

UNITED STATES DISTRICT COURT  
EASTERN DISTRICT OF NEW YORK

UNITED STATES OF AMERICA, )  
)  
Plaintiff, )  
)  
v. )  
)  
ARCHIE J. PUGH, JR., and )  
THEODORE PUGH, each )  
individually and d/b/a ARCHIE'S TAX )  
& ACCOUNTING SERVICE, )  
)  
Defendants. )

CV 07 2456

GARAUFIS, J.

Civil Action No. POHORELSKY, M.J.

U.S. DISTRICT COURT  
EASTERN DISTRICT OF NEW YORK

JUN 10 2007  
BROOKLYN OFFICE

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**COMPLAINT FOR PERMANENT INJUNCTION AND OTHER RELIEF**

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

**Nature of Action**

1. The United States brings this complaint to enjoin Archie J. Pugh, Jr., and Theodore Pugh, each individually and doing business as Archie's Tax and Accounting Service or through any other entity, and any other persons in active concert or participation with them, from directly or indirectly:

- (a) Organizing, promoting, marketing, or selling any tax shelter, plan or arrangement that advises or incites customers to attempt to violate the internal revenue laws or unlawfully evade the assessment or collection of their federal tax liabilities;
- (b) Making false or fraudulent statements about the securing of any tax benefit by the reason of participating in any tax plan or arrangement, including the false statements that individuals can obtain tax freedom by participating in their program and that wages or compensation for labor constitutes nontaxable income;
- (c) Instructing, advising and assisting others to violate the tax laws, including to evade the payment of taxes;

- (d) Engaging in conduct subject to penalty under 26 U.S.C. § 6694, including preparing a return or claim for refund that includes an unrealistic or frivolous position;
- (e) Engaging in conduct subject to penalty under 26 U.S.C. § 6695, including failing to furnish their customer list upon request of the Internal Revenue Service;
- (f) Engaging in conduct subject to penalty under 26 U.S.C. § 6700, including making or furnishing, in connection with the organization or sale of a shelter, plan, or arrangement, a statement the defendant knows or has reason to know to be false or fraudulent as to any material matter under the federal tax laws;
- (g) Engaging in conduct subject to penalty under 26 U.S.C. § 6701, *i.e.*, 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 the defendant knows will (if so used) result in the understatement of another person's tax liability;
- (h) Providing any tax advice or services for compensation, including preparing or assisting in the preparation of tax returns for any other person or entity, providing consultative services, or representing any persons or entities before the Internal Revenue Service in any manner, either directly or indirectly; and
- (i) Engaging in any conduct that interferes with the administration and enforcement of the internal revenue laws, including filing frivolous administrative tort claims against the Federal Government or its employees.

2. An injunction is warranted based on the defendants' continuing conduct as promoters of a tax-fraud scheme and preparers of frivolous federal income tax returns. If they are not enjoined, the defendants' continuing actions will result in the Internal Revenue Service having to devote scarce resources to pursue and investigate the defendants' customers, who by participation in the defendants' scheme have filed erroneous federal income tax returns and stopped paying the correct amount of federal income taxes. The defendants' actions, if not stopped, may result in penalties and other civil and criminal sanctions being imposed on those customers.

### **Jurisdiction and Venue**

3. Jurisdiction is conferred on this Court by 28 U.S.C. §§ 1340 and 1345, and §§ 7402(a), 7407 and 7408 of the Internal Revenue Code of 1986 (26 U.S.C.; the “Code”).

4. Archie J. Pugh, Jr., and Theodore Pugh are brothers who conduct business at 136-17 Thurston Street, Jamaica, New York, within this judicial district.

5. Venue is proper in this Court pursuant to 28 U.S.C. § 1391.

### **Authorization**

6. This action has been requested by the Chief Counsel of the Internal Revenue Service, a delegate of the Secretary of Treasury, and commenced at the direction of a delegate of the Attorney General of the United States, pursuant to Code §§ 7402, 7407 and 7408.

### **Defendants’ Activities**

7. The defendants are involved in marketing the so-called “Claim of Right” tax-evasion scheme under which all compensation or earnings are falsely deemed nontaxable. The defendants promote a grossly inaccurate interpretation of tax law and prepare returns and pursue litigation in accordance with their fraudulent programs.

8. Defendants also prepare income tax returns for customers based on the fraudulent Claim of Right program.

9. Defendants market the Claim of Right program by word of mouth to customers of Archie’s Tax and Accounting Service, which has been owned by Archie J. Pugh, Jr., since 1980.

10. Defendants charge customers \$250 to have the Claim of Right tax returns prepared.

11. Defendants falsely tell their customers that they have a common-law and

constitutional right (under the Fourteenth Amendment to the United States Constitution) to exclude from taxation all compensation for personal services or labor rendered.

12. Defendants falsely state that I.R.C. § 1341 codifies this so-called common-law or constitutional right and entitles their customers to take a deduction in the amount of compensation earned, which in most cases eliminates a participant's tax liability. Defendants state that this can be done by claiming an itemized deduction to offset wages reported on W-2 forms, or by taking a Schedule C deduction to offset any net income from self-employment.

13. The defendants make numerous false or fraudulent statements in support of their abusive program, including the following:

- Compensation earned is immune from taxation.
- Money earned in exchange for personal labor or services does not constitute taxable income and may be deducted.
- Income earned for labor is a not for profit activity and thus deductible on tax returns.
- Their "claim of right" claim is a "mandatory deduction allowed by United States law."

14. Defendants' claims regarding the tax benefits associated with their Claim of Right program are false. In addition, the tax returns defendants have prepared based on the Claim of Right tax-evasion scheme are fraudulent, and understate their customers' income based on this false, discredited concept.

15. The IRS has identified over 82 frivolous federal tax returns prepared by defendants for the years 2000-2005.

16. The IRS has requested from the defendants a complete list of customers for whom the defendants have prepared income tax returns, but the defendants have refused to provide such list.

17. In most cases, defendants do not sign the Claim-of-Right tax returns they prepare. However, defendants' customers have identified defendants as the individuals who prepared the fraudulent Claim of Right tax returns.

18. Moreover, defendants have prepared and filed many Claim-of-Right tax returns on behalf of customers without first showing the return to the customer.

19. The IRS has notified the defendants that their program is under investigation, and that their conduct is subject to penalty under Code §§ 6694, 6700 and 6701 and subject to injunction under Code §§ 7402, 7407 and 7408.

**Defendants' Knowledge of the Falsity  
of the Claimed Tax Benefits of Their Tax-Fraud Schemes**

21. Defendants hold themselves out as tax experts in marketing the Claim of Right program and promoting the alleged tax benefits. They know or have reason to know that the tax-fraud scheme they promote is unlawful and that their statements to customers about the scheme's tax benefits are false.

22. Defendants know or have reason to know that the Claim of Right program has been identified in the IRS's consumer alert of the "Dirty Dozen" tax scams that taxpayers should avoid. IRS information related to this scam is available at [www.irs.gov/newsroom/article/0,,id=136337,00.html](http://www.irs.gov/newsroom/article/0,,id=136337,00.html).

23. Defendants know or have reason to know that federal courts have permanently

enjoined other persons from promoting similar Claim of Right tax-fraud schemes, such as *United States v. Lloyd*, case no. 1:04CV00274 (December 6, 2005, M.D. N.C.), and *United States v. Blackstock*, case no. 04-cv-253-TCK (March 21, 2005, N.D. Okla.). Those court orders are available at <http://www.usdoj.gov/tax/txdv05657.htm> and <http://www.usdoj.gov/tax/txdv05142.htm>.

### **Harm to the Public**

20. Defendants' customers have been harmed by the defendants' fraudulent income tax return preparation because the customers have paid defendants significant sums to in order to have worthless false tax returns prepared. Moreover, those customers filing the fraudulent Claim of Right tax returns may be subject to civil and criminal penalties for the false returns.

21. The United States is harmed because defendants' customers are not paying their correct taxes to the United States Treasury. Moreover, given the IRS's limited resources, identifying and recovering all revenues lost from defendants' abusive schemes may be impossible, resulting in a permanent loss to the Treasury.

22. Thus far the IRS has identified over \$2.4 million of erroneous refunds issued based on the false and fraudulent income tax returns prepared by defendants.

23. The public is harmed because the IRS is forced to devote its limited resources to identifying and attempting to recover revenue lost as a result of defendants' schemes.

24. In addition to the harm caused by defendants' advice and services, defendants' activities undermine public confidence in the fairness of the federal tax system and incite violations of the internal revenue laws.

**Count I: Injunction under Code § 7407 for violations of Code §§ 6694 and 6695**

25. The United States incorporates herein by reference the allegations and averments in paragraphs 1 through 24.

26. Code § 7407 authorizes a court to enjoin an income tax return preparer if, *inter alia*, the court finds that the return preparer has engaged in conduct subject to penalty under Code §§ 6694 or 6695, and that injunctive relief is appropriate to prevent the recurrence of the conduct.

27. Code § 6694 imposes penalties on income tax return preparers who prepare returns that contain frivolous positions, or who willfully understate the tax liability of another person.

28. The defendants have engaged in conduct subject to the Code § 6694 penalty because they have willfully prepared or assisted in preparing returns that understated the tax liability of other persons. The defendants prepare federal income tax returns (Forms 1040) based on false and fraudulent theories, such as their “claim of right” theory. The defendants knew or had reason to know that the so-called Claim of Right deduction is a frivolous position with no realistic possibility of being sustained on the merits.

29. Code § 6695(a) penalizes a return preparer who fails to furnish a completed copy of a customer’s income tax return before it is signed and filed. *See* IRC § 6695(a) & 6107(a).

30. By filing copies of the Claim of Right tax returns without showing their customers a copy, defendants have engaged in conduct subject to penalty under Section 6695(a).

31. Code 6695(b) penalizes a return preparer who fails to sign the income tax returns he prepares.

32. Defendants prepared, but failed to sign many of the fraudulent Claim of Right tax returns they prepared. Thus, defendants have repeatedly and continually engaged in conduct subject to penalty under Section 6695(b).

33. Code § 6695(c) imposes penalties on income tax return preparers who refuse to provide a copy of their customer list on request of the IRS.

34. The IRS has requested from the defendants a list of customers for whom the defendants have prepared income tax returns but defendants failed to do provide the list. The defendants have engaged in conduct subject to the Code § 6695 penalty because they have refused to provide such list to the IRS.

35. Code § 7407 also authorizes a court to enjoin an income tax return preparer if the court finds (i) that the return preparer has engaged in any fraudulent or deceptive conduct that substantially interferes with the proper administration of the internal revenue laws, and (ii) that injunctive relief is appropriate to prevent the recurrence of the conduct.

36. The defendants have engaged in fraudulent or deceptive conduct that substantially interferes with the proper administration of the internal revenue laws by, among other things, filing false and fictitious returns or amended returns based on wholly unrealistic positions.

37. Because of the defendants' continued and repeated conduct subject to injunction under Code § 7407 they should be permanently enjoined from acting as income tax preparers and from engaging in conduct that substantially interferes with the proper administration of the internal revenue laws.

**Count II: Injunction under Code § 7408 for violations of Code §§ 6700 and 6701**

38. The United States incorporates by reference the allegations contained in paragraphs 1



through 37.

39. Code § 7408 authorizes a court to enjoin persons who have engaged in conduct subject to penalty under Code §§ 6700 or 6701 from engaging in further such conduct.

40. Code § 6700 imposes a penalty on any person who organizes or sells a plan or arrangement and in so doing makes a statement with respect to the allowability of any deduction or credit, the excludability of any income, or the securing of any tax benefit by participating in the plan or arrangement that the person knows or has reason to know is false or fraudulent as to any material matter.

41. Code § 6701 imposes a penalty on any person who aids in or advises with respect to the preparation of any portion of a tax return or other document that the person knows or has reason to believe will be used in connection with a material matter under the internal revenue laws, and that the person knows would result in an understatement of another person's tax liability.

42. The defendants organize and sell a fraudulent tax scheme — namely, their Claim of Right program. In organizing and selling the scheme, the defendants make statements regarding the tax benefits associated with participation in the scheme that they know or have reason to know are false or fraudulent as to material matters within the meaning of Code § 6700. The defendants have therefore engaged in conduct subject to penalty under Code § 6700.

43. The defendants aid or assist in, or advise with respect to, the preparation of tax returns or other documents, knowing (or having reason to believe) that such documents would be used in connection with a material matter arising under the internal revenue laws. The defendants know that the documents, if so used, will result in the understatement of the

participant's tax liability. The defendants have therefore engaged in conduct subject to penalty under § 6701.

44. The defendants have persisted in promoting their fraudulent tax scheme after being advised that their conduct was subject to penalty under Code §§ 6700 or 6701, and subject to injunction under Code § 7408.

45. Unless enjoined by this Court, the defendants are likely to continue to organize and sell their fraudulent tax scheme, and to prepare tax returns or other documents that they know will result in the understatement of tax liability.

### **Count III: Injunction under Code § 7402**

46. The United States incorporates by reference the allegations contained in paragraphs 1 through 45.

47. Code § 7402 authorizes courts to issue injunctions as may be necessary or appropriate for the enforcement of the internal revenue laws.

48. The defendants, through the actions described above, have engaged in conduct that interferes substantially with the administration and enforcement of the internal revenue laws.

49. The defendants' conduct results in irreparable harm to the United States and the United States has no adequate remedy at law. The defendants' conduct is causing and will continue to cause substantial revenue losses to the United States Treasury, much of which may be unrecoverable.

50. Unless the defendants are enjoined, the IRS will have to devote substantial time and resources to identify and locate their customers, and then construct and examine those persons' tax returns and liabilities. The burden of pursuing individual customers may be an

insurmountable obstacle, given the IRS's limited resources.

51. If the defendants are not enjoined, they likely will continue to engage in conduct that obstructs and interferes with the enforcement of the internal revenue laws.

### **Relief Sought**

WHEREFORE, the United States prays for the following relief:

A. That the Court find that the defendants, individually and doing business as Archie's Tax and Accounting Service, have engaged in conduct subject to penalty under Code §§ 6694, 6695, 6700 and 6701, and that injunctive relief is appropriate under Code §§ 7407 and 7408 to prevent the defendants, and any business or entity through which they operate, and anyone acting in concert with them, from further engaging in such conduct;

B. That the Court find that the defendants, individually and doing business as Archie's Tax and Accounting Service, have engaged in conduct that interferes with the enforcement of the internal revenue laws, and that injunctive relief against the defendants, and any business or entity through which they operate, and anyone acting in concert with them, is appropriate to prevent the recurrence of that conduct pursuant to the Court's powers under Code § 7402(a);

C. That the Court, pursuant to Code §§ 7402, 7407 and 7408, enter a permanent injunction prohibiting the defendants, individually and doing business through any other entity, and their representatives, agents, servants, employees, attorneys, and those persons in active concert or participation with them, from directly or indirectly:

- (1) Organizing, promoting, marketing, or selling any tax shelter, plan or arrangement that advises or incites customers to attempt to violate the internal revenue laws or unlawfully evade the assessment or collection of their federal tax liabilities;
- (2) Making false or fraudulent statements about the securing of any tax benefit by the

reason of participating in any tax plan or arrangement, including the false statements that individuals can obtain tax freedom by participating in their program and that wages or compensation for labor constitutes nontaxable income;

- (3) Encouraging, instructing, advising and assisting others to violate the tax laws, including to evade the payment of taxes;
- (4) Engaging in conduct subject to penalty under 26 U.S.C. § 6694, including preparing a return or claim for refund that includes an unrealistic or frivolous position;
- (5) Engaging in conduct subject to penalty under 26 U.S.C. § 6695, including failing to furnish their customer list upon request of the Internal Revenue Service;
- (6) Engaging in conduct subject to penalty under 26 U.S.C. § 6700, *i.e.*, by making or furnishing, in connection with the organization or sale of a shelter, plan, or arrangement, a statement the defendant knows or has reason to know to be false or fraudulent as to any material matter under the federal tax laws;
- (7) Engaging in conduct subject to penalty under 26 U.S.C. § 6701, *i.e.*, 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 the defendant knows will (if so used) result in the understatement of tax liability;
- (8) acting as federal income tax return preparers, or providing any tax advice or services for compensation, including preparing or filing, or assisting in preparing or filing tax returns for any other person or entity, providing consultative services, or representing any persons or entities before the Internal Revenue Service in any manner, either directly or indirectly; and
- (9) Engaging in any conduct that interferes with the administration and enforcement of the internal revenue laws.

D. That the Court, pursuant to Code §§ 7402 and 7407, enter an injunction requiring the defendants to provide to counsel for the United States a list identifying (with names, mailing and e-mail addresses, phone numbers and social security or taxpayer-identification numbers) all persons and entities for whom they have prepared any federal income tax returns, amended returns, or refund claims since December 31, 2001, and all individuals or entities who

participated in their Claim of Right program, or any other tax-related shelter, plan or arrangement;

E. That the Court, pursuant to Code §§ 7402 and 7407, enter an injunction requiring the defendants to turn over to the United States copies of all federal tax returns, amended returns, or refund claims prepared by them after December 31, 2001;

F. That the Court, pursuant to Code § 7402, enter an injunction requiring the defendants to contact by mail all individuals and entities that have purchased their tax plans, arrangements or programs, or who have had their tax returns or refund claims prepared by the defendants, and inform those individuals and entities of the Court's findings concerning the falsity of the defendants' prior representations and attach a copy of the permanent injunction against the defendants;

G. That the Court, pursuant to Code § 7402, enter an injunction prohibiting the defendants from representing or assisting any persons before the Internal Revenue Service for any reason;

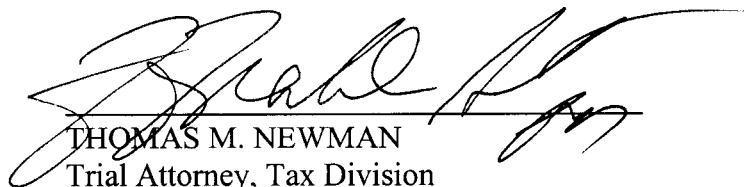
H. That the Court order that the United States is permitted to engage in post-judgment discovery to ensure compliance with the permanent injunction;

I. 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

J. That the Court grant such other and further relief as the Court may deem proper and just.

Respectfully submitted,

ROSLYNN R. MAUSKOPF  
United States Attorney

A handwritten signature in black ink, appearing to read 'Thomas M. Newman', is written over a horizontal line.

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