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UNITED STATES DISTRICT COURT

FOR THE CENTRAL DISTRICT OF CALIFORNIA

UNITED STATES OF AMERICA, Plaintiff, v. N.C.K. SERVICES, INC., CARLA D. BERRY; KAREN D. BERRY; and IVAN T. JOHNSON, Defendants.	No. EDCV 04-1566 VAP (SGGLx) **UNITED STATES' MEMORANDUM IN SUPPORT OF *EX PARTE* APPLICATION FOR TEMPORARY RESTRAINING ORDER AND ORDER TO SHOW CAUSE WHY DEFENDANTS SHOULD NOT BE PRELIMINARILY ENJOINED FROM PREPARING INCOME TAX RETURNS**

The United States of America respectfully submits this memorandum in support of its *ex parte* application for a temporary restraining order and an order to show cause why Defendants should not be preliminarily enjoined from preparing tax returns.

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INTRODUCTION

This is the busiest time of year for income tax return preparers. As the April 15 filing deadline approaches, the number of taxpayers turning to professionals to assist them in the preparation of their 2005 individual income tax returns increases by the day, with the most significant spike occurring in the last week before the deadline. The Internal Revenue Service ("IRS") heavily relies upon these preparers to uphold the integrity of the tax system by accurately reporting all qualifying sources of income for each of their customers, and by legitimately claiming only those deductions, credits, and exemptions supported by appropriate documentation and the internal revenue laws. Defendants, each of whom is an income tax return preparer, and each of whom is currently preparing 2005 tax returns for others, have shown by their fraudulent and deceptive pattern of conduct over the years that they have no respect whatsoever for this system, nor any concern for the enormous damage they have inflicted, and are continuing to inflict, upon it.

Defendants' abusive tax preparation scheme is fiendishly simple: first, using a basic formula sheet, they claim false and fraudulent home mortgage interest deductions and other unsupported Schedule A itemized deductions on more than 90% of their customers' income tax returns, resulting in undeserved refunds; second, in order to avoid detection by the IRS, they purposefully fail to sign the fraudulent returns, omit the

required identifying information (*e.g.*, employer identification number), and routinely destroy incriminating books and records. As simple as Defendants' scheme may be, it has far-reaching and disastrous consequences, including a direct tax loss to the government estimated to exceed $25 million. Immediate injunctive relief - in the form of an order restraining Defendants from preparing any additional 2005 tax returns pending a trial on the merits - is the only way to stop Defendants from wreaking further havoc on the administration and enforcement of the internal revenue laws.

ISSUE PRESENTED

Internal Revenue Code Sections 7402(a) and 7407, Title 26 U.S.C., authorize injunctive relief against income tax return preparers who violate the tax code, engage in fraudulent or deceptive conduct, or otherwise interfere with the administration and enforcement of the internal revenue laws. Defendants N.C.K. Services, Inc. ("NCK"), Carla D. Berry ("Carla Berry"), Karen D. Berry ("Karen Berry"), and Ivan T. Johnson ("Ivan Johnson") (collectively, "Defendants") have intentionally and systematically prepared thousands of federal tax returns claiming bogus deductions to create undeserved refunds.[1]

[1] For ease of reference, the term "Defendants" as used herein generally includes former Defendant Valerie M. Dixon. Ms. Dixon was employed as an income tax return preparer along with Carla Berry, Karen Berry, and Ivan Johnson during the 2000 through 2004 return preparation seasons. Dixon Declaration, ¶¶ 3-4, Exhibit 7 to Hulbig Declaration. Ms. Dixon was dismissed from this suit on May 9, 2005, after agreeing to stop preparing tax returns for 10 years, among other terms. Therefore, Ms. Dixon is excluded from any reference herein to (i) Defendants' preparation activities or other conduct occurring after May 9, 2005 and (ii) the injunctive relief the United States now seeks.

Based on an analysis of IRS audits to date, the combined tax loss from this scheme for the 2002-2005 return preparation seasons alone is estimated to exceed $25 million. The issue is whether Defendants should be enjoined from preparing federal tax returns for others pursuant to I.R.C. Sections 7402(a) and 7407 pending a trial on the merits.

STATEMENT OF FACTS

The relevant facts are set forth in the Declarations of Hannah Lee, IRS Revenue Agent ("Lee Declaration"), former Defendant Valerie M. Dixon ("Dixon Declaration"), and Adam F. Hulbig, Trial Attorney for the U.S. Department of Justice, Tax Division ("Hulbig Declaration"), which are attached hereto and incorporated herein by this reference.[2]

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[2] Although it does not rely upon them in support of its application, in this memorandum the United States refers the Court to its Requests for Admissions to Defendants ("RFAs"). The RFAs are deemed admitted as a matter of law pursuant to Fed. R. Civ. P. 36(a) because Defendants did not serve timely answers thereto.

ARGUMENT

I. Defendants Should Be Enjoined Immediately under I.R.C. §§ 7402(a) and 7407 Before They Prepare Any More Fraudulent Tax Returns.

A. Legal Standards for TRO and Preliminary Injunction

1. Temporary restraining order under Fed. R. Civ. P. 65(b).

Rule 65(b) of the Federal Rules of Civil Procedure provides in relevant part:

> A temporary restraining order may be granted without written or oral notice to the adverse party or that party's attorney only if (1) it clearly appears from specific facts shown by affidavit or by the verified complaint that immediate and irreparable injury, loss, or damage will result to the applicant before the adverse party or that party's attorney can be heard in opposition, and (2) the applicant's attorney certifies to the court in writing the efforts, if any, which have been made to give the notice and the reasons supporting the claim that notice should not be required.

Fed. R. Civ. P. 65(b).

The attached declarations meet Rule 65(b)'s requirement to prove "specific facts" showing that "immediate and irreparable injury, loss, or damage will result" to the United States if a temporary restraining order is not issued. *See, e.g., United States v. Venie*, 691 F. Supp. 834 (M.D. Pa. 1988)(issuing a TRO prohibiting defendant from preparing further tax returns where defendant had consistently claimed head of household status for his customers, regardless of whether the customers were entitled to that status under law, and where he had overstated their child care expenses).

As discussed below, the injunctive relief sought in this

case is authorized by Internal Revenue Code Sections 7402(a) and 7407, and irreparable injury is presumed from proof of violation of the statute. *See, e.g., United States v. Odessa Union Warehouse Co-op*, 833 F.2d 172, 175 (9th Cir. 1987) ("Where an injunction is authorized by statute, and the statutory conditions are satisfied as in the facts presented here, the agency to whom the enforcement of the right has been entrusted is not required to show irreparable injury"). The attached declarations supply such proof. Further, the attached declarations, and in particular the Lee Declaration, demonstrate that the threat of irreparable injury is immediate if the requested TRO is not issued: Defendants operate a high-volume business, this is the busiest time of the year for tax return preparation (as individual income tax returns are due on April 15), and the IRS lacks the resources to audit every return Defendants prepare and collect every dollar of additional tax resulting from such audits. *See* Lee Declaration, ¶¶ 53-63.

2. Preliminary Injunction under I.R.C. Sections 7402(a) and 7407.

This case is governed by Internal Revenue Code Sections 7402(a) and 7407. Thus, the United States need not satisfy the traditional equitable requirements for a preliminary injunction. *See United States v. Estate Preservation Services, Inc.*, 202 F.3d 1093, 1098 (9th Cir. 2000) (in an action for a statutory injunction under Section 7408 to enjoin a promoter of an abusive tax shelter, meeting the traditional equitable requirements was not necessary so long as the statutory requirements were

satisfied).

Section 7402(a) provides, in relevant part, that "[t]he district courts of the United States at the instance of the United States shall have jurisdiction to make and issue in civil actions . . . orders of injunction . . . and to render such judgments and decrees as may be necessary or appropriate for the enforcement of the internal revenue laws." I.R.C. § 7402(a). This broad grant of authority provides the United States with an independent basis upon which to seek an injunction against those who interfere with the enforcement of the internal revenue laws. *See* Senate Finance Committee, Tax Equity and Fiscal Responsibility Act of 1982, S. Rep. No. 494, 97th Cong., 2d Sess., reprinted in 1982 U.S. Code Cong. & Adm. News, pp. 781, 1016-17; *see also Brody v. United States*, 243 F.2d 378, 384 (1st Cir. 1957) ("[i]t 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.")

In addition to the broad injunctive relief available under Section 7402, Section 7407 separately authorizes a court to enjoin a person from acting as an income tax return preparer if that person has continually or repeatedly: (1) engaged in conduct subject to penalty under I.R.C. Section 6694, which prohibits the preparation or submission of a return containing an understatement of tax due to an unrealistic position or willful or reckless conduct; (2) engaged in conduct subject to penalty under I.R.C. Section 6695, which mandates that return preparers

sign and include their identifying number on each return they prepare (among other things); (3) engaged in conduct subject to any criminal penalty under the internal revenue laws; (4) misrepresented his or her eligibility to practice before the IRS, or otherwise misrepresented his or her experience or education as a return preparer; or (5) engaged in any other fraudulent or deceptive conduct substantially interfering with the proper administration of the tax laws. I.R.C. § 7407. In addition, Section 7407 provides that a court must find that (1) injunctive relief is appropriate to prevent the recurrence of such conduct, and (2) a narrower injunction prohibiting only such conduct would be insufficient to prevent further interference with the administration of the internal revenue laws. *Id.*

B. The Evidence Is Sufficient to Establish the Elements of I.R.C. Section 7407.

1. Defendants are "income tax return preparers."

Each of the Defendants is an "income tax return preparer" within the meaning of I.R.C. Section 7701(a)(36)(A). Under Section 7701(a)(36)(A), "income tax return preparer" is defined to mean "any person who prepares for compensation, or who employs one or more persons to prepare for compensation, any return of tax imposed by subtitle A [income taxes] or any claim for refund of tax imposed by subtitle A." Defendants have prepared and continue to prepare tax returns for compensation at Defendant NCK's office in Rialto, California. *See generally* Customer Declarations, Exhibits H-T to Lee Declaration; *see also* Dixon Declaration, ¶ 4. NCK is owned and principally operated by

Defendants (and sisters) Carla Berry and Karen Berry, who have been in the business of preparing income tax returns for compensation since at least the 2002 return preparation season (*i.e.*, tax returns for 2001). Carla Berry Tr. 70:1-4, Exhibit 6 to Hulbig Declaration; *see also* Lee Declaration, ¶¶ 28-31. Defendant NCK also employs Defendant Ivan Johnson as a return preparer. *Id.* at ¶ 28. Like the Berry Defendants, Ivan Johnson has prepared income tax returns for compensation since at least the 2002 return preparation season. *Id.* at ¶ .

2. Defendants have engaged in conduct subject to penalty under I.R.C. Sections 6694 and 6695, and conduct subject to criminal penalty.

(a) I.R.C. Section 6694

A return preparer is subject to penalty under I.R.C. Section 6694 if the preparer willfully understates a taxpayer's liability on a return or claim for refund, recklessly or intentionally disregards IRS rules or regulations, or both. I.R.C. §§ 6694(b)(1),(2).

In their capacity as return preparers, Defendants have violated I.R.C. Section 6694(b)(1) by willfully understating the tax liability of thousands of customers through the use of false and inflated deductions for home mortgage interest, among other fraudulent Schedule A deductions. Lee Declaration, ¶¶ 32-33; *see also* Dixon Declaration, ¶¶ 6-11. The Lee Declaration establishes that over 90% of the 2001-2004 returns audited by the IRS to date show understatements of tax resulting from Defendants' abusive deduction scheme, and that the average tax loss per return is $3,160. *Id.* at ¶ 39. This scheme has resulted in actual tax

losses to the United States in excess of $14 million. *Id.* at 36. If the unaudited returns are included, and it is assumed that 90% of these returns also suffer from an average tax loss of $3,160, the aggregate tax loss to the United States is estimated to exceed $25 million. *Id.* at ¶ 38. Notably, these totals do not include tax losses attributable to Defendants' systematic and reported use of other improper Schedule A deductions (*e.g.*, miscellaneous business expenses). *Id.* at ¶ 31; *see also* Dixon Declaration at ¶ 6-11.

Defendants overstated home mortgage interest on the overwhelming majority of the returns they prepared, even where the customers did not own homes (meaning there were no Forms 1098 mortgage interest statements ever prepared and filed by third-party lenders for these customers). *Id.* at ¶¶ 37, 45; *see also* Dixon Declaration at ¶ 7; *see generally* Customer Declarations, Exhibits H-T to Lee Declaration; *See* RFA Nos. 8-9, Exhibit 2 to Hulbig Declaration at p. 12 (admitting that Defendants prepared federal tax returns for customers containing overstated home mortgage interest deductions, even where the customers did not own homes). Defendants' systematic inclusion of overstated and fictitious deductions for home mortgage interest on their customers' returns had the desired effect of reducing the taxable income of those customers, resulting in undeserved refunds in the majority of cases. Lee Declaration at ¶¶ 47, 49; *see also* RFA No. 10, Exhibit 2 to Hulbig Declaration at p. 12 (admitting that Defendants prepared federal tax returns containing false home mortgage interest deductions in order to maximize the refunds due

to their customers). Defendants did not explain the bogus deductions to their customers, however. *Id.* at ¶ 46; *see generally* Customer Declarations, Exhibits H-T to Lee Declaration.

Even more troubling is that Defendants used a "formula sheet" to claim fraudulent home mortgage interest and other Schedule A deductions (*e.g.*, charitable contributions and miscellaneous business expenses) based solely on the amount of a given customer's income. Dixon Declaration at ¶¶ 9-11. The "formula sheet" set forth income ranges and corresponding ranges for Schedule A itemized deductions that were used by Defendants to randomly 'assign' deduction sub-totals on the returns.[3] *Id.* at ¶ 9. As a result, the deductions claimed on the returns were based only on the income of customers, and not on any actual interest, expenses, taxes, or charitable contributions paid by those customers. *Id.* To facilitate the operation of this abusive and unlawful system, Defendants routinely told customers that the tax law allowed for deductions up to a certain amount based on the customer's income level. *Id.* at ¶ 10. In the course of engaging in the conduct described above, Defendants have clearly violated I.R.C. Section 6694(b)(1).

Defendants have also violated I.R.C. Section 6694(b)(2) by recklessly or intentionally disregarding IRS rules and regulations governing the use of Schedule A deductions,

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[3] Presumably, Defendants selected a range of deduction values that they believed were least likely to subject customers to IRS audits. In this way, Defendants created the illusion that the claimed Schedule A deductions were reasonable, *i.e.*, a customer earning $20,000 would take a smaller home mortgage interest deduction than a customer earning $60,000.

particularly the use of the home mortgage interest deduction. Since all three Defendants have formal training in the preparation of federal income tax returns, Lee Declaration at ¶ 29, Defendants can hardly deny their awareness of the relevant rules regarding the use of Schedule A deductions.[4] *See* RFA No. 3, Exhibit 2 to Hulbig Declaration at p. 11 (admitting that "[Defendants] have read the instructions published by the Internal Revenue Service for IRS Form 1040 and Form 1040X."); *see also* RFA No. 12, Exhibit 2 to Hulbig Declaration at p. 13 (admitting that "[Defendants] are responsible for determining that information on a federal income tax return is true, accurate, and complete") To the contrary, Defendants' tax preparation activities, as demonstrated by the declarations submitted herewith, evince a flagrant disregard for those rules in order to maximize customer refunds. *See, e.g.*, Dixon Declaration, ¶¶ 6-11.

(b) *I.R.C. Section 6695*

A return preparer is subject to penalty under I.R.C. Section 6695 if he or she fails to sign a return or, under I.R.C. Section 6109(a)(4), fails to furnish an identifying number, unless the preparer shows that the failure was due to a reasonable cause and not due to willful neglect. I.R.C. § 6695(b),(c). Section 6109(a)(4) provides, in relevant part, that "[a]ny return or claim for refund prepared by an income tax return preparer shall

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[4] The rules applicable to the home mortgage interest deduction and other Schedule A deductions are set forth in IRS Publication 17, which is publicly available on the IRS' website.

bear such identifying number for securing proper identification of such preparer, his employer, or both, as may be prescribed." The IRS regulations prescribed under Section 6109(a)(4) require that individual preparers include their social security number, and that preparers employed by a corporate preparer also include the corporate preparer's employer identification number ("EIN"). Treas. Reg. § 1.6109-2.

Defendants have violated I.R.C. Sections 6695(b) and (c) by consistently failing to sign the returns they prepared for others and by failing to provide the appropriate identifying information. Lee Declaration, ¶ 34; *see also* Dixon Declaration, ¶¶ 14, 15; RFA Nos. 4-6, Exhibit 2 to Hulbig Declaration at p. 11 (admitting that Defendants failed to sign and provide identifying information on returns they prepared for customers). By way of illustration, the IRS has determined that Defendants failed to sign and provide identifying information on at least 1,946 returns they prepared during the 2004 preparation season alone (*i.e.*, tax returns for 2003). Lee Declaration, ¶ 34. According to a search of IRS records, Defendant NCK does not have an employer identification number, even though it began operations in January 2004. *Id.*

The IRS also cross-checked Defendants' social security numbers with returns on file. *Id.* Although Defendants are known to have prepared at least 1,946 total returns in 2004, Defendants Carla Berry and Karen Berry reported their social security on only 41 total returns. *Id.* Ivan Johnson did not report preparation of any returns in 2004, using his social security

number or otherwise. *Id.* Because Defendants do not include identifying information on the overwhelming majority of returns they prepare for others, their fraudulent tax preparation activities are extremely difficult to track. *Id.* This, in turn, places a substantial administrative burden on the IRS.

A return preparer is also subject to penalty under I.R.C. § 6695(d) if, under I.R.C. § 6107(b), he or she fails to retain completed copies of client tax returns or, alternatively, a list of clients and their taxpayer identification numbers for a three-year period after the close of the applicable return period, unless the preparer shows that the failure was due to a reasonable cause and not due to willful neglect. I.R.C. §§ 6695(d).

At a minimum, Defendants have violated I.R.C. 6695(d) by failing to maintain a complete list of their 2005 clients (*i.e.*, tax returns for 2004) with corresponding taxpayer identification numbers. Lee Declaration, ¶¶ 54, 56-57. Defendants, as part of their Fed. R. Civ. P. 26(a)(1) disclosures, provided the United States with what they represented was their complete 2005 client list. Hulbig Declaration, ¶ 14; Exhibit 1 to Hulbig Declaration. The purported client list contained names and addresses of approximately 230 taxpayers, but no taxpayer identification numbers were provided (*i.e.*, social security numbers, since all of the clients are individuals). *See* Exhibit 1 to Hulbig Declaration. Apart from being facially defective, the IRS has also determined that Defendants' 2005 client list is incomplete. Lee Declaration, ¶¶ 56 - 57; *see also* RFA No. 14, Exhibit 2 to

Hulbig Declaration at p. 14 (admitting that "the 2005 customer list [Defendants] provided to the United States as part of [its] Initial Disclosures under Fed. R. Civ. P. 26(a)(1) is incomplete"). To date, the IRS has identified at least 33 individuals who had their 2004 returns prepared by Defendants but were not included on Defendants' client list.[5] *Id.* Declarations from 7 of those individuals are attached to the Lee Declaration as Exhibits N-T. Not surprisingly, the vast majority of the undisclosed individuals overstated deductions for home mortgage interest, whereas the disclosed individuals overstated home mortgage interest at a rate of only 10%. *Id.* at ¶ 55; *see also* RFA No. 14, Exhibit 2 to Hulbig Declaration at p. 13 (admitting that "a number of the 2004 federal income tax returns [Defendants] prepared for customers contained false home mortgage interest deductions"). Defendants have refused to provide the United States with a complete 2005 client list, and they continue to withhold responsive documents used to create the defective list that they did provide, despite the United States' repeated requests for these materials (both informal and formal). Hulbig Declaration, ¶¶ 14-24. It is presumed that the 2005 client list is defective and incomplete due to NCK's liberal document-destruction policies. Dixon Declaration, ¶¶ 16-17.

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[5] Declarations from seven of those individuals are attached to the Lee Declaration as Exhibits N-T.

(c) *Criminal Law*

Inserting fictitious deductions on a customer's return is conduct subject to criminal penalty as well as civil penalty. *See, e.g., United States v. Kellog*, 955 F.2d 1244 (9th Cir. 1992) (sustaining conviction under I.R.C. Section 7206(2) of return preparer who claimed "excessive or wholly fictitious deductions for charitable contributions, dependents, interest payments, business expenses, tax return preparation fees, and the like.") This serves as an additional basis for injunctive relief pursuant to I.R.C. Section 7407(b)(1)(A).

3. Defendants have engaged in other fraudulent and deceptive conduct substantially interfering with the administration of the tax laws.

In addition to authorizing injunctive relief for the specific statutory violations, I.R.C. Section 7407 authorizes injunctive relief against an income tax preparer that has "engaged in any other fraudulent or deceptive conduct which substantially interferes with the proper administration of the Internal Revenue Code." I.R.C. § 7407(b)(D). Certain of Defendants' tax preparation activities fit squarely within the purview of this subpart. First, Defendants have engaged in fraudulent and deceptive conduct by regularly destroying books and records that should otherwise be used to maintain complete and accurate client information. Dixon Declaration, ¶ 16. By destroying these books and records, they prevent the IRS from easily tracing the effects of their tax preparation activities to individual clients, which substantially interferes with the proper administration of the Internal Revenue Code. *Id.* at ¶ 17.

Second, Defendants have engaged in fraudulent and deceptive conduct by using falsified "checklists" of documentation allegedly provided by customers in connection with the preparation of their tax returns. *Id.* at ¶ 18. This illegal system gives the appearance that Defendants are preparing tax returns based only on legitimate customer information, when nothing could be further from the truth. *Id.* It also attempts to shift the blame to Defendants' customers even though Defendants' flagrant violations of the internal revenue laws are the beginning and end points of the issue. Apart from the obvious fact that none of Defendants' customers qualify as income tax return preparers, these customers have paid, or will pay, a heavy price for their involvement with Defendants in the form of IRS audits resulting unforseen liabilities.

4. *Injunctive Relief is Appropriate to Prevent the Recurrence of Prohibited Conduct.*

In order to sustain the United States' request for injunctive relief under I.R.C. Section 7407, the Court must find that such relief is appropriate to prevent the recurrence of the conduct prohibited by the statute (*i.e.*, conduct subject to penalty under Sections 6694 and 6695, and conduct subject to criminal penalty). I.R.C. § 7407(b)(2). "In an action for a statutory injunction, once a violation has been demonstrated, the moving party need only show that there is a reasonable likelihood of future violations in order to obtain relief." *U.S. v. Kaun*, 827 F.2d 1144, 1148 (7th Cir. 1987). Factors that the Court may consider in determining the likelihood of future violations

include: (1) the gravity of the harm caused by the offense; (2) the extent of the defendant's participation, and her degree of scienter; (3) the isolated or recurrent nature of the infraction and the likelihood that Defendant's customary business activities might again involve her in such transaction; (4) the defendant's recognition of her own culpability; and (5) the sincerity of assurances against future violations. *See United States v. Thompson*, 395 F.Supp.2d 941, 945 (E.D. Cal. 2005). All of these factors are satisfied here.

First, the harm caused by Defendants' misconduct is grave. Based on audited returns, the IRS has calculated actual tax losses in excess of $14 million resulting solely from Defendants' abusive home mortgage interest scheme for tax years 2001, 2002, 2003, and 2004. If the unaudited returns are considered, the aggregate tax losses are estimated to exceed $25 million.[6]

Second, the extent of Defendants' participation is broad. Defendants are known to have prepared approximately 8,000 tax returns during the 2002-2005 return seasons. Given Defendants' liberal policy of destroying business records, however, it is assumed that Defendants prepared many more returns than that. Defendants' scienter is demonstrated by, among other things: (i) the consistently egregious audit results obtained to date; (ii) the evidence set forth in the Dixon declaration, which describes Defendants' intentional, systematic, and knowing violations of

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[6] This estimate does not include tax losses attributable to Defendants' systematic and known use of other improper Schedule A deductions (*e.g.*, miscellaneous business expenses). Lee Declaration, ¶ 33; Dixon Declaration, ¶¶ 6-11.

the internal revenue laws; and (iii) the evidence set forth in the declarations of Defendants' customers, all of whom were subjected to audits as a result of bogus tax returns prepared by Defendants.

Third, the conduct has been recurrent and continuing. In fact, Defendants' fraudulent tax preparation activities have continued unabated despite the execution of two search warrants, a criminal investigation, and the filing of the United States' complaint for injunctive relief.

Fourth, Defendants are not expected to concede culpability on their part. To the contrary, Defendants' conduct evinces a palatable lack of remorse for their unlawful tax preparation activities.

Fifth, given Defendants' pattern of conduct to date, which has continued without interruption, current and future violations are fully expected.

5. *A Narrower Injunction Prohibiting Such Conduct Would Not Be Sufficient to Prevent Defendants' Interference with the Proper Administration of the Internal Revenue Law.*

That Defendants have continually and repeatedly engaged in prohibited conduct is beyond dispute based on all of the evidence submitted herewith. The Lee Declaration incorporates as exhibits 13 separate declarations from Defendants' former customers. Each declaration, in turn, reflects at least one violation of Section 6694 and criminal law. The declaration of Valerie Dixon, who personally observed Defendants' fraudulent tax preparation activities, describes a continuing pattern of conduct that

violates Section 6694, Section 6695, criminal law, and otherwise demonstrates Defendants' unswerving commitment to interfering with the administration of the internal revenue laws through their fraudulent and deceptive practices. The Hulbig Declaration highlights Defendants' misconduct during discovery, including their refusal to provide the United States with a complete 2005 client list and related documents. In this regard, Defendants' actions in this litigation strongly suggest that they have something to hide (and indeed they do, considering the preponderance of the evidence).

Most importantly, the threat of harm is continuing. An injunction limited to prohibiting Defendants from engaging in the conduct described herein would be woefully insufficient to prevent their continued interference with the proper administration of the internal revenue laws. This sort of "obey the law" injunction would have the effect of rewarding Defendants for their refusal to do just that over at least the past four tax seasons. Under the circumstances, an injunction to stop Defendants from preparing any further returns pending a trial on the merits is the only appropriate remedy.

If Defendants are not immediately enjoined from preparing income tax returns, they will undoubtedly continue to prepare false and fraudulent tax returns, understating their customers' tax liability through the use of bogus Schedule A deductions. Lee Declaration, ¶ 61. Allowing Defendants to continue doing business as usual will also result in a continuing and severe loss of tax revenue. *Id.* at ¶ 62. Moreover, it will result in a

continuing strain on IRS resources because the IRS cannot audit every return Defendants prepare. *Id.* And it will cause financial hardships to customers who will be audited - many of whom will be required to pay unexpected tax liabilities, including interest accruing from the date of the return to the date of payment, and perhaps penalties. *Id.*

Finally, it should be emphasized that this is not a case where the United States will deprive Defendants of their livelihood should it obtain the requested injunctive relief. Rather, each of the Defendants suggested in their depositions that they prepare tax returns to supplement their income from their regular jobs. For example, Karen and Carla Berry both completed beauty college and have been working at a salon, which they now own, for 14 years. *See* Karen Berry Tr. 17:4-10, 19:4-9, Exhibit 5 to Hulbig Declaration. Ivan Johnson has an undergraduate degree in civil engineering, a master's degree in computer science, and he currently holds a position with the California Department of Transportation ("Caltrans") making $60,000 per year. *See* Johnson Tr. 13:22-24, 14:11-14, 30:12-13 Exhibit 4 to Hulbig Declaration. Certainly, the United States, and more importantly the taxpayer base, should not be forced to endure the panoply of Defendants' fraudulent activities and the resulting harm to the public fisc just so that Defendants can have an additional source of income.

C. Injunctive Relief under I.R.C. Section 7402(a) is Necessary for the Enforcement of the Internal Revenue Laws.

Defendants, through their actions described above and in the attached declarations, have engaged in conduct that substantially interferes with the administration and enforcement of the internal revenue laws. For this reason, injunctive relief pursuant to I.R.C. Section 7402(a) is also necessary and appropriate. *See United States v. Moser*, 2005 WL 3277965, *slip copy* (D. Hawaii 2005) (permanently enjoining defendant from acting as a tax preparer based on abusive deduction scheme pursuant to I.R.C. Section 7402(a) and I.R.C. Section 7407).

CONCLUSION

For the foregoing reasons, and based on the evidence submitted herewith, the Court is respectfully requested to exercise its statutory authority under I.R.C. Sections 7402(a) and 7407 to enter (i) a temporary restraining order enjoining Defendants, and all persons acting in concert with them, from preparing federal income tax returns, and (ii) an order to show cause why a preliminary injunction should not issue, after the temporary restraining order expires, to continue enjoining Defendants, and all persons acting in concert with them, from preparing federal income tax returns pending the trial on the merits of the United States' complaint for permanent injunctive relief. A proposed temporary restraining order and show-cause order is filed herewith.

Respectfully submitted this 10th day of March, 2006,

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CERTIFICATE OF SERVICE

I, **GINA HERNANDEZ,** declare:

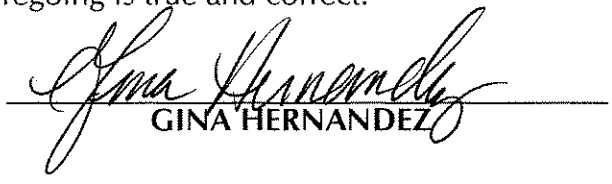
That I am a citizen of the United States and resident or employed in Los Angeles County, California; that my business address is the Office of United States Attorney, 3880 Lemon Street, Suite 210, Riverside, CA 92501; that I am over the age of eighteen years, and am not a party to the above-entitled action; That I am employed by the United States Attorney for the Central District of California who is a member of the Bar of the United States District Court for the Central District of California, at whose direction I served a copy:

UNITED STATES' MEMORANDUM IN SUPPORT OF *EX PARTE* APPLICATION FOR TEMPORARY RESTRAINING ORDER AND ORDER TO SHOW CAUSE WHY DEFENDANTS SHOULD NOT BE PRELIMINARILY ENJOINED FROM PREPARING INCOME TAX RETURNS

[ ] Placed in a closed envelope, for collection and interoffice delivery addressed as follows:	[XX] Placed in a sealed envelope for collection and mailing via United States Mail, addressed as follows:
[ ] By hand-delivery addressed as follows:	[XX] By facsimile as follows: **(909) 981-7508** [ ] By Fed Ex

DUANE D. DADE
DUANE D. DADE & ASSOCIATES
1317 WEST FOOTHILL BOULEVARD, SUITE 232
UPLAND, CALIFORNIA 91786

This Certificate is executed on **March 10, 2006**, in Riverside, California. I certify under penalty of perjury that the foregoing is true and correct.



GINA HERNANDEZ