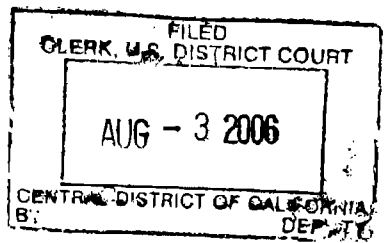


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Attorneys for the United States

IN THE UNITED STATES DISTRICT COURT
FOR THE CENTRAL DISTRICT OF CALIFORNIA

UNITED STATES OF AMERICA,

Plaintiff,

v.

STEPHEN DRAKE,
individually and doing business as,
BENECORP, LLC,

and

KENNETH SORENSON,
individually and doing business as,
BENECORP, LLC, and
SORENSON & SORENSON, CPAs,

Defendants.

**Amended Complaint for
Permanent Injunction**

Civ. No. 06-4831 JSL (VBKx)

Complaint

1681393.7

1
2 This is a civil action brought by the United States to permanently enjoin
3 Stephen Drake, individually and doing business as Benecorp, LLC, from
4 promoting a tax-fraud scheme by which members of the Santa Ynez Band of the
5 Chumash Indian Tribe illegally take false deductions and fail to pay federal
6 income tax owed on their per capita distributions of casino proceeds. The suit also
7 seeks to permanently enjoin Kenneth Sorenson, individually and doing business as
8 Benecorp, LLC, and as an accountant for Sorenson & Sorenson, CPAs, from
9 promoting that tax-fraud scheme and from preparing and filing false federal
10 income tax returns and forms for the Band and for Band members based on the
11 scheme.

12 **Nature of Action**

13 1. The Santa Ynez Band of the Chumash Indian Tribe operates the
14 Chumash Casino Resort in Santa Ynez, California. Defendants Drake and
15 Sorenson promote and operate a scheme (hereafter referred to as "the Benecorp
16 tax-fraud scheme") that helps some members of the Santa Ynez Band claim bogus
17 federal income tax deductions. The defendants cause their customers to use sham
18 entities (limited liability companies, also known as "LLCs") and sham transactions
19 to create a circular flow of funds of the customers' casino distributions from the
20 Santa Ynez Band through the customers' sham LLCs; through the defendants'
21 bank accounts, and back to the customers. The defendants also cause the Santa
22 Ynez Band to improperly fail to withhold required federal taxes from per capita
23 distributions paid to defendants' customers. The fees the defendants retain from
24 the fraudulent round-trip flow of funds skim off most of the customers' purported
25 tax savings.

1 2. Under the Benecorp tax-fraud scheme the defendants help each of their
2 customers set up a single-member LLC. Then defendants cause the Santa Ynez
3 Band to pay each customer's annual per capita casino-gaming distribution directly
4 to the customer's sham LLC, rather than to the customer. Defendants also
5 illegally caused the Santa Ynez Band to not withhold most of the federal income
6 tax required by law to be withheld from the distribution.

7 3. After the Band makes the per capita distribution to the customer's LLC,
8 defendants cause the LLC to pay the entire distribution to Drake and Sorenson's
9 company, Benecorp. Part of this payment to Benecorp is purportedly a
10 "consulting fee" to Benecorp for its purported "management" of the customer's
11 LLC. In fact the customers' LLCs are shams that do not engage in any business,
12 and Benecorp provides no real management services for the LLCs, other than
13 handling the circular flow of funds. The defendants and their customers make no
14 attempt to justify why the remaining part of the customer's per capita distribution
15 (*i.e.*, the part exceeding the purported consulting fee) is paid to Benecorp.

16 4. As part of the Benecorp tax-fraud scheme, defendants cause their
17 customers to deduct the purported management fees as business expenses on their
18 federal income tax returns, thereby offsetting most of the customers' taxable
19 income from the per capita distributions. Defendants cause Benecorp to transfer
20 to their customers the casino-distributions that the customers' LLCs transferred to
21 Benecorp, less fees that the defendants retain for operating the scheme.
22 Defendants falsely claim that part of the transfer to the customers is a loan.
23 Defendants are unable to explain the reason for the transfer of the remaining part
24 of the funds to the customers

25 5. Thus, under the scheme each customer receives his or her per capita
26 distribution, less the amount defendants retain as fees and less any taxes that are
27

1 withheld. But by claiming (at defendants' direction and with defendants'
2 assistance) a bogus tax deduction for the sham management fee that the LLC
3 purportedly pays to Benecorp, the customer fails to pay federal income tax on
4 most of his or her per capita distribution. The customer's purported federal
5 income tax saving from the bogus deduction exceeds the fees retained by
6 defendants. And when the Band failed to withhold required taxes on the per capita
7 distributions, the customer got the purported tax savings immediately, without
8 having to wait to file his or her federal income tax return.

9 6. In 2003 and 2004, 32 of the 156 Santa Ynez Band members who receive
10 per capita distributions participated in the Benecorp tax-fraud scheme.

11 7. This suit is brought to enjoin Drake from:

- 12 a. organizing or selling tax shelters, plans, or arrangements that
13 advise or assist customers to attempt to evade the assessments
14 or collection of their correct federal tax, including the
15 Benecorp tax-fraud scheme described below;
16 b. engaging in activity subject to penalty under I.R.C. §§ 6694,
17 6700, 6701, or any other penalty provision of the IRC; and
18 c. engaging in other conduct that interferes with the
19 administration or enforcement of the internal revenue laws.

20 8. This suit is brought to enjoin Sorenson from:

- 21 a. organizing or selling tax shelters, plans, or arrangements that
22 advise or assist customers to attempt to evade the assessments
23 or collection of their correct federal tax, including the
24 Benecorp tax-fraud scheme described below;
25 b. preparing or filing federal income tax returns, amended returns,
26 or other related documents and forms for others based on the
27 Benecorp tax-fraud scheme;
28 c. assisting in the preparation of federal income tax returns or
forms that he knows will, if used, result in understating other
persons' federal tax liability;

- d. engaging in activity subject to penalty under I.R.C. §§ 6694, 6700, 6701, or any other penalty provision of the IRC; and
- e. engaging in other conduct that interferes with the administration or enforcement of the internal revenue laws.

Jurisdiction and Venue

9. Jurisdiction is conferred on this Court by 28 U.S.C. §§ 1340 and 1345 and Internal Revenue Code (IRC) (26 U.S.C.) §§ 7401, 7402(a), 7407, and 7408.

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

Defendants

11. Defendant Kenneth Sorenson resides in Buellton, California, within this district.

12. Sorenson conducts business as a certified public accountant through Sorenson & Sorenson, CPAs, in Solvang, California, within this district.

13. Defendant Stephen Drake, a certified public accountant and certified financial planner, resides in Prescott, Arizona and conducts business through Benecorp, LLC, in Prescott, Arizona and Solvang, California, within this district.

14. Drake and Sorenson's customers are members of the Santa Ynez Band of Chumash Indians, who reside at the Santa Ynez Reservation in Santa Barbara County, California, within this district.

15. Because Sorenson resides in this district, Drake and Sorenson conduct business in this district, Drake and Sorenson's customers who participated in the Benecorp tax-fraud scheme reside in this district, and a substantial part of the events giving rise to this case occurred in this district, venue is proper in this Court under 28 U.S.C. §§ 1391 and 1396.

The Santa Ynez Band's Per Capita Distribution of Casino Proceeds

16. The Santa Ynez Band owns and operates the Chumash Casino Resort and makes per capita distributions of casino earnings to band members.

17. In 2005, the Santa Ynez Band distributed \$428,969 in casino earnings to each band member. In 2004 it distributed \$340,704 to each member.

18. Under the Internal Revenue Code, Native Americans are required to pay federal income tax on distributions of casino proceeds and tribes are required to withhold federal income tax when making distributions of casino proceeds.

19. Under the Benecorp tax-fraud scheme, Drake and Sorenson falsely advised Santa Ynez Band members that they could legally reduce federal income tax on distributions of casino proceeds by claiming deductions for sham management.

Drake and Sorenson's CapNet7 Plan

20. In 2003 defendants Drake and Sorenson developed a purported deferred-income plan to be offered by Benecorp to members of Native American tribes. In 2003 defendants and Benecorp began promoting that plan, known as the "CapNet7 plan" to Native American tribes and tribe members.

21. Drake is the president and Sorenson is the vice president of Benecorp, LLC.

22. Drake and Sorenson told Native American tribes and tribe members that they could use the CapNet7 plan to maximize tribe members' income (derived largely or exclusively from per capita distributions), by deferring their

1 current income from casino-gaming distributions and thereby reducing their
2 current federal income tax.

3 23. Drake and Sorenson promote the CapNet 7 plan at their website,
4 www.CapNet7.com, in articles in *Indian Gaming*, and at National Indian Gaming
5 Association and other conferences of interest to Native American tribes and tribe
6 members.
7

8 24. Drake and Sorenson's CapNet7 plan requires tribe members to defer
9 receipt of a portion of their per capita distribution until some point in the future or
10 until after death.

11 25. Under Drake and Sorenson's CapNet7 plan, the deferred income
12 is paid to the tribe member or his beneficiary after the tribe member dies or after a
13 prearranged deferral period expires.
14

15 26. Drake and Sorenson assert that under the CapNet7 plan, the deferred
16 portion of the per capita distribution is not taxable to the tribe member until it is
17 distributed to the tribe member or his or her beneficiary.

18 27. Under the Indian Gaming Regulatory Act, because Native American
19 tribes, not individual tribe members, have the exclusive authority to determine
20 how to distribute casino proceeds, individual tribe members are not able to use the
21 CapNet7 plan unless the plan is approved and implemented by the tribal
22 government.
23

24 28. In late 2003 and early 2004, Drake and Sorenson presented the
25 CapNet7 plan to the Santa Ynez Band.

26 29. On information and belief, the Santa Ynez Band refused to adopt the
27

1 CapNet7 plan because, among other reasons, it had not been approved by the IRS.

2 30. On information and belief, as part of the promotion of the CapNet7
3 plan to the Santa Ynez Band and other Native American tribes, Drake and
4 Sorenson falsely stated that individual Band members could legally reduce their
5 federal income taxes and increase their monthly cash flow from per capita
6 distributions by participating in the Benecorp tax-fraud scheme discussed below.
7

8 **Overview of the Benecorp Tax-Fraud Scheme**

9 31. Drake and Sorenson began promoting the Benecorp tax-fraud scheme
10 to Santa Ynez Band members in July of 2003.

11 32. As part of the scheme, Drake and Sorenson advise and assist Band
12 members to form LLCs so that Band members can claim they are engaged in a
13 legitimate business activity as "advisor[s] to Indian tribes" considering adopting
14 the CapNet7 plan.
15

16 33. Drake and Sorenson assert that the Band members' LLCs are engaged
17 in a legitimate business activity because they undertake "marketing activities,"
18 including lobbying the Santa Ynez Band to adopt the CapNet7 plan.

19 34. Drake and Sorenson assert that Band members' LLCs are engaged in
20 a legitimate business activity because Band members' LLCs enter into a contract
21 with Benecorp entitling the LLC to an "Incentive Fee" if Benecorp contracts with
22 the Santa Ynez Band or other Native American tribes to implement the CapNet7
23 plan.
24

25 35. Under the "Incentive Fee" plan entered into between Band members'
26
27

1 LLCs and Benecorp, Benecorp purports to pay the Band members' LLCs 10% of
2 the amount Benecorp earns from any Native American tribe that enters into the
3 CapNet7 plan, "multiplied by the percentage of such amount that is derived from
4 the Tribal Agreement [adopting the CapNet7 plan] attributable to the tribal
5 member's LLC."

6 36. Drake and Sorenson assert that any payments under the Incentive Fee
7 arrangement will be offset by "advances" made by Benecorp to the LLCs
8 discussed below.
9

10 37. The "advances" Benecorp makes to the LLCs are shams. They are
11 simply the final step of the circular flow of casino distributions designed to create
12 bogus tax deductions.

13 38. On information and belief, no tribes have adopted the CapNet 7 plan
14 and thus the tribe members' LLCs are not entitled to any "incentive fee" from
15 Benecorp.
16

17 39. On information and belief, because no tribes have adopted the
18 CapNet 7 plan, Benecorp has not paid an "incentive fee" to any of the customers'
19 LLCs. Moreover, the amounts of the purported advances bear no relationship to
20 any work or services provided by Band members or their LLCs to Benecorp.
21 Rather, the advances, like the earlier sham transactions in the circular flow of
22 casino distributions, are a thinly veiled disguise intended to conceal the
23 defendants' efforts to help customers evade federal income taxes.

24 **The Mechanics of the Benecorp Tax-Fraud Scheme**

25 40. Under the Benecorp tax-fraud scheme, Drake and Sorenson furnish
26 documents to Band members and assist them in forming single-member LLCs.
27

1 Band members purportedly assign their per capita distribution of casino proceeds
2 to the LLC.

3 42. In addition to helping Band members form LLCs, which use
4 Sorenson's address as their place of business, Sorenson sets up bank accounts for
5 the LLCs, with Sorenson having signature authority on the accounts.
6

7 43. After Sorenson assists each Band member in setting up an LLC, the
8 LLC enters into a purported business consultation agreement with Benecorp,
9 which Drake signs on behalf of Benecorp.
10

11 44. The purported business consultation agreement provides that Benecorp
12 will supply business management and consultation services to the Band member's
13 LLC, in return for a monthly payment, referred to as a "consulting fee."
14

15 45. Under the scheme, the Band member's per capita distribution is first
16 transferred to the LLC, and then paid to Benecorp. Part of the payment is
17 disguised as a sham "consulting fee." The defendants and the participating
18 customers have no explanation as to why the remainder of the per capita
19 distribution is also paid to Benecorp.

20 46. Under the purported business-consultation agreement, Band members
21 are required to pay Benecorp a minimum "consulting fee" of \$20,000 a month
22 (\$240,000 a year), but in fact they pay the full amount of their per capita
23 distribution to Benecorp.

24 47. Drake has falsely asserted that the Band members' LLCs have a
25 legitimate business purpose, and that the LLCs can therefore deduct payments
26 made to Benecorp for "consulting fees"
27

1 48. Under the Benecorp tax-fraud scheme, Sorenson prepared federal
2 income tax returns for some Band-member customers on which Sorenson deducted
3 the "consulting fee" purportedly paid to Benecorp as a business expense.
4

5 49. Band-member customers' LLCs also enter into an agreement with a
6 sham entity known as Native American Member Services LLC ("NAMS"), which
7 purports to lend money to the Band members' LLCs on purported revolving line of
8 credit.

9 50. To the extent, if any, that NAMS exists, it is managed and controlled by
10 Drake and has the same business address as Benecorp. On information and belief
11 NAMS is wholly controlled by Drake and is used by the defendants to effectuate
12 the sham transactions of the Benecorp tax-fraud scheme.

13 51. The purported revolving line of credit agreement between each Band
14 member's LLC and NAMS provides that the line of credit is secured by a life
15 insurance policy for the Band member.

16 52. The purported line of credit agreement further provides that the Band
17 member will name NAMS or Benecorp as the beneficiary of the insurance policy
18 as security for the line of credit.

19 53. Drake and Sorenson falsely assert that the purported loans from NAMS
20 to the Band members' LLCs (which in reality are simply transfers of the Band
21 members' casino-gaming distributions back to themselves) are bona fide debt
22 obligations of the Band members' LLCs.
23

24 54. Under the Benecorp tax-fraud scheme, Band members do not in fact
25 turn over their per capita distribution to Benecorp, but retain full benefit of the per
26 capita distribution (minus the amounts the defendants keep for themselves as a fee
27

1 for implementing the scheme), which is merely channeled back to the Band
2 members through the sham revolving line of credit.

3
4 55. Under the scheme Band members' per capita distributions flow in
5 circular fashion (1) from the Santa Ynez Band's general account to the Santa Ynez
6 Band's per capita distribution account in Mid-State Bank; (2) then to the Band
7 members' LLC accounts at Mid-State Bank (set up and controlled by Sorenson);
8 (3) then to Benecorp's account at Mid-State Bank (controlled by Drake); and (4)
9 finally from the Benecorp account to the Band member's personal account as a
10 purported "advance" from NAMS (controlled by Drake), even though NAMS
11 never has possession of the funds.

12 56. On information and belief, the transactions that transfer the Band
13 member's per capita distribution through the Drake and Sorenson-controlled
14 entities, and then back to the Band member (minus the defendants' fees), occur on
15 the same day through the multiple transactions at Mid-State Bank.

16 57. As part of the Benecorp tax-fraud scheme, participating Band members'
17 LLCs transferred a total of \$9,418,938 in per capita casino gaming distributions to
18 Benecorp's bank account in 2004.

19 58. On information and belief, before Drake and Sorenson began
20 promoting the scheme the Santa Ynez Band properly withheld income tax for all
21 per capita distributions and issued 1099 forms to Band members correctly listing
22 their distribution and withheld tax. For Band members who are not participating
23 in the scheme, Sorenson, on behalf of the Santa Ynez Band, continues to properly
24 withhold federal income tax for all per capita distributions, and issues correct
25 1099 Forms reflecting those distributions.
26

1 59. But after defendants established the Benecorp tax-fraud scheme,
2 defendant Sorenson, who does the Band's accounting, caused the Band to stop
3 withholding most of the federal taxes required to be withheld for Band members
4 participating in the scheme. Additionally, Sorenson has prepared these
5 participating Band members' federal income tax returns and has falsely claimed
6 tax deductions on those returns for the purported business consulting fees. This
7 deduction effectively purports to eliminate most tax on the Band members' per
8 capita distributions of gaming proceeds.

9 60. The Benecorp tax-fraud scheme is, if not detected and the false tax
10 deductions reversed, somewhat beneficial to Band members and very lucrative for
11 Drake and Sorenson. But the amounts the defendants skim for themselves from
12 the circular flow of funds are substantial. Thus the defendants, rather than their
13 customers, keep the lion's share of the gains from the fraudulent scheme.

14 61. Drake and Sorenson retained \$2,268,427 of the total per capita
15 distributions transferred to Benecorp by the Band members' LLCs as Benecorp's
16 fees in 2004 for the Benecorp tax-fraud scheme.

17 **An Example of One Participating Band Member in 2004**

18 62. A review of one participating Band member's transactions with
19 Benecorp in 2004 illustrates the mechanics of the Benecorp tax-fraud scheme.
20 The Band member was entitled to receive annual per capita casino gaming
21 distributions from the Band in 2004 totaling \$340,704—payable in monthly
22 installments of \$27,040 from January through June and thereafter \$29,744 from
23 July through December.

24 63. The Band member entered into a sham "business consultation
25 agreement" with Benecorp under which she purportedly was to pay Benecorp
26

1 \$240,000 a year or \$20,000 per month through her LLC for Benecorp's purported
2 management services. In return, NAMS purportedly lent her money under a
3 purported line of credit.

4
5 64. In fact, however, the Band paid the Band member's monthly per capita
6 distributions directly from the Band's Mid-State Bank account to the Band
7 member's LLC account at Mid-State Bank, after which defendants transferred the
8 distributions from the LLC's account to the Benecorp account at Mid-State Bank,
9 after which the defendants transferred the distributions (less the defendants' fees)
10 to the Band member.

11 65. The defendants' fees charged to this Band member were deducted from
12 Benecorp's payments to her each month as purported "loan repay & costs" and
13 "loan repayment indemnification." Over the course of the year the defendants
14 retained fees in this manner totaling \$46,705.38. The defendants also retained
15 \$5,946 for federal tax withholding and \$800 for "LLC State Minimum Tax." Thus,
16 the Band member ended up with \$287,252.62 of her total \$340,704 per capita
17 distribution for 2004. Benecorp kept \$46,705.38. Thus on \$340,704 of taxable
18 income from which substantial federal tax withholding was required, the
19 defendants caused the Santa Ynez Band to withhold only \$5,946.

20 66. Sorenson prepared this Band member's 2004 federal income tax return.
21 On Line 21 of the Band member's 2004 income tax return, Sorenson reported
22 "other income" of only \$100,704. This amount equals the \$340,704 in per capita
23 distributions paid to her that year, less the \$240,000 the Band member purportedly
24 paid to Benecorp for management fees.

25 67. After the IRS detected the Benecorp tax fraud scheme it audited this
26 Band member's 2004 income tax return and added to her income the \$240,000 that

1 Sorenson improperly deducted. That resulted in more than \$70,000 in additional
2 federal income tax being owed. Thus this customer paid the defendants
3 \$46,705.38 to obtain some \$70,000 in purported 2004 income-tax benefits. But
4 because the IRS detected the scheme the customer will now have to pay the IRS
5 delinquent taxes, interest, and penalties.

6 **The IRS's Investigation of the Benecorp Tax-Fraud Scheme.**

7
8 68. Contrary to Drake and Sorenson's assertion that the Band members'
9 LLCs are engaged in legitimate business activities, Band members have stated that
10 Drake and Sorenson did not mention any business purpose to them. They say that
11 the Benecorp tax-fraud scheme was pitched to them exclusively as a purported
12 deferred-income plan.

13 69. Contrary to Drake and Sorenson's assertion that Band-member
14 customers evidenced a business purpose by setting up LLCs and bank accounts,
15 customers have stated that they were not given information regarding the LLCs
16 when they met with Sorenson, and that they did not authorize Sorenson to set up
17 bank accounts for their LLCs. Indeed, the Band-member customers did not know
18 that Sorenson had created bank accounts for their LLCs because the LLCs' bank
19 statements were sent to Sorenson's place of business rather than to the customers
20 who purportedly managed the LLCs.

21 70. Contrary to Drake and Sorenson's assertion that Band members were
22 engaged in legitimate business activities by marketing the CapNet7 plan to the
23 Santa Ynez Band and other Band members, Band members have acknowledged
24 that they did not perform work or services on behalf of Benecorp or their LLCs,
25 including marketing or promoting the CapNet7 plan.
26
27

1 71. Contrary to defendants' claim that Benecorp "earned" its \$2.2 million
2 gross profit in 2004 for providing "consulting services" to Band members' LLCs,
3 Band members have acknowledged that Benecorp did not perform any work or
4 services for the LLCs and thus Benecorp had no legitimate reason to receive an
5 average of \$240,000 a year from individual Band members' LLCs as a "consulting
6 fee."

7
8 72. Contrary to Drake and Sorenson's assertion that NAMS makes bona
9 fide "loans" to Band members that are supposedly secured by life insurance
10 policies naming NAMS or Benecorp as the beneficiary, Drake has admitted that
11 life insurance policies were not obtained.

12 **Sorenson's Promotion as the Santa Ynez's Band Accountant**

13 73. Sorenson has served as the Santa Ynez Band's accountant since 1997.

14 74. Sorenson used his position of trust as the Santa Ynez's Band's
15 accountant to further the Benecorp Tax-Fraud Scheme.

16 75. As the Santa Ynez Band's accountant, Sorenson performs accounting
17 functions for the Santa Ynez Band's per capita distributions, including
18 maintaining records for the Santa Ynez Band that account for the per capita
19 distributions, preparing monthly bank reconciliations for the per capita income
20 bank account, preparing checks or electronic transfers to distribute the per capita
21 income to each member, and making deposits of the federal income taxes that are
22 withheld from the per capita payments to the members.

23
24 76. As the Santa Ynez's Band's accountant, Sorenson prepares IRS
25 Forms 945 (similar to IRS Forms 941 federal employment tax returns) for the
26 Band that report the amounts of federal income tax withheld by the Band on per
27

1 capita distributions and paid to the Internal Revenue Service on the Band
2 member's behalf.

3 77. As the Santa Ynez Band's accountant, Sorenson prepares IRS
4 Forms 1099 for the Band reflecting per capita distributions from the Band to Band
5 members for the per capita casino distributions at the end of each year.
6

7 78. As the Santa Ynez Band's accountant, Sorenson prepared the Band's
8 2003 IRS Forms 1099 for the per capita distributions.

9 79. For each Band member who participated in the Benecorp tax-fraud
10 scheme in 2003, Sorenson prepared an IRS Form 1099 which reported the per
11 capita distribution to the Band member showing income tax withholdings for the
12 months in 2003 before the Band member participated in the Benecorp tax-fraud
13 scheme. This amount was properly reported on the Band member's federal
14 income tax return as taxable "other income."
15

16 80. Sorenson then prepared a second IRS Form 1099 that reported the Band
17 member's distribution for 2003 after the Band member participated in the
18 Benecorp Tax-Fraud Scheme. This IRS Form 1099 improperly did not include
19 any federal income tax withholding because under the scheme the Band member
20 had purportedly assigned the distribution to the LLC.

21 81. As the Santa Ynez Band's accountant, Sorenson also prepared the
22 Band's IRS Forms 1099 in 2004 that reported the Band's per capita distributions
23 to Band members.

24 82. For Band members participating in the Benecorp tax-fraud scheme in
25 2004 Sorenson prepared IRS Forms 1099 reporting the full amount of the per
26
27

1 capita distribution to the Band member, with no federal tax withholding by the
2 Santa Ynez Band.

3 83. For Band members participating in the Benecorp tax-fraud scheme in
4 2004, Sorenson also prepared IRS Forms 1099 that reported the Band members'
5 alleged payments to Benecorp under the purported business consulting agreement,
6 so that Band members could then falsely claim a deduction for these payments to
7 Benecorp.
8

9 **Sorenson's Preparation of Band Members' Federal Income Tax Returns**

10 84. For Band members who participated in the Benecorp tax-fraud
11 scheme in 2003, Sorenson prepared Band members' federal income tax returns,
12 improperly reporting the per capita distribution on Schedule E of the Band
13 members' IRS Form 1040 as "royalties received" so as to disguise or conceal their
14 true nature as casino gaming distributions.
15

16 85. Sorenson also improperly reported a corresponding deduction for the
17 same amount on Band members' Form 1040 Schedule E as "commissions paid,"
18 thereby reducing to zero the Band members' reported tax attributable to per capita
19 distribution of casino proceeds.

20 86. As a result of Sorenson's fraudulent return preparation, Band
21 members failed to report and pay the correct 2003 federal income tax due on the
22 per capita casino-gaming distribution.
23

24 87. For Band members who participated in the Benecorp tax-fraud
25 scheme in 2004, Sorenson prepared federal tax returns that subtracted the amounts
26 paid to Benecorp for purported business consulting from the per capita
27

1 distribution reported on the return, thereby reducing taxable income on the return
2 by the amount paid to Benecorp for purported consulting.

3 88. Sorenson knew that he was required to report the full amount of the
4 Band members' \$340,074 per capita distribution as taxable income, but failed to
5 do so.

6 89. As a direct result of Sorenson's fraudulent return preparation,
7 Band members participating in the scheme failed to report and pay most of the
8 federal income tax owed on their per capita distributions for 2004.

9 90. In addition to fraudulently preparing individual Band members'
10 federal income tax returns, Sorenson provided to Band members who had retained
11 other return preparers to prepare their returns, a document that falsely instructed
12 these return prepares to deduct income from per capita casino proceeds based on
13 the Benecorp tax-fraud scheme. As a certified public accountant, Sorenson knew
14 or had reason to know that the document he provided to other return preparers
15 falsely instructed these return prepares to deduct income from per capita casino
16 proceeds on the Benecorp tax-fraud scheme, which is not allowed under the
17 Internal Revenue Code.
18

19
20 **Sorenson's Improper Accounting of the**
21 **Santa Ynez's Band's Per Capita Distributions.**

22 91. As the accountant for the Santa Ynez Band, Sorenson knew or should
23 have known that per capita casino-gaming distributions can be made only to
24 individual Band members, not LLCs, and that the per capita distributions are
25 taxable to individual Band members.
26
27

1 92. As the accountant for the Santa Ynez Band, Sorenson knew that the
2 Santa Ynez Band was required to withhold federal income tax on per capita
3 distributions to individual Band members, whether or not these distributions were
4 later purportedly transferred to individual Band members' LLCs.

5 93. As an accountant for the Santa Ynez Band, Sorenson knew or had
6 reason to know that the Santa Ynez Band was required to distribute casino
7 proceeds to individual Band members and not the Band members' LLCs.

8
9 **Drake and Sorenson Continued to Promote**
10 **the Tax-Fraud Scheme After Receiving Notice of Its Illegality**

11 94. On March 24, 2005, Drake met with the IRS and was extensively
12 questioned regarding the Benecorp tax-fraud scheme.

13 95. During this interview, Drake falsely asserted that Band members
14 entered into consultation agreements with Benecorp to promote the CapNet7 plan
15 and thus that he is not promoting a tax-fraud scheme.

16 96. Despite the IRS's investigation of his illegal activities, Drake
17 continued to assert the validity of the Benecorp tax-fraud scheme, has not posted a
18 retraction at the Capnet7.com website explaining that the Benecorp tax-fraud
19 scheme is not permissible under the Internal Revenue Code, has not otherwise
20 informed Band members that they are participating in a tax-fraud scheme, or
21 assisted Band members in filing corrected amended returns to report their accurate
22 tax liabilities.

23 97. After Drake met with the IRS, Sorenson continued to prepare federal
24 income tax returns for Band members based on the Benecorp tax-fraud scheme,
25 and to prepare 1099s and other forms for the Band based on the scheme.
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1 98. On February 8, 2006, Sorenson prepared and filed for a Band member
2 who participated in the scheme a 2005 federal income tax return that claimed a
3 \$200,000 bogus deduction on the IRS Form 1040 Schedule C for expenses related
4 to purported "outside services," amounts paid to Benecorp for purported "business
5 consulting."

6 99. Sorenson then used this purported business expense to reduce the Band
7 member's reported taxable income on IRS Form 1040, thus underreporting the
8 Band member's taxable income.

9 100. On information and belief, Drake and Sorenson continue to promote
10 the CapNet7 plan, on which the Benecorp tax-fraud scheme is based, at the
11 capnet7.com website and at gaming conferences.

12 101. Sorenson continues to serve as the Santa Ynez Band's accountant and
13 remains responsible for accounting for the Band's per capita distributions.

14 102. On information and belief, Drake and Sorenson continue assisting
15 current Santa Ynez Band customers to effectuate the Benecorp tax-fraud scheme
16 and continue to solicit business from other Native American tribes and tribe
17 members who receive per capita casino-gaming distributions.

18 103. Drake and Sorenson harm the United States because Band members
19 are not correctly reporting and paying their federal income tax liabilities. The total
20 known tax loss from the Benecorp tax-fraud scheme is approximately \$3.3 million
21 so far. This tax loss does not include the substantial costs of detecting the scheme
22 and assessing and collecting the additional taxes that Band members owe.

23 104. By promoting the Benecorp tax-fraud scheme, Drake and Sorenson
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1 undermine public confidence in the administration of the federal tax system and
2 encourage violations of the internal revenue laws.

3 105. Drake and Sorenson further harm the United States because the
4 Internal Revenue Service must devote its limited resources to identifying their
5 customers and recovering any refunds erroneously issued. Given the IRS's limited
6 resources, identifying and recovering all revenues lost from Drake and Sorenson
7 plan may be impossible.
8

9 106. Drake and Sorenson also harm their customers, both the individual
10 Band members who receive per capita distributions and the Santa Ynez Band
11 itself, which makes the distributions. By making false statements to these
12 customers, and preparing false tax forms, returns, and other documents for them,
13 the defendants subject their customers to paying substantial delinquent taxes,
14 interest, penalties. The defendants also potentially subject customers to possible
15 criminal prosecution for participating in the defendants' illegal scheme.
16

17 **Count I**

18 **(Injunction under IRC § 7407)** 19 **(As to Kenneth Sorenson)**

20 107. The United States incorporates herein the allegations in paragraphs 1
21 through 106.

22 108. IRC § 7407 authorizes a court to enjoin a person from engaging in
23 specified misconduct if the person has:

- 24 a. engaged in conduct subject to penalty under IRC § 6694
(which penalizes a return preparer who prepares or submits a
25 return that contains an unrealistic or frivolous position);
- 26 b. guaranteed the payment of a tax refund or allowance of a tax
27 credit; or

1 c. engaged in any other fraudulent or deceptive conduct that
2 substantially interferes with the proper administration of the
3 internal revenue laws.

4 109. Sorenson has engaged in conduct subject to the IRC § 6694 penalty
5 by preparing federal income tax returns and forms that understate his customers'
6 income and tax liabilities based on the Benecorp tax-fraud scheme.

7 110. Sorenson's conduct violates IRC § 6694 and is subject to
8 injunction under IRC § 7407.

9 111. If he is not enjoined, Sorenson is likely to continue to prepare and file
10 false and fraudulent forms and returns for Band members, for the Santa Ynez
11 Band, and for others.

12 **Count II**

13 **(Injunction under 26 U.S.C. § 7408 for** 14 **Conduct Subject to the IRC § 6700 Penalty)** 15 **(As to Stephen Drake and Kenneth Sorenson)**

16 112. The United States incorporates by reference the allegations in
17 paragraphs 1 through 111.

18 113. IRC § 7408 authorizes a court to enjoin persons who have engaged in
19 any conduct subject to penalty under IRC § 6700 if the court finds that injunctive
20 relief is appropriate to prevent the recurrence of such conduct.

21 114. IRC § 6700 penalizes any person who organizes or sells a plan or
22 arrangement and in connection with the organization or sale makes a statement
23 regarding the securing of any tax benefit that the person knows or has reason to
24 know is false or fraudulent as to any material matter.

25 115. Drake and Sorenson organize and sell a plan or arrangement and in
26

1 connection therewith make or furnish, to their customers and others, statements
2 regarding the characterization of casino distributions and the allowance of
3 deductions for amounts purportedly paid to Benecorp, which Drake and Sorenson
4 know or have reason to know are false and fraudulent.

5 116. Drake and Sorenson falsely state that Band members can legally
6 reduce their federal income tax liabilities on their per capita distributions and
7 retain a higher cash flow by participating in the Benecorp tax-fraud Scheme.

8 117. If not enjoined under IRC § 7408, Drake and Sorenson are likely to
9 continue to organize and sell the Bencorp tax-fraud scheme and engage in conduct
10 subject to penalty under IRC § 6700.
11

12 **Count III**

13 **(Injunction under I.R.C. § 7408 for Violation of I.R.C. § 6701)** 14 **(As to Sorenson)**

15 118. The United States incorporates by reference the allegations in
16 paragraphs I through 117.

17 119. IRC § 7408 authorizes a court to enjoin persons who have engaged in
18 any conduct subject to penalty under IRC § 6701 if the court finds that injunctive
19 relief is appropriate to prevent the recurrence of such conduct.
20

21 120. IRC § 6701 penalizes any person who (1) aids or assists in, procures,
22 or advises with respect to, the preparation or presentation of any portion of a
23 return, affidavit, claim or other document; (2) knows (or has reason to believe)
24 that such document or portion will be used in connection with any material matter
25 arising under the internal revenue laws; and (3) knows that such portion (if so
26 used) will result in an understatement of another person's tax liability.
27

1 121. Sorenson prepared or assisted in the preparation of false and
2 fraudulent 1099 Forms for the Santa Ynez Band and false and fraudulent federal
3 income tax returns for Drake and Sorenson's customers.

4 122. Sorenson knew or had reason to know that these income tax forms
5 and returns would be used in connection with computing and reporting federal
6 income tax liabilities and knew that if they were so used they would result in
7 understatements of other persons' tax liabilities.

8 123. If Sorenson is not enjoined, he is likely to continue to engage in
9 conduct subject to penalty under IRC § 6701.
10

11
12 **Count IV**

13 **(Unlawful Interference with the Administration of the Internal Revenue**
14 **Laws)**

15 124. The United States incorporates herein the allegations in paragraphs 1
16 through 123.

17 125. IRC § 7402 authorizes a court to issue orders of injunction as may be
18 necessary or appropriate for the enforcement of the internal revenue laws.

19 126. Drake and Sorenson, through the conduct described above, have
20 engaged in conduct that substantially interferes with the administration and
21 enforcement of the internal revenue laws. Unless enjoined, Drake and Sorenson
22 are likely to continue to engage in such improper conduct. If the Court does not
23 enjoin Drake and Sorenson from engaging in fraudulent and deceptive conduct the
24 United States will suffer irreparable injury.
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1 127. Enjoining Drake and Sorenson is in the public interest because an
2 injunction, backed by the Court's contempt powers if needed, will stop their illegal
3 conduct and the harm it causes the United States Treasury.

4 128. The United States is entitled to injunctive relief under 26 U.S.C.
5 § 7402(a).

6 WHEREFORE, the plaintiff, United States of America, prays for the
7 following:

8 A. That the Court find that Sorenson has engaged in conduct subject to
9 penalty under IRC §§ 6694, and that an injunction under IRC §§ 7402 and 7407 is
10 appropriate to prevent him and anyone acting in concert with him from preparing
11 or filing federal tax forms based on the Benecorp tax-fraud scheme or otherwise
12 asserting unrealistic positions;

13 B. That the Court find that Sorenson engaged in conduct subject to penalty
14 under IRC §§ 6700 and 6701, and that injunctive relief is appropriate under IRC
15 § 7408 to prevent him and anyone acting in concert with him from engaging in any
16 further such conduct;

17 C. That the Court find that Sorenson engaged in conduct that interferes
18 with the administration and enforcement of the internal revenue laws, and that
19 injunctive relief against him and anyone acting in concert with him is appropriate
20 to prevent the recurrence of that conduct under the Court's inherent equity powers
21 and IRC § 7402(a);

22 D. That the Court, under IRC §§ 7402 and 7408, enter a permanent
23 injunction prohibiting Sorenson and his representatives, agents, servants,
24 employees, or anyone in active concert or participation with him, from:
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- 1) Engaging in activity subject to penalty under I.R.C. § 6700, including organizing or selling a plan or arrangement and in connection therewith making a statement regarding tax deductions, the excludability of income, or the securing of any tax benefit that he knows or has reason to know is false or fraudulent as to any material matter, including but not limited to promoting the Benecorp tax-fraud scheme;
- 2) Engaging in activity subject to penalty under I.R.C. § 6701, including preparing or assisting in the preparation or presentation of any portion of a return, affidavit, claim or other document, which he knows or has reason to know will be used in connection with any material matter arising under the internal revenue laws; and if so used will result in an understatement of another person's tax liability, including but not limited to documents implementing the Benecorp tax-fraud scheme;
- 3) Engaging in any other activity subject to penalty under I.R.C. §§ 6700 or 6701;
- 4) Engaging in other similar conduct that substantially interferes with the proper administration or enforcement of the internal revenue laws;

E. That the Court find that Drake engaged in conduct subject to penalty under IRC §§ 6700, and that injunctive relief is appropriate under IRC § 7408 to prevent him and anyone acting in concert with him from engaging in any further such conduct;

F. That the Court find that Drake engaged in conduct that interferes with the administration and enforcement of the internal revenue laws, and that

1 injunctive relief against him and anyone acting in concert with him is appropriate
2 to prevent the recurrence of that conduct under the Court's inherent equity powers
3 and IRC § 7402(a);

4 G. That the Court, under IRC §§ 7402 and 7408, enter a permanent
5 injunction prohibiting Drake and his representatives, agents, servants, employees,
6 or anyone in active concert or participation with him, from:

- 7 1) Engaging in activity subject to penalty under I.R.C. § 6700, including
8 organizing or selling a plan or arrangement and in connection
9 therewith making a statement regarding tax deductions, the
10 excludability of income, or the securing of any tax benefit that he
11 knows or has reason to know is false or fraudulent as to any material
12 matter, including but not limited to promoting the Benecorp tax-fraud
13 scheme;
- 14 2) Engaging in any other activity subject to penalty under I.R.C. § 6700;
15 and
- 16 3) Engaging in other similar conduct that substantially interferes with
17 the proper administration or enforcement of the internal revenue laws.
18

19 H. That this Court, under IRC §§ 7402, 7407, and 7408, enter an
20 injunction requiring Drake and Sorenson to contact:

- 21 1) all persons to whom they gave, sold, or distributed any materials
22 promoting or otherwise related to the Benecorp tax-fraud scheme;
- 23 2) all persons for whom Sorenson prepared and/or assisted in the
24 preparation of any federal income tax returns or tax-related
25 documents (including 1099 forms) based on the Benecorp tax-fraud
26 scheme; and
27

1 3) provide these persons with a copy of the Court's permanent
2 injunction.

3 I. That this Court, pursuant to I.R.C. §§ 7402 and 7408, enter an injunction
4 requiring Drake and Sorenson and their representatives, agents, servants,
5 employees, attorneys, and those persons in active concert or participation with
6 them, to display prominently, at the top of the first page of the capnet7.com
7 website, a complete copy of the Court's permanent injunction within 14 days of
8 the entry of this Order, and to keep the Order posted there for one year.

9 J. That this Court, under IRC §§ 7402, 7207, and 7408, enter an injunction
10 requiring Drake and Sorenson to turn over to the United States a list of the names,
11 addresses, e-mail addresses, phone numbers, and Social Security numbers of (1)
12 all persons to whom they gave or sold, directly or indirectly, any materials related
13 to the Benecorp tax-fraud scheme, (2) all persons who assisted in the marketing or
14 preparation of materials used by Drake and Sorenson or written materials sent to
15 potential customers as part of the Benecorp tax-fraud scheme, (3) all persons for
16 whom Drake and Sorenson, or their associates, prepared or assisted in the
17 preparing any tax-related documents, including Forms 1099 or tax returns, as part
18 of the Benecorp tax-fraud scheme (4) all persons who purchased or used any other
19 tax shelter, plan, or arrangement that Drake and Sorenson have organized or
20 promoted; and (5) all persons who assisted Drake and Sorenson in promoting and
21 implementing the Benecorp tax-fraud scheme;

22 K. That the Court allow the government full post-judgment discovery to
23 monitor Drake and Sorenson's compliance with the injunction; and
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L. That the Court grant such other and further relief as it deems appropriate.

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