to notify all customers in writing of: (1) the injunction, (2) his false or frivolous tax positions, (3) the falsity of the tax returns he prepared for them, and (4) the possibility that penalties will be imposed against them and that the United States may seek to recover any erroneous tax refund received); *United States v. Mayer*, No. CIV8:03CV415T26TGW, 2003 WL 1950079, at *1 (M.D. Fla. Feb. 20, 2003) (requiring promoter to provide client list); *Rosile*, 2002 WL 1760861 at *3 (ordering promoter to provide client list and copies of all tax returns promoter prepared or for which he provided assistance); *United States v. Sweet*, No. 8:01-CV-331-T-23TGW, 2002 WL 963398, at *2 (M.D. Fla. Feb. 20, 2002) (ordering promoters to provide client list and all records of abusive promotion customers).

past abusive schemes; or (2) for whom they have prepared federal tax returns.[57] This relief is needed to keep the IRS from spending its limited resources to get information that the defendants readily have in their possession. The IRS needs this information so that it can attempt to audit any returns of these individuals or entities, and recover additional tax revenue.

CONCLUSION

Defendants' activities have caused and are causing substantial harm—to their clients, to the Government, and to law-abiding taxpayers who pay their properly reported taxes. As demonstrated above, the United States is entitled to the relief it seeks—a preliminary injunction that: (1) bars the defendants from further promoting their abusive tax schemes; (2) bars defendant Martin from preparing federal tax returns; (3) requires the defendants to inform current customers by mail that their abusive schemes are illegal; and (4) provide the United States the names of persons or entities for which they have sold their abusive tax schemes or prepared tax returns. Because of the serious nature of the harm caused, the government requests an expedited

[57]Although defendant Martin has provided the IRS a list of the customers for whom she has prepared tax returns, she should be required to update that list from June 20, 2002.

hearing on this motion to prevent further harm while this case is litigated.

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