

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF GEORGIA

FILED IN CLERK'S OFFICE
U.S.D.C. Atlanta

OCT 02 2009

JAMES N. HATTEN, Clerk
By: *[Signature]* Deputy Clerk

UNITED STATES OF AMERICA,)
)
Plaintiff,)
)
v.)
)
ROBERT L. KNUPP, individually and)
d/b/a RLK, Inc.,)
Defendant.)

Civil No.

1:09-CV-2724

**UNITED STATES' MEMORANDUM OF LAW IN SUPPORT OF
MOTION FOR PRELIMINARY INJUNCTION**

The United States of America ("United States"), in support of its motion for entry of a preliminary injunction against defendant Robert L. Knupp, individually and doing business as RLK, Inc., respectfully states as follows:

PRELIMINARY STATEMENT

The IRS has received at least 58 fraudulent federal income tax returns that Knupp, individually and doing business as RLK, Inc., prepared or filed in 2009. (Declaration of Shauna Henline, at ¶ 12, Ex. A). Those returns have claimed more than \$11 million in fraudulent refunds, and (before Knupp's scheme was identified)

resulted in the issuance of \$65,000 in erroneous refunds to his customers. (Henline Decl. at ¶¶ 12, 14, Ex. A).

Knupp's method for seeking fraudulent tax refunds for his customers is simple. He not only fraudulently, but absurdly, claims that his customers are entitled to credit for federal income tax withholding for the amount of money they pay to or owe to their creditors. Such claims arise out of an increasingly-popular tax defier scheme that involves the filing of false Forms 1099-OID ("original issue discount") - or, in Knupp's case, the mere classification of a customer's debt as OID income without even filing a false Form 1099-OID - as a means of drawing funds from each taxpayer's "secret" Treasury account. Through the above, Knupp claims grossly inflated withholding on the Forms 1040 he prepares, allowing him to claim for his customers fraudulent tax refunds, sometimes in the millions of dollars. Knupp's capacity for filing returns claiming huge refunds for his customers is limited only by a customer's actual indebtedness to his creditors.

By employing this scheme to request fraudulent tax refunds, Knupp has repeatedly defrauded the Government on behalf of his customers and has substantially interfered with the proper administration of the internal revenue laws. Because of his egregious and undeniably fraudulent conduct, and given the risk that he may continue

to engage in this conduct unless enjoined immediately by this Court, Knupp should be preliminarily enjoined, under 26 U.S.C. (“I.R.C.”) §§ 7402, 7407, and 7408 and Fed. R. Civ. P. 65, from preparing tax returns for others, and should be required to notify his customers of this Court’s injunction against him, pending a full hearing on his illegal conduct.

FACTUAL BACKGROUND

Knupp resides in Marietta, Georgia and does business there as well. He is the owner and Chief Executive Officer of RLK, Inc. (“RLK”), a for-profit corporation incorporated in Georgia in 1999. Through RLK, Knupp prepares tax returns for compensation. Knupp utilized an Electronic Filing Identification Number (“EFIN”) and has used it repeatedly to electronically file tax returns he has prepared in 2009 (Henline Decl. at ¶ 4, Ex. A).

Knupp’s Tax Fraud Scheme

Knupp has prepared numerous returns in the past two years, or has been identified on returns as the filing taxpayer’s third party designee or having been granted power of attorney. (*Id.* at ¶¶ 4, 13, Ex. A). But the same fraudulent scheme is evident in all such returns connected to him.

Knupp's customers provide him with evidence of their mortgage loans, car loans, and credit card debts. He then uses that information to prepare fraudulent tax returns that add up these amounts (usually reporting them on the Schedule B of the customer's 1040 income tax return) and then classify the sum of a customer's indebtedness as both interest income and as withheld federal income taxes - even when the IRS has no record at all of such sums ever having been withheld by any entity on behalf of the customer at issue. (*Id.* at ¶ 10, Ex. A). As a result of this blatantly false classification, the returns Knupp prepares are engineered to look as if the customer/taxpayer (who may owe substantial taxes due to their purported high income) has had so much in federal taxes withheld that the customer is entitled to a significant refund. (*Id.* at ¶ 9, Ex. A).

Underlying Knupp's obviously fraudulent practices is a branch of tax defier dogma (sometimes referred to as "redemption") that has become regrettably widespread in the past several years. (*Id.* at ¶ 7, Ex. A). Proponents of these frivolous theories purport that taxpayers have secret bank accounts at the Treasury Department. To satisfy their indebtedness to other creditors, the frivolous theory goes, a taxpayer need only access the sums held within these accounts. (*Id.*). Knupp, like other

proponents of redemption schemes, contends that IRS Forms 1099-OID are the key required to unlock these fictional treasury accounts created on behalf of all citizens.

The term “original issue discount” (OID) refers to the difference between the price for which a debt instrument is issued and the instrument’s stated redemption price at maturity. I.R.C. § 1273(a). The federal tax laws include OID as a component of a taxpayer’s income as the OID income accrues over the term of the debt instrument, whether or not the taxpayer actually receives payments from the issuer of the debt instrument. For purposes of reporting such income in a tax return, OID is treated like a payment of interest, and therefore a party issuing a financial instrument generating OID income must issue a Form 1099-OID information return in accordance with I.R.C. § 6049(d)(6). (*Id.* at ¶¶ 7-8, Ex. A).

While Forms 1099-OID are legitimate IRS forms, proponents of the frivolous redemption theory often prepare and file Forms 1099-OID for themselves, or on behalf of their customers, in order to claim (and sometimes obtain) fraudulent tax refunds. Although such redemption theorists file IRS Forms 1099-OID as if they report “original issue discount” purportedly received or paid by a taxpayer to a creditor, the document is false. (Henline Decl. at ¶ 10, Ex. A). Indeed, the IRS

invariably has no independent corroboration from the lender or creditor referenced in a fraudulent Form 1099-OID that any interest income was earned or paid.

Although many individuals who have adopted the redemption theory in preparing fraudulent tax returns have filed false Form 1099-OID documents, the IRS's review of returns prepared and filed by Knupp suggests that he did not bother to do so. Instead, he merely classified a customer's debts as if they were both OID income and withheld taxes, e-filing the Form 1040 without even bothering to take the time later to file a falsified Form 1099-OID. (*Id.* at ¶ 10, Ex. A). He thus employed an even more streamlined version of the redemption/Form 1099-OID theory.

Regardless of how it is put into practice, however, there is one constant to the frivolous redemption theory: it has been soundly and repeatedly rejected by federal courts. *See, e.g., United States v. Kahn*, No. 5-03-CV-436-OC-10GRJ, 2004 WL 1089116, at *1 (M.D. Fla. Mar. 30, 2004) (court held defendants in contempt of injunction that arose from defendants' promotion of abusive tax schemes including "outlandish machinations" such as using counterfeit bonds and checks to draw on fictitious treasury accounts supposedly in their customer's name); *Ray v. Williams*, No. CV 04-863-HU, 2005 WL 697041, at *5-6 (D. Or. Mar. 24, 2005) (in considering prison's bar on the delivery of the book "Cracking the Code, Third Edition," found

that book contained fraudulent claim of “Redemptionists” that direct treasury account exists that has a balance equal to the monetary value the government places on the life of an individual); *Monroe v. Beard*, No. 05-04937, 2007 WL 2359833, at *2 (E.D. Pa. Aug. 16, 2007) (characterizing redemption as an “anti-government scheme that utilizes commercial law to harass and terrorize its targets”).

Examples of Fraudulent Returns Prepared and Filed by Knupp

The IRS has identified approximately 58 returns that Knupp prepared and/or filed in 2009 that request refunds based on the redemption/Form 1099-OID scheme. (Henline Decl. at ¶ 12, Ex. A). Forty-nine of these returns were electronically filed in 2009 for tax year 2008; the remaining nine returns were paper returns filed either for the 2008 tax year or Form 1040X returns amending returns filed in prior years. (*Id.* ¶¶ 11, 12, Ex. A). All, however, request substantial refunds premised on the same fraudulent scheme. Below are specific examples of returns claiming such fraudulent refunds.

1. **Thomas and Terri Whitehead**

In 2009, Knupp prepared and electronically filed a 2008 Form 1040 on behalf of Thomas W. and Terri Whitehead of Lexington, South Carolina. (Henline Decl. at ¶ 15, Ex. A, and Ex. 1 attached thereto). On that tax return, Knupp falsely reported

\$617,799 in taxable interest income. Their return also reported \$46,798 in wage income and \$65,368 in Schedule E income. Although the Whiteheads' tax return reported tax of \$229,234, it claimed a refund of \$394,744, based upon \$623,978 in purported federal income tax withholding.

The \$617,799 in taxable interest income claimed for the Whiteheads in their income tax return was the sum of interest allegedly paid by ten different credit card or mortgage and lending companies. (*See* Ex. 1 to Henline Decl. at Schedule B). But none of these third party companies reported to the IRS sums in any figure close to what Knupp had reported in the Whiteheads' return. Thus, to give one example, the Whiteheads' return reported receipt of interest from the Palmetto Citizens Federal Credit Union in the amount of \$58,721, but the Palmetto Citizens Federal Credit Union independently reported to the IRS interest of merely \$141 earned by the Whiteheads in 2008. (*See* Whiteheads' 1099 Verification Information, Ex. B and C). Accordingly, the Whiteheads' tax return prepared by Knupp claimed a fraudulent refund based on falsely reported interest income and withholding.

2. **Derek Mobley**

Knupp also prepared and e-filed in 2009 a 2008 Form 1040 return on behalf of Derek Mobley of Atlanta, Georgia. (Henline Decl. at ¶ 18, Ex. A, and Ex. 4

attached thereto). Mr. Mobley learned of Knupp's tax preparation business through a company that purports to provide foreclosure relief to financially beleaguered homeowners. According to Mr. Mobley, that same entity sought a percentage of the anticipated tax refund as its "fee" for assisting in the process). (Declaration of Derek Mobley, at ¶¶ 3-4, Ex. D). That entity repeated to Mr. Mobley the same fiction underlying Mr. Knupp's fraudulent tax preparation practices: that taxpayers were simply unaware of certain funds they were "entitled" to access, and that the key to obtaining those funds was Mr. Knupp's services. (Mobley Decl. at ¶ 4, Ex. D).

Mobley's return (as prepared and filed by Knupp) falsely reported \$271,797 as taxable interest income. This figure was set forth on the Schedule B filed with his income tax return and was comprised of amounts received from Mobley's mortgage companies and/or financial institutions such as Countrywide Home Loans, Home Q Servicing, Litton Loan Servicing, and Bank of America. (*Id.*). Based on a false claim of \$274,847 in federal tax withheld, Mobley's return claimed a refund in the amount of \$190,182. (*Id.*). Yet, as with other customers of Knupp, this claimed withholding was obviously false; Mobley's return attached five separate Form W-2s establishing that some federal taxes had been withheld from the various jobs he held, but the

aggregate amount of taxes actually withheld as reflected in the W-2s was nowhere near the total sum reported in his Form 1040. (Ex. D).

The refund amount, as claimed on Mr. Mobley's tax return, was so plainly false that the bankruptcy Trustee overseeing Mr. Mobley's Chapter 13 case, Adam Goodman, refused to cash the \$190,182 refund check he received from the IRS in connection with Mr. Mobley's 2008 tax return. (Declaration of Adam Goodman at ¶¶ 5-7, 10, Ex. E). Trustee Goodman was familiar with Mr. Mobley's financial status, including his modest income, and therefore immediately viewed the receipt of a six-figure refund as highly suspicious. (*Id.* at ¶ 6). Fortunately, due to Mr. Goodman's responsible conduct, the IRS recovered Mr. Mobley's fraudulent refund check. (Mobley Decl. at ¶ 8, Ex. D; Goodman Decl. at ¶ 10, Ex. E).

3. *Other Knupp Customers*

Knupp prepared and electronically filed in 2009 numerous other 2008 Form 1040s for customers in which fraudulent refunds were claimed based upon the same redemption/Form 1099-OID scheme. For example, Knupp claimed fraudulent refund requests for Constantin and Alina Ivaniciuc of Hoschton, Georgia, as well as John E. and Monya J. Ballah of Tucson, Arizona. (Henline Decl. at ¶¶ 16-17, Ex. A, and Ex. 2 and 3 attached thereto). The Ivaniciucs' federal income tax return of \$994,747 - an

incredible sum, given that their verifiable income (ignoring falsely-claimed interest income) was less than \$35,000 - was based on purported, but nonexistent, withholding of \$1,498,985 reported on the return prepared by Knupp based upon the Form 1099-OID scheme. (Henline Decl. at ¶ 16, Ex. A). The Ballahs' refund claim of \$362,844 was based on purported withholding of \$510,104 (a difference of \$80 from the Ballahs' reported taxable interest income). (*Id.* at ¶ 17). Luckily, the IRS detected the fraud in these two instances and did not pay the claimed refunds.

Knupp Has Acknowledged his Participation in the OID/Redemption Scheme

Astoundingly, Knupp has *admitted* to the IRS that he has relied upon the OID/Redemption scheme in preparing tax returns. This past March, Knupp corresponded with the IRS to ascertain why a hold had been placed on the income tax refunds he anticipated for the 2007 and 2008 tax years. (*See* Letter from Robert L. Knupp to J. Russell George and appended attachments, Ex. G). In the letter, Knupp attempted to explain to the IRS (through attached copies of tax returns) that if he had filed a tax return the correct way (*i.e.*, without relying on the 1099-OID scheme), he would have owed very little in taxes; in contrast, he reasons that by filing a return which relies on this scheme, he “generates a tax to the IRS of \$16,597.” (*Id.*). This sum, plus the \$61,914 refund he expected to receive from the IRS based on his 2008

tax return, is derived from “income that I am entitled to receive” - in other words, the secret Treasury account that Knupp and other adherents to the frivolous redemption theory believe exists. (*Id.*).

The Government is Harmed by Knupp’s Fraudulent Misconduct

Knupp’s tax return preparation business causes harm to the Government, his customers, and substantially interferes with the proper administration of the internal revenue system. The returns Knupp prepares for others fabricate the amount of tax withheld on behalf of his customers, resulting in fraudulent refund claims by his customers in amounts as large as \$2 million. (Henline Decl. at ¶¶ 12-13, Ex. A). Knupp’s tax return preparation is not guided by the law, but rather is rooted in the frivolous and thoroughly-discredited “redemption” theory.

As noted above, the IRS has identified at least 58 returns prepared and/or filed by Knupp in 2009 that request refunds based on Knupp’s fraudulent Forms 1099-OID. Many of the refund requests on these fraudulent returns exceed \$200,000 and one return requests a refund of over \$2 million. (Henline Decl. at ¶ 12, Ex. A). The total amount of refunds fraudulently requested on the 58 returns prepared by Knupp and reviewed by the IRS to date exceeds \$11 million, with \$16 million in false reported withholding. (*Id.*). The IRS has uncovered the same pattern of fraudulent

refund claims in those returns where Knupp is identified as the taxpayer's third party designee or has been given the taxpayer's power of attorney. In such thirty-eight returns such filed since 2007, the total amount of refunds claimed exceeds \$9.5 million. (*Id.* at ¶ 13, Ex. A). Although the IRS is able to detect and stop most of his fraudulent refund claims, Knupp's fraudulent tax return preparation has resulted in the issuance of at least \$65,000 in erroneous refunds to his customers to date. (*Id.* at ¶ 14, Ex. A).

The scheme employed by Knupp exemplifies a growing trend among tax defiers to rely on the frivolous redemption theory in order to evade tax obligations or obtain other wrongful financial benefits. *See e.g., United States v. Marty*, No. CIV s-09-06000 (E.D. Cal. Aug. 31, 2009 (Dkt. No. 34)) (injunction order enjoining tax preparer who employed redemption/Form 1099-OID practices in tax returns she prepared, and adopting reasoning of Magistrate Judge Recommendation, dated July 29, 2009)(Ex. F); *Abbott v. Suntrust Mortgage, Inc.*, No. 3:08cv665, 2009 WL 127858, at *3-*5 (E.D.Va. Jan. 15, 2009)(dismissing claim by mortgagees against mortgagor when claim was based in part on their claim that bank did not process IRS Forms 1099-OID, mortgagees also supported claim with IRS Form 1040V, and letter from mortgagee to Secretary Paulson demanding a setoff and requesting that

mortgagor release them from loan); *Lundy v. Yost*, No. 07-4180 (JBS), 2008 WL 4378207, at *5 - *7 (D.N.J. Sept. 22, 2008) (denying motion to vacate contempt order that was issued in part due to petitioner's assertion of fraudulent and fictitious financial claims and contracts against court officials and other employees of the government including Forms 1099-OID sent to judge and clerk of court). Knupp's practices merit similar treatment.

Knupp's tax preparation for his customers has resulted in their failing to file proper federal income tax returns, thus depriving the United States of additional tax revenue owed by his customers, or causing the United States to issue improper refunds. As a result of Knupp's fraudulent returns, Knupp's customers are also subject to penalties which can amount to as much as 20 percent of the excessive refund claimed. *See* 26 U.S.C. § 6676.

In addition to the lost revenue due to the issuance of erroneous refunds, the Government has also incurred the expense of conducting the investigation of Knupp's fraudulent return preparation and responding to and processing the frivolous documents Knupp submitted to the IRS. Any false Forms 1099-OID submitted with Knupp's returns may also result in the assessment of erroneous penalties against creditors identified in the false Forms 1099-OID for failing to timely submit those

forms to the IRS. The fraudulent returns that Knupp prepared and filed may also result in the issuance of erroneous notices of liens, levies, and tax deficiencies to public officials identified in Knupp's documents.

ARGUMENT

The United States seeks a preliminary injunction under I.R.C. §§ 7402, 7407, and 7408 to prevent Knupp from further violating the Internal Revenue Code and from further harming his customers and the Government. The United States also seeks to prevent Knupp from preparing federal tax returns for others, from representing others before the IRS, engaging in conduct subject to penalty under the I.R.C., or other conduct that substantially interferes with the proper administration and enforcement of the internal revenue laws.

Here, the United States moves for injunctive relief pursuant to several sections of the Internal Revenue Code which specifically provide for the remedy of an injunction. "A statutory injunction is available where a statute bars certain conduct . . ., then specifies that a court may grant an injunction to enforce the statute." *Forum Healthcare Group, Inc. v. Centers for Medicare and Medicaid Services*, 495 F. Supp.2d 1321, 1327 (N.D. Ga. 2007), quoting *Klay v. United Healthcare Group, Inc.*, 376 F.3d 1092, 1097 (11th Cir. 2004). Because the United States moves for

injunctive relief pursuant to statute, it “need only establish what the statute requires” - that illegal conduct has occurred. *See United States v. James*, No. 5:03-cv-113-1 (DF), 2004 WL 838078, at *1 (M.D. Ga. Feb. 23, 2004), *quoting SEC v. Caterinichia*, 613 F.2d 102, 105 n.3 (5th Cir. 1980).

Given that preliminary injunctions are intended to be an efficient and swift means of ceasing ongoing illegal conduct pending a full adjudication of the claims underlying the action, a motion for such an injunction “is customarily granted on the basis of procedures that are less formal and evidence that is less complete than in a trial on the merits. A party is thus not required to prove his case in full at a preliminary-injunction hearing.” *Univ. of Texas v. Camenisch*, 451 U.S. 390, 395 (1981). Courts frequently consider affidavits and other hearsay materials that would not be admissible evidence for a permanent injunction. *SEC v. Cherif*, 933 F.2d 403, 412 n.8 (7th Cir. 1991) (“hearsay can be considered in entering a preliminary injunction.”); *Asseo v. Pan Am. Grain Co., Inc.*, 805 F.2d 23, 26 (1st Cir. 1986) (“[t]he dispositive question is not their classification as hearsay but whether, weighing all the attendant factors, including the need for expedition, this type of evidence was appropriate given the character and objectives of the injunctive proceeding.”).

A. A Preliminary Injunction is Appropriate Under Section 7407

Knupp should be preliminarily restrained and enjoined under I.R.C. § 7407 from preparing tax returns for others because he has repeatedly and continually prepared tax returns claiming fraudulent tax refunds and is likely to do so absent an injunction. Section 7407 grants federal district courts the authority to enjoin income tax return preparers from further engaging in any conduct prohibited under the statute upon proving: (1) an income tax return preparer has engaged in specified prohibited conduct; and (2) injunctive relief is appropriate to prevent the recurrence of such conduct. *United States v. Fernandez*, No. CIV-604-CV-1772ORL31-JGG, 2005 WL 1332278, at *1 (M.D. Fla. May 4, 2005). Because I.R.C. § 7407 expressly authorizes the issuance of an injunction upon satisfying the criteria above, the United States is not required to meet the traditional equitable factors typically required before the issuance of an injunction. *United States v. Reddy*, 500 F.Supp.2d. 877, 881-82 (N.D. Ill. 2007). The government must merely prove the two enumerated factors by a preponderance of the evidence. *United States v. Estate Preservation Servs.*, 202 F.3d 1093, 1098 (9th Cir. 2000).

The “prohibited conduct” by a preparer that the Government must demonstrate includes conduct subject to penalty under Code Sections 6694, 6695 or any other

fraudulent or deceptive conduct which substantially interferes with the proper administration of the internal revenue laws. *See* I.R.C. § 7407(b); Complaint (Dkt No. 1) at ¶¶ 35-38. In addition, upon a showing that an injunction merely prohibiting the outlawed conduct would be insufficient to prevent further interference with internal revenue laws, a court may enjoin a defendant from further acting as a return preparer altogether. *Id.*

Having prepared over fifty returns claiming more than \$11 million in fraudulent refunds, Knupp has repeatedly and continually engaged in fraudulent and deceptive conduct and cannot be trusted to properly prepare tax returns for others in the future. Ignoring the frivolous facade of the redemption theories underlying Knupp's practices, at bottom the returns Knupp prepares falsely represent that his customers are entitled to a credit for withheld federal income tax equivalent to the amount of their debts, thus allowing him to make huge refund claims for those customers. The fraudulent returns Knupp prepares have caused significant harm to his customers and the Government. Many of these returns claimed fraudulent tax refunds exceeding \$200,000, with some claiming refunds in the millions of dollars. Before Knupp's scheme was identified, the Government erroneously paid thousands of dollars in improper refunds to Knupp's customers.

The Government is dependent upon taxpayers' and tax preparers' honest compliance with internal revenue laws. Knupp's tax return preparation causes significant harm to the Government and his customers. An injunction prohibiting him from preparing tax returns is appropriate and necessary to stop the harm caused by Knupp's tax preparation business.

B. A Preliminary Injunction is Also Appropriate Under Section 7408

Knupp should also be enjoined under I.R.C. § 7408 from promoting his fraudulent scheme. I.R.C. § 7408 authorizes the Court to issue an injunction barring any person from further engaging in any conduct subject to penalty under sections 6700 or 6701. I.R.C. § 7408(b). As with an injunction requested under Section 7407, Knupp may be preliminarily enjoined without considering the traditional equitable prerequisites. *See Estate Preservation Servs.*, 202 F.3d at 1098; *United States v. Hempfling*, 431 F. Supp. 2d 1069, 1075-76 (E.D. Cal. 2006).

Here, the United States must only prove: 1) that Knupp has acted in violation of either of the above-referenced statutes; and 2) that injunctive relief is appropriate to prevent the recurrence of such conduct. *See* I.R.C. § 7408(b). The United States can meet these elements based on both demonstrated violations of Section 6700 as well as Section 6701.

Section 6700 imposes penalties on any person who:

- (1) organized or sold, or participated in the organization or sale of, an entity, plan, or arrangement;
- (2) In connection therewith made or caused to be made false or fraudulent statements concerning the tax benefits to be derived from the entity, plan, or arrangement;
- (3) knew or had reason to know that the statements were false or fraudulent; and
- (4) the false or fraudulent statements pertained to a material matter.

26 I.R.C. § 6700(a). Knupp violated I.R.C. § 6700 because, in promoting his tax preparation business, he falsely represented to his customers, through his preparation practices, that they could legitimately file tax returns relying on Forms 1099-OID and the “redemption” theory as a means for realizing significant tax refunds. Knupp, who holds himself out as a tax professional, knew or had reason to know that his statements were false, especially given that the bases for his claims are facially absurd and have been repeatedly rejected by the Courts and the IRS.

Knupp also violated I.R.C. § 6701, and will likely continue to do so absent an injunction. Section 6701 specifically imposes a penalty on any person who (1) “aids or assists in, procures, or advises with respect to, the preparation or presentation of any portion of a return, affidavit, claim, or other document,” (2) “knows (or has

reason to believe) that such portion will be used in connection with any material matter arising under the internal revenue laws,” and (3) “knows that such portion (if so used) would result in an understatement of the liability for tax of another person.” I.R.C. § 6701(a). Knupp unquestionably knew or had reason to believe that the returns he directly prepared, or in which he was designated as a contact for purposes of communicating with the IRS about those returns, contained false statements reporting massive sums allegedly withheld by financial institutions on behalf of his customers, all based on the Form 1099-OID scheme. And he knew that by so doing, his customers would be able to claim very large refunds.

Based on such obvious violations, Knupp should be preliminarily enjoined under Section 7408 because there is a significant likelihood that he will continue preparing false and fraudulent tax returns absent an injunction. To determine whether there is a substantial likelihood of a recurrence of unlawful conduct, courts routinely consider several factors: “(1) the gravity of the harm caused by the offense; (2) the extent of the defendant’s participation; (3) the defendant’s degree of scienter; (4) the isolated or recurrent nature of the infraction; (5) the defendant’s recognition (or non-recognition) of his own culpability; and (6) the likelihood that the defendant’s occupation would place him in a position where future violations could be

anticipated.” *Estate Preservation. Servs.*, 202 F.3d at 1105; *United States v. Harkins*, 355 F. Supp. 2d 1175, 1181 (D. Or. 2004).

Here the gravity of harm caused by Knupp’s tax preparation business is significant. Knupp prepared the fraudulent tax returns on behalf of his customers and thus was a central figure in the above-described tax-fraud scheme. There was no legal or factual basis to support the claims Knupp included on the returns he prepared - as any competent tax preparer would have known. His misconduct was not isolated to a few returns, but rather extended to the majority of returns he prepared this past year. At present, Knupp still may legally prepare returns for others. He is thus still in a position going forward to prepare tax returns that fraudulently claim refunds on behalf of his customers, unless he is enjoined from so doing.

C. A Preliminary Injunction is Also Appropriate Under 26 U.S.C. §7402

Section 7402(a) grants federal district courts broad authority to issue, “writs and orders of injunction . . . and such other orders and processes, 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. An injunction under Section 7402 can be issued “in addition to and not exclusive of any and all other remedies of the United States in such courts or otherwise to enforce such laws.” Section 7402 manifests the

“congressional intention to provide the district courts with a full arsenal of powers to compel compliance with the internal revenue laws.” *Brody v. United States*, 243 F.2d 378, 384 (1st Cir. 1957). Indeed, injunctive relief has been granted under Section 7402 even where the enjoined conduct does not itself specifically violate any particular Tax Code provision. *United States v. Kaplowitz*, 201 Fed. Appx. 659, 661 (1st Cir. 2006), *citing United States v. Ernst & Whinney*, 735 F.2d 1296, 1300 (11th Cir. 1984).¹

Here, all of the factors supporting entry of injunctive relief based on Section 7402 can readily be met. The IRS has identified over 50 returns prepared by Knupp that claim fraudulent tax refunds. All of these returns rely on the same OID/redemption scheme; none of the refunds sought by any of the returns can be substantiated or corroborated by any other documentation or proof. Accordingly, the United States is likely to succeed on the merits of its claim.

1. Unlike the case with injunctions sought under Sections 7407 or 7408, the Government must satisfy the “traditional” elements that comprise the test for injunctive relief before such equitable relief will be granted under Section 7402: (1) the likelihood that the plaintiff will sustain irreparable injury as a result of the defendant’s conduct; (2) the likelihood of harm to the defendant if an injunction is entered; (3) the likelihood the plaintiff will ultimately prevail on the merits; and (4) that injunctive relief serves the public interest. *United States v. Fernandez*, No. CIV-604-CV-1772ORL31-JGG, 2005 WL 1332278, at *1 (M.D. Fla. May 4, 2005); *see also Ernst & Whinney*, 735 F.2d at 1301.

The harm caused by Knupp's conduct is also easy to discern. The returns Knupp prepared have to date claimed over \$11 million in fraudulent tax refunds. As a result of Knupp's fraudulent returns, Knupp's customers are subject to penalties. There is therefore a significant possibility of irreparable harm to the United States and to Knupp's customers, who presume that a tax preparer of Knupp's expertise would know enough not to recommend a completely phony grounds for declaring refund entitlements. The IRS spends valuable resources contacting the customers and conducting an examination until the tax liability is determined. After the correct liability is determined, the IRS must then engage in an often-lengthy collection process to recover taxes owed.

The damage caused by Knupp's unlawful conduct greatly outweighs any injury he may suffer from the entry of a preliminary injunction. Certainly Knupp would suffer no harm in being required to obey the law going forward. Preventing Knupp from continuing to prepare returns during the pendency of this action may be more onerous a remedy, but given that Knupp's entire tax preparation business is premised on a frivolous tax defier theory and dishonest refund claims, it is hardly disproportionate to his wrongdoing. And the public interest is plainly served by preventing such illegal conduct, the impact of which extends beyond merely Knupp's

particular customers to the public at large. Injunctive relief under Section 7402 is thus necessary and appropriate to prevent Knupp from continuing to violate the rules of the federal tax system. Without an injunction, Knupp is likely to continue to prepare returns for others that fraudulently claim tax refunds.

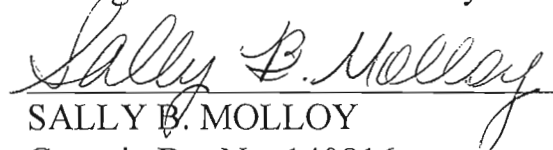
CONCLUSION

For the reasons stated above and to prohibit Knupp's future violations of the internal revenue laws, the United States requests that the Court enter a preliminary injunction in its favor pursuant to I.R.C. §§ 7402, 7407, and 7408.

This 2nd day of October, 2009

Respectfully submitted,

SALLY QUILLIAN YATES
Acting United States Attorney

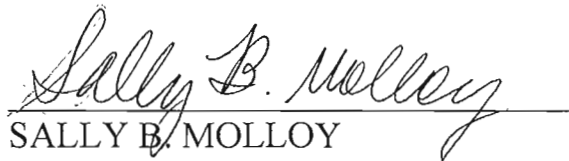


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CERTIFICATE OF COMPLIANCE

I hereby certify that the **UNITED STATES' MEMORANDUM OF LAW IN SUPPORT OF MOTION FOR PRELIMINARY INJUNCTION** has been prepared in accordance with Local Rule 5.1(C) in Times New Roman font (14 point).



SALLY B. MOLLOY
ASSISTANT UNITED STATES ATTORNEY