

Case No. 06-53883
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12 IN THE UNITED STATES DISTRICT COURT FOR THE
13 NORTHERN DISTRICT OF CALIFORNIA
14 SAN FRANCISCO DIVISION

EMC

15 UNITED STATES OF AMERICA,

16 Plaintiff,

17 v.

18 WILLIAM J. KENNEDY, individually and
d/b/a AMERICAN LEGAL SERVICES and the
19 EAR OF MALCHUS,

20 Defendant.

C Case No. **06 53883**

**COMPLAINT FOR PERMANENT
INJUNCTION AND OTHER
EQUITABLE RELIEF**

21 The United States of America, plaintiff, for its Complaint states as follows.

22 **Nature of Action**

23 1. The United States brings this complaint to enjoin William J. Kennedy, individually
24 and doing business as American Legal Services, the Ear of Malchus, or any other entity, and any
25 persons in active concert or participation with him, from directly or indirectly engaging in
26 conduct subject to penalty under 26 U.S.C. (I.R.C. or "Code") § 6700, including making or
27

1 furnishing, in connection with the organization or sale of any shelter, plan, or arrangement, a
2 statement he knows or has reason to know is false or fraudulent as to any material matter under
3 the federal tax laws; and from violating any other provision of the internal revenue laws.

4 **Jurisdiction**

5 2. Jurisdiction is conferred on this Court by 28 U.S.C. §§ 1340 and 1345, and I.R.C.
6 §§ 7402(a) and 7408.

7 **Authorization**

8 3. This action has been requested by a delegate of the Secretary of Treasury and
9 commenced at the direction of a delegate of the Attorney General of the United States, pursuant
10 to I.R.C. §§ 7402 and 7408.

11 **Defendant**

12 4. William J. Kennedy resides in Livermore, California.

13 **Defendant's Activities**

14 5. Kennedy conducts business through entities named American Legal Services and the
15 Ear of Malchus.

16 6. Kennedy markets a program or arrangement known as a "corporation sole" as a tax
17 dodge to help participants evade reporting and paying federal income taxes, as well to conceal
18 assets and thereby evade estate taxes and IRS collection efforts. He charges customers \$15,000
19 to \$25,000 to purchase his corporation-sole program.

20 7. Kennedy markets the corporation-sole program through word of mouth, in personal
21 meetings with customers, and on his website.

22 8. Kennedy has promoted his corporation-sole program since least 2003, and he has
23 continued to promote this program despite being notified that he is subject to an I.R.C. §§ 6700
24 and 7408 investigation.

25 9. Corporations sole are authorized under some state laws to enable religious leaders to
26 hold property and conduct business for the benefit of the religious entity (as opposed to the
27 benefit of the individual office holder or entity creator). Rev. Rul. 2004-27, 2004-1 C.B. 625,

1 626. The purpose of a corporation sole is to ensure continuity of ownership of property
2 dedicated to the benefit of a religious organization. By operation of law, title to property that
3 vests in the officeholder as a corporation sole passes to the successors to the office (not to the
4 officeholder's heirs).

5 10. Corporations sole do not bestow a special tax status on their creators. But to induce
6 sales of his corporation-sole program, Kennedy falsely tells customers that his corporations sole
7 provide significant tax advantages and can eliminate or reduce customers' federal tax liabilities.

8 11. In order to receive special tax status, an entity must independently qualify as a
9 religious or charitable organization under I.R.C. § 501(c)(3). As part of the scheme, Kennedy
10 falsely tells customers that his corporations sole do not have to qualify under that statute in order
11 to enjoy tax-exempt status.

12 12. As part of the scheme, Kennedy falsely advises customers that they can treat their
13 corporations sole as a purported church with no tax-filing or tax-paying requirement, and yet can
14 control and use the assets and income of the corporation sole for their own personal benefit.
15 Such use of a bogus church in fact confers no tax benefits.

16 13. Kennedy falsely advises participants that corporations sole that are used for the
17 participants' personal benefit are tax-exempt, do not need to file tax returns of any kind, and do
18 not need to keep records. At promotional meetings, Kennedy boasted that he had not filed a
19 federal income tax return or paid federal taxes in ten years.

20 14. Kennedy falsely advertises that customers who have a corporation sole can assign
21 their income to the entity and thereby transform taxable individual income into nontaxable
22 income of the corporation sole.

23 15. Kennedy falsely states that a corporation sole can be engaged in any occupation,
24 business or profession, and that all earnings therefrom are tax-exempt, and that no tax return
25 need be filed.

26 16. Kennedy also falsely advertises that his corporation-sole scheme can legally
27 eliminate his customers' debts, and that any cancellation-of-indebtedness income will be tax-

1 exempt to the customers. As part of the scheme, Kennedy instructs customers who purchase his
2 corporations sole to borrow money, using their homes as collateral. Kennedy further requires
3 that customers pay him a portion of the loan, which he falsely promises he can legally eliminate
4 using the corporation sole the customer has purchased. As part of the scheme, Kennedy falsely
5 advises his customers that creditors, including the IRS, will be unable to assert a claim against
6 any asset, including the real property securing the loan, if it is titled in the name of a corporation
7 sole.

8 17. Kennedy's promotional literature lists the following purported tax benefits of the
9 corporation-sole program:

- 10 • You can legally generate income without any federal tax reporting requirements.
- 11 • The IRS recognizes a corporation sole as a Section 508 non-profit entity.
- 12 • You can use a corporation sole to pass on all your assets to your family without
13 probate or taxation.
- 14 • You can protect your assets from unnecessary government interference and
15 taxation.
- 16 • Your corporation sole can be used to hold all your property (including homes,
17 automobiles and RV's) and protect it from liens, levies, seizures and confiscation
18 from events arising as a result of your personal actions.
- 19 • You can legally eliminate your debts using a corporation sole, and creditors will
20 be unable to assert a claim over any assets you transfer to a corporation sole.

21 18. Kennedy's statements to customers about the tax benefits associated with the
22 corporations sole are false or fraudulent.

23 19. The effect of Kennedy's corporation-sole promotion is that participants live in the
24 same residence and operate the same business as they did before joining the program. Under the
25 program, participants' living expenses are paid from the participants' earnings—just as before
26 the corporation sole was created. Participants receive the full benefit of, and have full control
27

1 over, all corporation-sole funds. The only substantive change in the participants' regular
2 business and lifestyle activities is the purported benefit of no taxation.

3 20. The corporations sole that Kennedy markets are operated for the benefit of the owner,
4 are devoid of economic substance and are shams for federal tax purposes. The program
5 constitutes an improper assignment of income and a fraudulent transfer of assets.

6
7 **Defendant's Knowledge of the Falsity
of the Tax Benefits of His Tax-Fraud Schemes**

8 21. Kennedy holds himself out as a tax expert by marketing corporations sole and
9 promoting their alleged tax benefits, and therefore he knows or should have known that the tax-
10 fraud scheme promotes by the American Legal Services and Ear of Malchus were unlawful.

11 22. Kennedy knows or should have known that the corporation-sole program is identified
12 in the IRS's annual consumer alert of tax scams that taxpayers are urged to avoid for 2004-2005.
13 IRS information related to this scam is available at
14 www.irs.gov/newsroom/article/0,,id=136337,00.html.

15 23. Kennedy knows or should have known that federal courts have permanently barred other
16 persons from promoting similar corporation-sole tax-fraud schemes, such as *United States v. Lloyd*,
17 case no. 1:04CV00274 (December 6, 2005, M.D. N.C.), and *United States v. Blackstock*, case no.
18 04-cv-253-TCK (March 21, 2005, N.D. Okla.). Those court orders are available at
19 <http://www.usdoj.gov/tax/txdv05657.htm> and <http://www.usdoj.gov/tax/txdv05142.htm>.

20 24. At the time Kennedy was marketing his tax-fraud scheme he knew or should have
21 known the purported tax benefits of the corporations sole that he sold were false because:

- 22 a. Kennedy purchased his corporation sole, the Ear of Malchus, from Joseph O.
23 Saladino.
- 24 b. The United States filed a complaint seeking to bar Joseph O. Saladino from
25 preparing returns, and promoting corporation-sole and "claim of right" tax-fraud
26 schemes on March 29, 2004.

1 c. On October 18, 2004, the District Court for the Central District of California
2 preliminarily enjoined Saladino from promoting the corporation sole tax-fraud
3 scheme. A permanent injunction against Saladino was entered on January 25,
4 2005. *United States v. Saladino*, case no. 2:04cv2100-FMC (C.D. Cal.). The
5 court order barring Saladino from promoting the corporation-sole scheme is
6 available at <http://www.usdoj.gov/tax/txdv05030.htm>.

7 d. The court order required that Saladino notify his customers, including Kennedy,
8 of the injunction barring the him from selling the corporation-sole scheme, and
9 file a certificate of compliance that he had done so.

10 e. Saladino filed with the District Court on March 7, 2005, a certificate of
11 compliance stating, among other things, that he had sent his customers copies of
12 the injunction barring him from selling the corporation-sole tax-fraud scheme.

13 f. On information and belief, Kennedy received the notification from Saladino, yet
14 continued to sell the corporation-sole tax-fraud scheme.

15 25. Kennedy knows or has reason to know that his corporation-sole tax-fraud scheme is
16 unlawful because he was contacted by the IRS in September 2005, as part of its investigation.
17 Kennedy continued to promote his tax-fraud scheme, however, and sold at least 5 additional
18 corporations sole after being notified of this investigation by the IRS.

19 26. Kennedy refused to cooperate with the IRS during the course of the investigation by
20 sending the IRS correspondence claiming he could ignore requests for information, including
21 summonses, and instructing customers not to respond to IRS inquiries.

22 **Harm to the Government**

23 27. The tax-fraud scheme promoted and marketed by Kennedy through American Legal
24 Services and the Ear of Malchus harms the government by fraudulently reducing customers'
25 reported tax liabilities.

1 28. The IRS estimates that Kennedy's tax-fraud scheme results in an annual loss to the
2 United States Treasury of \$500,000, because his customers either fail to file returns or file returns
3 that misreport taxable income as tax-exempt income.

4 29. The Internal Revenue Service is harmed because it must dedicate scarce resources to
5 detecting and examining inaccurate returns filed by defendant's customers, to preparing
6 substitute returns for customers failing to file tax returns, and to attempting to recover unpaid
7 taxes.

8 30. Defendant's background and extensive involvement in the corporation-sole tax-fraud
9 scheme indicate that the misconduct described in this complaint or other similar misconduct is
10 likely to recur unless he is permanently enjoined.

11 **Count I: Injunction under I.R.C. § 7408 for violations of I.R.C. § 6700**

12 31. The United States incorporates by reference the allegations contained in paragraphs 1
13 through 30.

14 32. Section 7408 authorizes a court to enjoin persons who have engaged in conduct
15 subject to penalty under I.R.C. § 6700 from engaging in further such conduct or any other
16 conduct subject to penalty under the Code.

17 33. Section 6700 imposes a penalty on any person who organizes or sells a plan or
18 arrangement and in connection therewith makes a statement with respect to the allowability of
19 any deduction or credit, the excludability of any income, or the securing of any tax benefit by
20 participating in the plan or arrangement that the person knows or has reason to know is false or
21 fraudulent as to any material matter.

22 34. In organizing and selling his corporation-sole program, Kennedy makes statements
23 regarding the tax benefits associated with participation in the program that he knows are false or
24 fraudulent as to material matters within the meaning of I.R.C. § 6700.

25 35. Unless enjoined by this Court, Kennedy is likely to continue to organize and sell his
26 corporation-sole program and other tax-fraud programs.

1 **Count II: Injunction under I.R.C. § 7402**

2 36. The United States incorporates by reference the allegations contained in paragraphs 1
3 through 35.

4 37. Section 7402 authorizes courts to issue injunctions as may be necessary or
5 appropriate for the enforcement of the internal revenue laws.

6 38. Kennedy, through the actions described above, has engaged in conduct that interferes
7 substantially with the administration and enforcement of the internal revenue laws.

8 39. Kennedy's conduct results in irreparable harm to the United States for which the
9 United States has no adequate remedy at law. Kennedy's conduct is causing and will continue to
10 cause substantial revenue losses to the United States Treasury, much of which may be
11 unrecoverable.

12 40. Unless Kennedy is enjoined, the IRS will have to devote substantial time and
13 resources to identifying and locating his customers, and then examining those persons' tax
14 liabilities. The burden of pursuing individual customers may be an insurmountable obstacle,
15 given the IRS's limited resources.

16 41. If Kennedy is not enjoined, he likely will continue to engage in conduct that obstructs
17 and interferes with the enforcement of the internal revenue laws.

18 **Relief Sought**

19 WHEREFORE, plaintiff the United States of America respectfully prays for the
20 following:

21 A. That the Court find that Kennedy has engaged in conduct subject to penalty under
22 I.R.C. § 6700, and that injunctive relief is appropriate under I.R.C. § 7408 to prevent Kennedy,
23 and any business or entity through which he operates, and anyone acting in concert with him,
24 from engaging in further such conduct;

25 B. That the Court find that Kennedy has engaged in conduct that interferes with the
26 enforcement of the internal revenue laws, and that injunctive relief against Kennedy, and any
27 business or entity through which he operates, and anyone acting in concert with him, is

1 appropriate to prevent the recurrence of that conduct pursuant to the Court's powers under I.R.C.
2 § 7402(a);

3 C. That the Court, pursuant to I.R.C. §§ 7402 and 7408, enter a permanent injunction
4 prohibiting Kennedy, individually and doing business as the American Legal Services, the Ear of
5 Malchus, or any other entity, and his representatives, agents, servants, employees, attorneys, and
6 those persons in active concert or participation with his, from directly or indirectly:

- 7 (1) Organizing, promoting, marketing, or selling any tax shelter, plan or arrangement
8 that advises or assists customers to attempt to violate the internal revenue laws or
9 unlawfully evade the assessment or collection of their federal tax liabilities,
10 including his corporation-sole program;
- 11 (2) Making false statements about the allowability of any deduction or credit, the
12 excludability of any income, or the securing of any tax benefit by reason of
13 participating in any tax shelter, plan or arrangement, including the false statements
14 about his corporation-sole scheme described in the complaint;
- 15 (3) Instructing, assisting, or advising or assisting others to violate the tax laws,
16 including to evade the payment of taxes;
- 17 (4) Engaging in conduct subject to penalty under I.R.C. § 6700, *i.e.*, by making or
18 furnishing, in connection with the organization or sale of any plan, or
19 arrangement, a statement Kennedy knows or has reason to know to be false or
20 fraudulent as to any material matter under the federal tax laws; and
- 21 (5) Engaging in any other conduct that interferes with the administration and
22 enforcement of the internal revenue laws; and
- 23 (6) Engaging in any activity subject to penalty under any other section of the Code.

24 D. That this Court, pursuant to I.R.C. § 7402, enter an injunction requiring Kennedy to
25 contact by mail (or by e-mail, if a mailing address is unknown) all persons and entities who have
26 previously purchased his corporation-sole scheme or any other plans, arrangements or programs,
27 and inform those persons and entities of the Court's findings concerning the falsity of Kennedy's

1 prior representations and attach a copy of the permanent injunction against Kennedy, and to file
2 with the Court, within 20 days of the date the permanent injunction is entered, a certification
3 signed under penalty of perjury stating that he has done so;

4 E. That this Court, pursuant to I.R.C. § 7402(a), order defendant and his representatives,
5 agents, servants, employees, attorneys, and those persons in active concert or participation with
6 him to remove from defendant's website and those websites over which he has control, all tax-
7 fraud-scheme promotional materials, false commercial speech regarding the internal revenue
8 laws, and speech likely to incite others imminently to violate the internal revenue laws; to display
9 prominently on the first page of those websites a complete copy of the permanent injunction; and
10 to maintain those websites for one year with a complete copy of the Court's permanent injunction
11 so displayed throughout that time

12 F. That this Court, pursuant to I.R.C. § 7402, enter an injunction requiring Kennedy to
13 produce to counsel for the United States his complete customer list, including the names,
14 addresses, e-mail addresses, telephone numbers, and social security or tax identification numbers,
15 of all persons and entities who have purchased his corporation-sole scheme or any other tax
16 plans, arrangements or programs, and to file with the Court, within 20 days of the date the
17 permanent injunction is entered, a certification that he has done so;

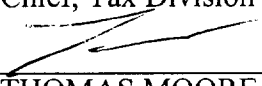
18 G. That this Court order that the United States is permitted to engage in post-judgment
19 discovery to ensure compliance with the permanent injunction;


20 H. That this Court retain jurisdiction over this action for purposes of implementing and
21 enforcing the final judgment; and

1 I. That the Court grant the United States such other and further relief as the Court deems
2 proper.

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