IN THE UNITED STATES DISTRICT COURT FOR THE
DISTRICT OF KANSAS

UNITED STATES OF AMERICA	)	
	)	
Plaintiff,	)	
	)	
v.	)	Civil No.
	)	
HARROLD E. JONES,	)	
EVELYN P. JOHNSON	)	
individually and d/b/a	)	
EVELYN'S SECRETARIAL AND	)	
TAX SERVICE and ASAP SPEEDEE TAX	)	
SERVICE,	)	
Defendants.	)	

MEMORANDUM OF LAW IN SUPPORT OF MOTION FOR PRELIMINARY INJUNCTION

Defendants Harrold E. Jones a/k/a Harold G. Jones, and Evelyn P. Jones, individually and doing business as Evelyn's Secretarial and Tax Service, and ASAP Speedee Tax Service, prepare federal income tax returns claiming fictitious or inflated deductions in order to claim unlawful tax refunds for their customers. If Jones and Johnson are not enjoined now from acting as return preparers, their continuing actions, especially during this tax-filing season, will result in additional losses to the United States.

The Government requests that the Court issue a preliminary injunction under I.R.C. (26 U.S.C.) §§ 7407, 7408, and 7402(a) to prevent Jones, Johnson, and anyone acting in concert with them from preparing federal tax returns for others while this case is pending. Each of these statutes provides an independent basis for entering the requested preliminary injunction.

QUESTION PRESENTED

Jones and Johnson prepare federal-income-tax returns claiming inflated or contrived deductions, often from fictitious businesses, in order to obtain unlawful tax refunds. Should they be preliminarily enjoined from promoting such schemes, and from preparing returns or amended returns claiming refunds, while this lawsuit is pending?

STATEMENT OF FACTS

Harrold E. Jones, a/k/a Harold G. Jones, has been preparing federal tax returns for fifty years. Jones enjoys a reputation in the Wichita community for producing rapid and large refunds for customers. Jones relies on word-of-mouth advertising for recruiting customers. Jones falsely told several of his customers that he was certified, bonded, and a Certified Public Accountant. (Declaration of Tax Compliance Officer Jean Hawley attached as Exhibit 1, ¶¶ 6 and 7). Jones is not a lawyer. In 1993 Jones was permanently enjoined by the United States Bankruptcy Court for the District of Kansas from the unauthorized practice of law in any bankruptcy case or proceeding filed in this District. *In re Robinson*, 162 B.R. 319 (Bankr. D. Kan. 1993).

Jones was convicted in 1973 of a felony in federal court in California for preparing fraudulent returns. Due to this conviction, the IRS revoked Jones's electronic-filing privileges.

After his conviction, Jones moved to Kansas and began preparing tax returns through his daughter's business, Evelyn's Secretarial and Tax Service, located at 5110 E. 21st Street, N., Wichita, Kansas. Johnson obtained an electronic filing number. Under their arrangement, Jones prepared the majority of the returns and Evelyn Johnson used her IRS electronic-filing number to submit the fraudulent returns to the IRS. (Hawley Dec., ¶ 10).

Jones and Johnson have prepared 5,231 income tax returns for customers between 1999 and 2003. The high volume of returns prepared by two people indicates a lack of due care in preparing the returns. Most of them were electronically filed and purport to be prepared by Evelyn Johnson. But in interviews, Harrold Jones and Evelyn Johnson stated that Evelyn Johnson prepares only a few Form 1040 (individual returns) and on rare occasions simple Schedules A (itemized returns). Jones and Johnson both stated that Jones prepares most of the Form 1040 returns and Schedules A, and that Jones prepared all of the Schedules C (self-employment business returns), Schedules E (additional rental/business income or losses) and other miscellaneous returns. (Hawley Dec., ¶¶ 11 and 12).

Jones not only used Johnson to file returns he prepared, but after the IRS started investigating Jones and Johnson, Johnson enlisted another return preparer to e-file returns that Jones had prepared. Marlene Harris electronically filed forty-four tax returns for Jones and Johnson in 2004. Johnson contacted Harris and asked her to e-file Jones's and her customers' tax returns, claiming that Jones was the only one in her office who knew how to e-file, but that he was now unable to do so because he was seriously ill and in the hospital. Johnson offered to pay Harris $40 per return to e-file the returns. (Declaration of Marlene Harris attached as Exhibit 2).

Jones is continuing to prepare and e-file 2005 federal individual tax returns. Jones prepared a customer's 2005 federal individual tax return and arranged for the return to be e-filed by A&J Battle Tax and Bookkeeping. (Hawley Dec., ¶ 37).

Even though the IRS has investigated Johnson and Jones, and audited many of their customers, Jones and Johnson persist in preparing improper returns. Jones recently placed an advertisement in Careerbuilder.com through the Wichita Eagle seeking an employee to assist in

his tax preparation business. (Declaration of Christopher Groboske attached as Exhibit 3). Johnson has recently sent a form letter to her old customers in Wichita, announcing that, although she moved to Dallas, Texas, she is still preparing income tax returns doing business as ASAP Speedee Tax Service. She writes: "I can still prepare your income tax returns with the same quickness, accuracy and service that you are used to receiving from me." (Hawley Dec., ¶ 36 and Exhibit DD).

A substantial percentage of the returns Jones has prepared and Johnson had filed contained one or more positions resulting in understatements of customers' tax liabilities. Jones-prepared returns often contained inflated or fictitious business deductions designed to reduce the customer's reported income. Jones claimed these business expenses as part of his customer's purported home business. If his customers did not have a business, Jones often created a fictitious one for them. Jones then deducted fictitious business expenses and attributed personal expenses. (Hawley Dec. ¶ 14).

One of the most common improper deductions Jones has taken are IRC § 179 depreciation deductions on Schedule C (Income from Self-employment). Jones repeatedly claimed 100% of the allowable business deduction on any vehicle purchase regardless of the vehicle's value or whether it had a legitimate business use. Jones typically reported $20,000 to $24,000 in depreciation deductions on his customers' returns for a single year. Jones has admitted to an IRS agent that he has claimed improper § 179 deductions, but claimed he did so because he did not understand the tax code. (Hawley Dec. ¶ 15).

Jones has prepared returns with fictitious or inflated deductions by preparing fraudulent Forms 1120S (Subchapter S corporate income tax returns), Forms 1065 (partnership income tax

returns), and accompanying Schedules K-1 for customers. Jones inflated business expenses or create fictitious expenses and reported them on customers' Forms 1120S and 1065. These forms are used to report corporate or partnership income and expenses, which then flow through to the individual shareholder's or partner's tax return. These improper deductions therefore reduce the customer's reported tax liability. Jones has also repeatedly created fictitious corporations for customers in order to take these deductions. (Hawley Dec. ¶¶ 17 and 18).

Jones reported other fraudulent deductions on his customers' returns, including fictitious unreimbursed employment expenses and fictitious or inflated gambling losses. (Hawley Dec. ¶ 19). Jones has also intentionally misidentified social security income as Schedule C income, or personally-owned business income. By falsely categorizing this income as earned Schedule C income Jones improperly claims an Earned Income Tax Credit for the customer (Hawley Dec. ¶ 20).

Jones and Johnson have repeatedly failed to furnish copies of completed tax returns to their customers. Jones advised several of his customers not to talk with the IRS agents or cooperate with the IRS. (Hawley Dec.¶ 35).

Specific Examples of Fraudulent Return Preparation

The IRS has audited approximately ninety returns prepared by Jones and Johnson. These are the results of some of the audits:

- Jones improperly deducted fictitious business depreciation expenses, inflated utility bills, inflated mortgage payments, and inflated charitable deductions on Mitchell Richardson's 2001 and 2002 federal income-tax returns. After correcting these improper deductions the

IRS determined that Richardson owes $16,494 in additional taxes for 2001 and $27,093 for 2002. (Hawley Dec. ¶ 23, Exhibits B, C, and D).

- Jones created a fictitious business for his customer Michael Biglow on Biglow's 2002 tax return. Jones falsely reported that an $812 year-end bonus that Biglow received from his employer was income of the fictitious business. Jones then claimed $24,000 for depreciation of assets in Biglow's non-existent business. Correcting the improper deductions resulted in Biglow owing an additional $3,768 in tax for 2002. (Hawley Dec. ¶ 24, Exhibits E and F).
- Jones reported losses of more than $16,000 for his customer Dwain Martin for a purported lawn-care business, claiming such expenses as utilities, entertainment, and $2,500 in depreciation on Martin's 2001 federal income-tax return. The IRS's investigation revealed that Martin did not have a lawn-care business and the claimed business deductions and losses were fabricated. Jones also falsely reported that Martin made $11,500 in charitable contributions, which the IRS disallowed. Correcting Jones's improper deductions resulted in Martin owing $5,874 in additional taxes for 2001 and $3,849.22 for 2002. (Hawley Dec. ¶ 25, Exhibits G, H, and I).
- In preparing Leonard Holford's 2002 federal income-tax return, Jones falsely claimed that Holford owned Marilyn's Cleaning Service, and deducted $24,000 for deprecation on Holford's 2002 return. During the audit the IRS learned that the business was non-existent and disallowed all Schedule C deductions. As a result of correcting Jones's improper deductions Holford now owes $7,701 in additional tax for 2002. (Hawley Dec. ¶ 26, Exhibits J and K).

- Jones improperly claimed $20,000 worth of depreciation for David Bigley's home business "Korupt Kennels" on Bigley's 2001 return. Jones also improperly claimed an exemption for Bigley by claiming head-of-household status for him and claiming that he cared for a foster-child. An IRS agent learned that the child was Bigley's sister's and not Bigley's foster child. Correcting Jones's improper items resulted in Bigley owing an additional $7,928. (Hawley Dec. ¶ 27, Exhibits L and M).
- Jones improperly claimed a $5,582 deduction for moving expenses on Duane and Carrie Adams's 2002 federal tax return. The couple had moved only three blocks away from their previous house. A move of such a short distance is ineligible for a federal income tax deduction. Moreover the moving expenses were likely inflated. The IRS further determined that Jones improperly claimed deductions for other miscellaneous expenses totaling $19,941. Correcting Jones's improper deductions resulted in the Adamses owing an additional $4,356 in tax. (Harley Dec. ¶ 28, Exhibits N and O).
- Jones improperly reported $21,800 worth of purported miscellaneous business expenses on David Griffin's 2001 federal income tax return and fabricated other expenses on Griffin's 2002 return. Jones improperly reported Griffin's wages as self-employed business income on the 2002 return, which he offset by improper Schedule C deductions. **[** Correcting Jones's improper treatment resulted in Griffin owing $4,252 in taxes for 2001 and $2,760 for 2002. (Hawley Dec. ¶ 29, Exhibits P, Q and R).
- Jones customer Michale Vann is a part owner of a small funeral-home business in addition to his regular employment. Vann purchased a vehicle for personal use in 2001, and Jones improperly claimed a $20,000 depreciation business deduction for the vehicle on Vann's

2001 federal income tax return. Jones also falsely reported on Vann's 2002 return that the funeral home business incurred $22,549 in losses. As a result of correcting Jones's improper deductions, Vann owed $6,110 in additional taxes for 2001 and $6,162 for 2002. (Hawley Dec. ¶ 30, Exhibits S and T).

- Jones falsely reported on Gary McNett's 2002 federal income tax return that McNett owned a music-production business. Jones claimed the business received no income and incurred a $32,093 loss for the year. The IRS investigation determined that McNett had not incurred the loss, which resulted in McNett owing an additional $6,972 in tax for 2002. (Hawley Dec., ¶ 31 Exhibits U and V).
- Jones prepared Richard and Reba Halbrook's 2002 and 2003 federal income tax returns. Jones claimed on the 2002 return that Reba incurred an $11,870 loss from her tutoring business. The IRS audit revealed that Reba does not tutor or own a business. Jones also improperly reported moving expenses on the Halbrook's 2002 return. The Halbrooks were in the process of filing for bankruptcy in 2002 and told Jones that a bank was foreclosing on their their house in Oklahoma. Jones told Richard Halbrook that he was allowed to take a one-time deduction for the foreclosure of his home, and reported a fictitious moving expense on the Halbrooks's return. As a result of correcting Jones's improper items on their tax returns, the Halbrooks owe $792.69 in taxes for 2002 and $353.45 for 2003. (Hawley Dec. ¶ 32, Exhibits W, X and Y).
- The IRS audited Darin Campbell's 2001 and 2002 Jones-prepared federal income-tax return. Jones fabricated a boating business "Lil D's Consulting, Inc.," on Schedule C of Campbell's 2001 and 2002 returns. Jones claimed $24,000 in IRC § 179 deprecation

deductions along with $15,259 in office expenses for the fictitious business on the 2001 return and reported a $23,354 loss for the fictitious business in 2002. While Campbell owns a boat, he does not operate a business with it. As a result of correcting these improper deductions Campbell owed an additional $11,282 in taxes for 2001 and $13,372.87 for 2002. (Hawley Dec. ¶ 33, Exhibits BB and CC).

- Jones prepared Charles Miller's 2003 federal income-tax return. Although Miller provided to Jones all relevant paperwork, Jones failed to report $74,500 in income from Miller's business, $55,000 in stock transactions, $3,869 in dividends, and $647 in interst on Miller's return. (Declaration of Charles Miller).
- Jones prepared Roderick Houston's 2003 federal income tax return. Although Jones prepared the return Johnson improperly signed it as preparer. Jones reported a net loss of $6,053 on Houston's return for his work as a minister, even though Houston in fact made $17,700 as a minister that year. (Declaration of Roderick Houston).

ARGUMENT

Jones and Johnson's tax-preparation schemes, which include improper depreciation deductions, completely fabricated businesses, and a myriad of other fraudulent and improper deductions, should be enjoined. Although many variations exist, the fraudulent tax arrangements that Jones and Johnson employed share common characteristics, including the improper reduction or elimination of taxable income, and improper deductions for non-deductible personal expenses. Congress implemented three statues for injunctive relief to halt abusive tax schemes and tax preparers: I.R.C. §§ 7407, 7408 and 7402(a). Section 7407 provides an action against income-tax-return preparers who violate or substantially interfere with the internal revenue laws; § 7408

combats the promotion of abusive tax schemes; and § 7402(a) is a broad grant of power allowing the Government to seek injunctive relief "as may be necessary or appropriate for the enforcement of the internal revenue laws."

Congress views injunctions as the most effective way to enforce the law against promoters of such abusive tax schemes.[1] By obtaining an injunction against the promoter or return preparer, the Government can avoid a drain on IRS resources, a multiplicity of suits on the same issue against individual taxpayers, and piecemeal litigation.[2] Otherwise, the Government would be unable to effectively combat the abusive position and taxpayers would be encouraged to violate the tax laws because of "the doubtless accurate belief that the IRS would be unable to detect and pursue every taxpayer in violation[.]"[3]

Where an injunction is expressly authorized by statute, the Court should look to whether the Government has satisfied the requirements for a statutory injunction.[4] The United States need not show irreparable harm for a statutory injunction to issue because such harm is presumed by the "very fact that the statute has been violated."[5] Nor does the existence of alternative criminal or civil remedies preclude the issuance of a statutory injunction.[6] In enacting §§ 7407

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[1] S.Rep. No. 97-494(I), at 268 (1982), *reprinted in* 1982 U.S.C.C.A.N. 781, 1016.

[2] *United States v. Buttorff,* 761 F.2d 1056, 1064 (5th Cir. 1985).

[3] *Id.*

[4] *See, e.g., United States v. Estate Preservation Servs.,* 202 F.3d 1093, 1098 (9th Cir. 2000). *See also United States v. Buttorff,* 761 F.2d at 1063; *Kemp v. Peterson,* 940 F.2d 110, 112-13 (4th Cir. 1991); *United States v. Kaun,* 827 F.2d 1144, 1148 (7th Cir. 1987).

[5] *United States v. Hayes Int'l Corp.,* 415 F.2d 1038, 1045 (5th Cir. 1969).

[6] *Buttorff,* 761 F.2d at 1063-64.

and 7408, Congress has already determined that existing legal remedies are insufficient.[7] In addition, the Government represents the public interest. Consequently, the Court's equitable powers "*assume an even broader and more flexible character* than when only a private controversy is at stake."[8] Furthermore, procedures for issuing a preliminary injunction are customarily less formal and may be granted on evidence that is less complete than at a trial.[9]

A preliminary injunction is appropriate in this case under I.R.C. §§ 7407, 7408, and 7402(a) to prevent Jones, Johnson, and anyone acting in concert with them from engaging in this illegal conduct while this case is pending. Each of these statutes provides an independent basis for entering the requested preliminary injunction.

A preliminary injunction is appropriate under I.R.C. § 7408 because Jones has engaged in conduct subject to penalty under I.R.C. §§ 6700; and Jones and Johnson have engaged in conduct subject to penalty under § 6701. Jones has violated § 6700 by organizing and promoting his abusive tax schemes; and making false statements regarding the deductibility of non-deductible items. Both Jones and Johnson violate § 6701 by preparing and electronically filing federal-income-tax returns based on the schemes, knowing that the returns understate their customers' true tax liabilities.

Finally, a preliminary injunction is also appropriate under I.R.C. § 7402(a), because an injunction prohibiting Johnson and Jones from filing false tax returns; and prohibiting Jones from

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[7] *See Id.* at 1063-64.

[8] *FSLIC v. Dixon*, 835 F.2d 554, 562 (5th Cir. 1987) (*quoting Porter v. Warner Holding Co.*, 328 U.S. 395, 398 (1946)) (emphasis in original)).

[9] *FSLIC*, 835 F.2d at 558 (*quoting Univ. of Texas v. Comenisch*, 451 U.S. 390, 395 (1981)).

promoting the availability of nonexistent tax deductions, and instructing people not to talk to or cooperate with the IRS, is necessary and appropriate for the enforcement of the internal revenue laws.

I. Jones and Johnson should be enjoined under I.R.C. § 7407.

A preliminary injunction against both Jones and Johnson is appropriate under § 7407 because they are paid tax-return preparers who have engaged in activity subject to penalty under I.R.C. §§ 6694 and 6695. Jones and Johnson violate I.R.C. § 6694 by preparing tax returns for compensation based on the unrealistic and frivolous position that customers are entitled to tax deductions for nondeductible personal and even nonexistent expenses. Jones and Johnson violate § 6695 by failing to furnish a copy of the completed tax return to their customers in violation of § 6695 (a). The United States is entitled to an injunction under I.R.C. § 7407 if it shows that:

1. Jones and Johnson are tax preparers; and

2. a. engaged in conduct subject to penalty under I.R.C. § 6694 (which penalizes a return preparer who prepares or submits a return containing an unrealistic position); or

   b. engaged in conduct subject to penalty under I.R.C. § 6695 (which penalizes the failure to sign returns or claims and the failure to furnish an identifying number); or

   c. guaranteed the payment of any tax refund or allowance of any tax credit; or

   d. engaged in any other fraudulent or deceptive conduct that substantially interferes with the proper administration of the internal revenue laws; and

3. an injunction is appropriate to prevent the recurrence of such conduct.

Jones and Johnson are paid return preparers who violate §§ 6694 and 6695. IRC § 6694 imposes a penalty on a return preparer who prepares a claim for refund based on an unrealistic position. The following requirements must be met:

a. Any part of any understatement of liability with respect to any return or claim for refund is due to a position for which there was not a realistic possibility of being sustained on its merits,

b. any person who is an income tax return preparer with respect to such return or claim knew (or reasonably should have known) of such position, and

c. such position was not disclosed on the return as provided by statute or was frivolous.[10]

The three requirements are clearly established on the record before the Court here. Jones and Johnson violated § 6694 by preparing numerous income-tax returns for customers that used fabricated businesses and fabricated deductions both to understate federal-income-tax liability, and to requested improper refunds. There is no possibility that deductions based on fabrications will be, or could be, sustained on the merits. Moreover, the fabricated items were frivolous.

Jones violates I.R.C. § 6695, which imposes a penalty on a return preparer who:

a. fails to comply with I.R.C. § 6107 which requires each preparer to "furnish a completed copy of such return . . . to the taxpayer. . . ;" or

b. fails to sign returns as required by law; or

c. fails to furnish their return preparer identification number as required by I.R.C. § 6109(a)(4).

Jones is subject to penalty under § 6695 for failing to sign the returns he prepares as required by law. He had Johnson file all of his returns under her preparer identification number because the IRS revoked his electronic filing privileges. When the IRS began investigating

[10] I.R.C. § 6694.

Johnson, he had Johnson find another preparer, Marlene Harris, to file Jones-prepared returns in her name. The failure to sign and file returns he prepares in his own name was clearly an attempt to avoid detection and investigation by the IRS.

Finally, an injunction under § 7407 is necessary to prevent recurrence of defendants' illegal conduct. When addressing likelihood of recurrence, courts have looked to: 1) the gravity of the harm caused by the offense; 2) the extent of the defendant's participation and his degree of scienter; 3) the isolated or recurrent nature of the infraction; 4) the defendant's recognition or non-recognition of his own culpability; and 5) the likelihood that the defendants' customary business activities might again involve her in such transactions.[11]

These factors weigh entirely in favor of granting a preliminary injunction. First, defendants' activities have caused the Government substantial harm. The IRS estimates the current tax loss to the Treasury as a result of Jones's and Johnson's schemes at over $12 million for the tax years 1999 through 2003. IRS employees have had to devote substantial resources attempting to locate and process the fraudulent returns that defendants prepare, and to assess and collect proper tax liabilities and penalties. Moreover, defendants' activities expose their customers to IRS examinations and potential penalties, interest, and criminal prosecution. Second, Jones and Johnson knowingly prepared or assisted in preparing the returns containing fictitious and inflated tax deductions; and failed to review the tax returns with their customers. Third, defendants' conduct is not isolated, Jones and Johnson have prepared more than 5,000

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[11] *United States v. Schiff*, 379 F.3d 621, 625 (9th Cir. 2004); *United States v. Raymond*, 228 F.3d 804, 813 (7th Cir. 2000), *cert. denied*, 533 U.S. 902 (2001); *Kaun*, 827 F.2d at 1149-50. *See also SEC v. Carriba Air, Inc.*, 681 F.2d 1318, 1322 (11th Cir. 1982) (action by SEC to enjoin alleged violations of securities laws).

returns between 1999 and 2003, which demonstrates the gravity of the harm they have caused.[12] Finally, it appears that Jones is hiring help for this new tax season, which makes the prompt entry of a preliminary injunction critical.

The United States requests that the Court enjoin defendants Jones and Johnson from acting as income-tax-return preparers during the pendency of this case. Under I.R.C. § 7407(b), if a court finds that defendants have "continually or repeatedly" engaged in conduct listed in subsection(b)(1), and that an injunction merely barring such misconduct would be insufficient to prevent the defendants' interference with tax administration, then the court may enjoin not only that misconduct but also bar the defendants altogether from preparing tax returns for others.[13] That is a harsh sanction, but the facts in the record here fully justify imposing it now. Furthermore, I.R.C § 7402 provides additional authority for injunctions to prevent the continued interference with the proper administration of the law. [14]

In this case, is is entirely appropriate to bar Jones and Johnson from preparing any returns for others during the pendency of the suit, First, the defendants have "continually or repeatedly" engaged in illegal conduct over several years. Jones, who has previously been convicted of filing false returns, has for many years filed a substantial number of returns which contain false and fraudulent information. Johnson has aided her father in this endeavor by filing his returns in her name, and soliciting another return preparer to do the same

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[12] *United States v. Bailey*, 789 F. Supp. 788, 816 (N.D. Tex. 1992).

[13] *United States v. Savoie*, 594 F. Supp. 678 (W.D. La. 1984).

[14] *Abdo v. United States*, 234 F. Supp. 553 (M.D.N.C. 2002).

Moreover, anything less than a complete bar on the preparing returns is unlikely to stop the harm defendants cause the Government. Defendants' returns contain a multitude of improprieties, including omitted and mischaracterized income, fictitious business entities, and false and fictitious deductions. One characteristic of defendants' schemes is that their returns appear at first glance to be legitimate returns; it is only after careful scrutiny that many of their schemes can be detected.[15] If Jones and Johnson are merely barred from filing improper returns, their track record of deceit and fraud to date shows there is a high likelihood that they would continue these schemes to the detriment of the public and defendants' customers.

II. Defendants Should Be Preliminarily Enjoined Under I.R.C. § 7408

A preliminary injunction against both Jones and Johnson is appropriate under I.R.C. § 7408 because they have engaged in activity subject to penalty under I.R.C. §§ 6700 and 6701. Jones violates I.R.C. § 6700 by promoting schemes involving fictitious businesses and inflated and false deductions. Jones and Johnson violate I.R.C. § 6701 by preparing and filing fraudulent returns based on the schemes. Specifically, the United States may obtain an injunction under I.R.C. § 7408 if it shows that:

1. defendants engaged in any conduct subject to penalty under I.R.C. § 6700, which requires the United States to show:

    a. defendants organized or assisted in the organization of a plan or arrangement; or

    b. participated, directly or indirectly, in the sale of a plan or arrangement, and

[15] See *United States v. Bailey*, 789 F. Supp. At 788 (lifetime ban for preparing fraudulent income tax returns appropriate where defendant used deceptive and indiscernible tax scheme.)

c. defendants made or furnished or caused another person to make or furnish (in connection with such sale or organization)–a statement with respect to the allowability of any deduction or credit, the excludability of any income, or the securing of any other tax benefit by participating in the plan or arrangement which the

d. defendants knew or had reason to know is false or fraudulent as to any material matter; or

2. defendants engaged in any conduct subject to penalty under I.R.C. § 6701, which requires the United States to show:

a. defendants aided or assisted in, procured, or advised with respect to the preparation or presentation of any portion of a return, affidavit, claim, or other document; and

b. knew (or had reason to believe) that such portion would be used in connection with any material matter arising under the internal revenue laws; and

c. knew that such portion (if so used) would result in an understatement of the liability for tax of another person; and

3. injunctive relief is appropriate to prevent recurrence of such conduct.

The record establishes that Jones violates § 6700. Jones promotes his tax schemes. In the promotion and furtherance of those schemes, he makes false statements to customers regarding the availability of "standard deductions" for expenses incurred in connection with military duty, and false statements regarding the availability of deductions for personal expenses through the use of S-corporations. Jones knew or had reason to know that his customers were not entitled to claim deductions for these expenses.

The facts establish that both Jones and Johnson violate § 6701. Jones and Johnson are in the business of preparing income-tax-returns with improper and often fabricated deductions. These tax returns are used in connection with determining a taxpayer's tax liability—a material matter. These activities meet the first requirement of aiding and assisting in the preparation of a

tax return. This also demonstrates the second requirement that defendants knew that the filed returns would be used in connection with a material matter, namely the determination of customers' tax liabilities.

Knowledge of a potential understatement is required for imposition of a Section 6701 penalty.[16] That knowledge may be proved by inferences.[17] Factors relevant to this inquiry include: "(1) the extent of the defendant's reliance upon knowledgeable professionals; (2) the defendant's level of sophistication and education; and (3) the defendant's familiarity with tax matters." [18] By his own admission Jones has been preparing returns for more than fifty years. Johnson has been in the return-preparation business for more than twenty years. Additionally, when confronted by customers under IRS audit, Jones tells them not to cooperate with the IRS. This evidence shows that defendants knew that there was no legal basis for the amounts claimed as refunds on customers' tax returns.

Finally, as noted above in the discussion of Section 7407, an injunction is appropriate relief in this case. To prevent defendants' illegal conduct, the Court should preliminarily enjoin them under I.R.C. § 7408.

III. The Court should enter an injunction under I.R.C. § 7402(a).

Section 7402(a) of the Internal Revenue Code authorizes injunctions "as may be necessary or appropriate for the enforcement of the internal revenue laws." This provision, in and of itself, authorizes the United States to seek an injunction against those who interfere with the

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[16] *Mattingly v. United States*, 924 F.2d 785, 791 (8th Cir. 1991).

[17] *See Nielsen v. United States*, 976 F.2d 951, 956 (5th Cir. 1992).

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

enforcement of tax laws.[19] Section 7402(a), however, goes beyond merely codifying a district court's general equity power to grant injunctions. This provision gives the district courts a full range of powerful tools to ensure the enforcement of both the spirit and the letter of the internal revenue laws. As the First Circuit has noted, "[it would be difficult to find language more clearly manifesting a congressional intention to provide the district courts with a full arsenal of powers to compel compliance with the internal revenue laws."[20]

Consistent with the statute's broad purpose, the federal courts have relied on Section 7402(a) to issue a broad range of injunctions where necessary or appropriate for the enforcement of the internal revenue laws. Injunctions have been issued under Section 7402(a) to enjoin a taxpayer's harassment of IRS agents,[21] to enjoin the promotion and sale of tax evasion trust plans,[22] and to enjoin the dissemination of materials encouraging taxpayers to file improper tax returns.[23]

Jones and Johnson have engaged in conduct that interferes substantially with the administration and enforcement of the internal revenue laws, thereby making a permanent injunction pursuant to Section 7402 appropriate. They have prepared fraudulent tax returns and

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[19] *United States v. Ernst & Whinney*, 735 F.2d 1296, 1300-01 (11th Cir. 1984), *cert. denied*, 470 U.S. 1050 (1985); *United States v. Franchi*, 756 F.Supp. 889, 890 (W.D. Pa. 1991) (citing legislative history).

[20] *Body v. United States*,243 F.2d 378, 384 (1st Cir.), *cert. denied*, 354 U.S. 923 (1957). *Accord Ernst & Whiney*, 735 F.2d at 1300.

[21] *United States v. Ekblad*, 732 F.2d 562 (7th Cir. 1984); *United States v. Hart*, 701 F.2d 749 (8th Cir. 1983).

[22] *United States v. Landsberger*, 692 F.2d 501 (8th Cir. 1982) (affirming district court order relying on both I.R.C. §§ 7407 and 7402(a)).

[23] *United States v. May*, 555 F. Supp. 1008 (E.D. Mich. 1983).

attempted to elude detection by filing returns they prepare with other persons listed as the preparer. Jones has also misrepresented himself as a certified public accountant and as bonded and licensed. Unless enjoined, Jones and Johnson are likely to continue to engage in such conduct. Further, as discussed below, their conduct causes irreparable injury to the United States for which the United States has no adequate remedy at law.

Section 7402(a) contains sufficient standards that a court need not consider traditional equitable factors that are applicable in non-statutory injunction cases.[24] In dictum, however, the Eleventh Circuit has said that traditional equitable factors should be considered in a Section 7402 injunction case.[25] Should this Court require the United States to show that it is equitable to grant a preliminary injunction against Jones and Johnson, we can easily do so. Consideration of the traditional equity factors supports a Section 7402 injunction here.

First, there is a substantial likelihood that the United States will prevail on the merits: it is unlawful for taxpayers to claim fictitious deductions and deductions for personal expenses. Second, the hardships to the Government and the public outweigh any potential hardship to the defendants. The Government will suffer irreparable injury unless the injunction is entered: defendants' activities have caused more than $12 million in losses to the Treasury, and losses will continue to accrue until they are enjoined. Additionally, the defendants' unlawful activities create a substantial administrative burden on the IRS. While barring Jones and Johnson from preparing returns for others may cause them hardship, the record establishes that the hardship is their having to live without fees charged for preparing fraudulent returns—fees which they have no right to

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[24] *See* discussion of statutory injunctions, *supra*.

[25] *Ernst & Whinney*, 735 F.2d at 1301.

charge and no right to keep. The threatened injury to the United States outweighs any damage the proposed injunction could cause to Jones and Johnson.

Conclusion

Defendants Harrold Jones and Evelyn Johnson have repeatedly and continually prepared federal-income-tax returns claiming fictitious or inflated deductions in order to improperly claim tax refunds for their customers. These returns are prepared based on a scheme that fabricates businesses, and takes improper depreciation and other deductions. If Jones and Johnson are not preliminarily enjoined, their continuing actions especially during this tax season, will result in additional losses to the United States during the pendency of this lawsuit, and additional harm to their customers.

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