IN THE UNITED STATES DISTRICT COURT
FOR THE MIDDLE DISTRICT OF TENNESSEE
NASHVILLE DIVISION

UNITED STATES OF AMERICA,	)	Case No. 3:06-cv-175
	)	
Plaintiff,	)	Judge Robert Echols
	)	
v.	)	Magistrate Judge Juliet Griffin
	)	
SUSAN ANN SPERL;	)	
RANDALL E. THOMPSON; and	)	
SUSANSTAX, INC.,	)	
	)	
Defendants.	)	

MEMORANDUM OF POINTS AND AUTHORITIES IN SUPPORT OF UNITED STATES' MOTION FOR PRELIMINARY INJUNCTION

The Internal Revenue Service has received over 640 returns prepared by defendants and their subordinates for customers in at least 22 states that claimed false and fraudulent deductions to understate customers' federal tax liability. The estimated understatements in a recent two-year period totaled $4,000,000. Defendants have also packaged their false statements regarding federal income tax laws into a promotional book, audio cassette, computer software, and newsletter they call the SusanTax Membership Program. Defendants continue to cause injury to the federal government and their customers despite knowing that the IRS has consistently rejected their position during audits of their customers. With another tax-preparation season is underway, defendants should be enjoined quickly from preparing federal income tax returns for others and from selling their fraudulent tax program.

BACKGROUND

Defendants' tax preparation business

Susan Sperl began to prepare tax returns in 1998. (Declaration of Carla Gamboni ¶ 14.) In recent years Sperl, joined by her son Randall Thompson and their subordinates, prepared over 1,000 federal income tax returns for tax years 2002, 2003, and 2004 for customers in at least 22 states. (*Id*. ¶¶ 9, 15, 16, 17, 18.) The IRS determined that 648 of the 791 returns the defendants prepared for the 2002 and 2003 tax years reported deductions for purported business expenses. (*Id*. ¶¶ 16, 17.) The IRS selected 68 of these 648 returns for examination. (*Id*. ¶¶ 16, 17.) The IRS determined that each of these 648 returns contained tax understatements, primarily due to deductions related to false or fraudulent home-based business expenses and depreciation. (*Id*. ¶0 18.) By extrapolating from this sample that all business expenses on the 2002 and 2003 returns they prepared were likely falsely or fraudulently claimed, and recalculating the tax on returns claiming net business losses to offset other income, the IRS estimates that defendants caused $4 million in understatements of tax liability for those two years. (*Id*. ¶ 19.)

Defendants' customers

Louie David Garcia of Temecula, California, first asked Sperl to prepare his 2002 federal income tax return. (*Id*. ¶ 34.) When they met to discuss the return, Sperl told him that if he signed up to sell direct-marketing products, he would be able to deduct personal expenses such as those he spent on his car. (*Id*. ¶ 35.) He declined the offer. (*Id*.) Garcia believes that, even though he did not have a business, Sperl and Thompson, the actual preparer of his 2002 return, deducted car expenses on his return. (*Id*.) The following year, Garcia met with Thompson to have him prepare his 2003 income tax return. (*Id*.) Thompson asked Garcia whether he had any activity on which he spent money. (*Id.*) Garcia responded that he spent money on fixing up cars. (*Id.*) Thompson told Garcia that this was "his business" and proceeded to deduct related expenses on Garcia's tax return. (*Id.*)

Sperl told Garcia that she had been preparing returns for years. (*Id.* ¶ 34.) He believed that she was very experienced in tax matters and paid more than $700 for the preparation of his 2002 and 2003 returns. (*Id.*) Sperl also offered to amend Garcia's prior-year returns in order to obtain refunds for those years, but he declined the offer. (*Id.*) Garcia now believes that Sperl improperly targeted members of his Indian tribe to take advantage of its members and the members' lack of tax knowledge. (*Id.*)

Jo Ann Garcia, also of Temecula, California, learned of Sperl through her brother, Louie David Garcia. (*Id.* ¶ 37.) Jo Ann hired Sperl to prepare her 2001, 2002, and 2003 federal income tax returns. (*Id.*) During the preparation of one return, Sperl asked Garcia questions such as when she had bought her car. (*Id.* ¶ 38.) Sperl told Garcia that the car would help reduce her taxes if she used it for a small business. (*Id.*) Because Garcia did not have a business, Sperl suggested that Garcia sell direct-marketing products for Melaleuca, a business similar to Avon or Amway that sells its products through agents. (*Id.*) Garcia started the business but sold very few to no items because, as she described, she lacked a sales personality. (*Id.*) Sperl, however, told Garcia that her sales results or efforts did not matter and that she could deduct expenses on her return regardless. (*Id.*)

Sperl charged Garcia more than $400 per return prepared. (*Id.* ¶ 37.) Thompson prepared Garcia's 2003 return. (*Id.*) Sperl prepared a return for Garcia for 2002 that offset $93,950 in miscellaneous income received from the Pechanga Indian Reservation with a

Schedule C business loss of $16,802 for her purported business of “caretaker marketing.” (*Id.* ¶ 40.) Garcia’s 2003 return similarly offset $187,302 in miscellaneous income from the Pechanga Indian Reservation with a Schedule C business loss of $40,784. (*Id.* ¶ 41.) The returns also claimed the “single” standard deduction for Garcia. (*Id.*) In 2004, after an examination by the IRS, Garcia agreed with the IRS that the majority of the reported business losses from 2002 and 2003 should be disallowed. (*Id.* ¶ 42.) These adjustments, along with an adjustment in Garcia’s favor to claim the “head of household” standard deduction, resulted in a $2,010 deficiency for tax year 2002 and a $9,086 deficiency for tax year 2003, not including interest. (*Id.*)

Laurene Reyes of Wildomar, California also hired Sperl to prepare her federal income taxes. (*Id.* ¶ 43.) Reyes believed that Sperl was knowledgeable about tax matters, because she knew that Sperl had prepared returns for others on the Pechanga Indian Reservation who had obtained large tax refunds. (*Id.*) Sperl told her that having a business would help her taxes. (*Id.* ¶ 44.) Reyes told Sperl that she did not have a business but that her then-boyfriend cleaned carpets part-time. (*Id.*) Sperl told her that carpets would be Reyes’s new business. (*Id.*) Sperl prepared a return for Reyes for 2002 that offset $93,950 in miscellaneous income from the Pechanga Indian Reservation with a Schedule C business loss of $22,861 for her purported business of “carpet marketing.” (*Id.* ¶ 46.) In 2004, after an examination by the IRS, Reyes agreed with the IRS to disallow the business loss and to pay $7,119 in additional tax plus interest and a $1,423.80 accuracy penalty. (*Id.* ¶ 47.) Reyes also believes that Sperl improperly targeted her Indian tribe to take advantage of its members and the members’ lack of tax knowledge. (*Id.* ¶ 43.)

Frances Bergmann of Temecula, California, hired Sperl to prepare federal income tax returns for four years. (*Id.* ¶ 48.) Despite Bergmann's having few documents to give Sperl, Sperl prepared tax returns for Bergmann that claimed business losses. (*Id.* ¶ 49.) Bergmann's 2003 return prepared by Sperl claimed a Schedule C business loss of $11,839 for "sales marketing." (*Id.* ¶ 51.) This loss caused Bergmann to report no tax owed that year. (*Id.*) In 2004, after examination by the IRS, Bergmann agreed with the IRS to have the business loss disallowed and to pay a $784 tax deficiency plus interest. (*Id.* ¶ 52.) Bergmann attempted to contact Sperl for assistance with the audit, but Sperl did not return her calls or contact her again. (*Id.* ¶ 48.)

Wendy Bergmann of Escondido, California, hired Sperl to prepare her 2002 and 2003 federal income tax returns. (*Id.* ¶ 53.) Bergmann operates a candle-making business. (*Id.* ¶ 54.) Although Bergmann's sons helped her in this business, Bergmann was not able to tell Sperl how much she had paid her sons. (*Id.*) Sperl filled in amounts for payments to the sons on Bergmann's returns despite Bergmann's lack of knowledge. (*Id.*) Bergmann's 2002 joint income tax return prepared by Sperl listed a business loss of $37,309. (*Id.* ¶ 56.) This loss caused the Bergmanns to report no tax owed that year. (*Id.*) Sperl assured Bergmann that the refund requested was legal. (*Id.* ¶ 54.) In 2004, after examination by the IRS, the Bergmanns agreed with the IRS to have $27,757 of the business loss disallowed and to pay $3,033 in additional tax plus interest. (*Id.* ¶ 57.) Bergmann described Sperl as unhelpful and hard to reach during the audit. (*Id.* ¶ 53.)

Gary Davenport, of Mannford, Oklahoma, learned of Sperl through a friend. (*Id.* ¶ 58.) He attended a seminar at which Sperl was the only speaker. (*Id.*) He asked Sperl to prepare his

2001, 2002, and 2003 federal income tax returns. (*Id*.) She charged him $700 to prepare the 2001 return and also charged him $24 per month to receive a newsletter and discounts on tax-preparation services. (*Id*.) Sperl, contradicting the accountant who previously prepared Davenport's previous returns, told Davenport that he qualified as a statutory employee and listed his expenses on Schedule C along with deductions related to his home including a garage, office, and home addition containing a pool table that was used for entertaining. (*Id*. ¶ 59.) She also claimed depreciation and mileage for his truck and instructed Davenport to write a check at the end of the year to his children to claim as an expense. (*Id*.) The purpose of the payment was to be for services his children provided throughout the year that she claimed could be deducted even though Davenport told her that he did not keep track of the time and that the payment was much more than he would have paid another child to do the same work. (*Id*.)

In 2005, after examination by the IRS, the Davenports agreed with the IRS to disallowance of $121,491 of the business loss, to allow the deduction of $32,903 of these expenses on Schedule A, and to pay $20,168 in additional tax plus interest. (*Id*. ¶ 61.)

Barbara Beamer

Sperl's sister, Barbara Beamer, began working for Sperl preparing income tax returns in 2002. (*Id*. ¶ 62.) Beamer had learned to prepare returns by taking a course at H&R Block. (*Id*.) She also had earned an Associates of Science in Business degree. (*Id*.) Sperl, however, falsely told customers that Beamer had an accounting degree. (*Id*.) A year after she joined Sperl, Beamer contemplated buying Sperl's tax practice but decided against it. (*Id*.) Beamer stopped preparing returns with Sperl after Sperl continued to use Beamer's electronic filing identification number without Beamer's knowledge or consent. (*Id*.)

Beamer observed Sperl interview customers. (*Id*. ¶ 63.) Beamer frequently observed Sperl claim expenses for bogus businesses on returns. (*Id*.) Beamer saw Sperl question customers about their hobbies and then deduct hobby activity expenses as business expenses. (*Id*.) For example, Sperl deducted a van as part of a business based on a customer's hobby of playing baseball on the Internet. (*Id*.) The IRS later disallowed the deduction after an examination. (*Id*.) If Sperl did not discern that the customer had an appropriate hobby, Beamer observed Sperl recruit the customer to buy a home-based direct-sales business such as Melaleuca. (*Id*.) She saw Sperl then claim business losses even though her customers did not attempt to sell the products. (*Id*.)

Patrice Ancelot

Patrice Ancelot also prepared income tax returns with Sperl from February 2001 through April 2001. (*Id*. ¶ 65.) Ancelot observed that Sperl never asked customers if their expenses were for personal or business purposes. (*Id*.) Ancelot, who had no formal tax training, erroneously understood from working with Sperl that as long as customers had a receipt, they could claim a business expense. (*Id*.) Ancelot followed Sperl's directions, because she believed them to be correct at the time due to Sperl's years of experience. (*Id*.)

SusanTax Membership Program

In addition to their return preparation, defendants also offer the SusanTax Membership Program (the "Program"). (*Id*. ¶ 22.) They describe the Program as a "simplified one book tax accounting system" to support owners of home-based business. (*Id*. ¶ 23.) The Program purports to assist customers with determining the profitability of their business, with paying estimated quarterly income taxes to the IRS, and with determining deductions to income taxes from their business. (*Id*. ¶ 24.) The Program solicits customers by stating that they can "convert [their] non deductible to deductibles" and thereby create a large "paper loss" that will reduce their overall tax liability, without spending more than a few hundred dollars for defendants' services. (*Id*. ¶ 25.) Defendants inform potential customers that they will "[l]earn how to legally deduct the money you are *already* spending in your home and for your children," such as vehicle expenses, furniture, equipment, telephones, and children's allowances. (*Id*.) Defendants promote the Program at seminars held around the country where they also prepare tax returns. (*Id*. ¶ 26.)

For an initial enrollment fee of $125, customers receive a daily record keeping book, audio cassette, and computer software. (*Id*. ¶ 27.) Customers also pay monthly fees of $24 to remain in the Program and receive a monthly newsletter that contains tax tips and updates. (*Id*.) If Program customers use the Program to track expenses, defendants prepare Program customers' tax returns at a discounted rate. (*Id*. ¶ 29.)

Defendants describe the Program as "widely known in the industry for the Tax Seminars which have been held across the country for major Network Marketing Companies as well as individual business owners." (*Id*. ¶ 31.) They state that their manuals "have been written by an expert." (*Id*. ¶ 32.) Defendants boast of Sperl's 17 years of experience and contrast themselves with "a lot of accountants, bookkeepers and CPA's [who] don't keep up with the ever changing tax laws to maximize your tax advantages and write offs [that] your home business is providing you with." (*Id*. ¶ 33.)

Defendants have persisted in selling their Program and preparing returns falsely or fraudulently claiming business deductions despite being contacted about an injunction investigation by the IRS. (*Id*. ¶¶ 6, 7.) Sperl refused a December 2004 meeting that provided her an opportunity to present any facts or legal arguments to the IRS in her support. (*Id*. ¶¶ 7, 8.)

ARGUMENT

The evidence submitted with this motion establishes that the Court should preliminarily enjoin defendants under Sections 7407, 7408, and 7402 of the Internal Revenue Code (26 U.S.C., "I.R.C.") from preparing any federal tax returns for others, from selling their SusanTax Membership Program or any other similar plan or arrangement, and from otherwise interfering with the administration or enforcement of internal revenue laws. The evidence also demonstrates that the Court should require defendants to provide the United States with a list of their customers.

The Sixth Circuit has identified four factors that determine whether a preliminary injunction should issue: "(1) the plaintiff's likelihood of success on the merits; (2) whether the plaintiff may suffer irreparable harm absent the injunction; (3) whether granting the injunction will cause substantial harm to others; and (4) the impact of an injunction upon the public interest."[1] Because of the urgent need to halt irreparable harm, "a preliminary 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."[2] Moreover, courts frequently consider affidavits and other

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[1] *Tucker v. City of Fairfield, Ohio*, 398 F.3d 457, 461 (6th Cir. 2005).

[2] *Univ. of Texas v. Camenisch*, 451 U.S. 390, 395 (1981).

hearsay materials that would not be admissible evidence for a permanent injunction, as long as the evidence is appropriate, given the character and objectives of the injunctive proceeding.[3]

The first three sections of this memorandum will address the United States' likelihood of success under each of the bases it alleges for injunction. The fourth and final section will address, to the extent not already covered, the other three preliminary-injunction factors.

I. Defendants' repeated claims of false and fabricated home-based businesses and deductions demonstrate that the United States will likely succeed in proving that defendants should be enjoined under I.R.C. § 7407.

Section 7407 authorizes a court to enjoin a person from acting as an income tax return preparer if that person continually or repeatedly engaged in conduct subject to penalty under I.R.C. § 6694 or engaged in any other fraudulent or deceptive conduct substantially interfering with the proper administration of the tax laws and the court finds that a narrower injunction prohibiting only specific misconduct would be insufficient. Because Section 7407 sets forth specific criteria for injunctive relief, the United States need only meet those statutory criteria and need not demonstrate the traditional equitable factors to obtain a permanent injunction.[4]

A. Defendants continually and repeatedly engaged in conduct subject to penalty under I.R.C. § 6694.

A return preparer is subject to penalty under I.R.C. § 6694 if (1) the preparer submits a return that contains an understatement of liability; (2) the understatement is based upon a

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[3] *Levi Strauss & Co. v. Sunrise Int'l Trading, Inc.*, 51 F.3d 982, 985 (11th Cir. 1995); *S.E.C. v. Cherif*, 933 F.2d 403, 412 n.8 (7th Cir. 1991). "The 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." *Asseo v. Pan Am. Grain Co.*, 805 F.2d 23, 26 (1st Cir. 1986).

[4] *See United States v. Estate Pres. Servs.*, 202 F.3d 1093, 1098 (9th Cir. 2000).

position taken for which there was not a realistic possibility of being sustained; (3) the preparer knew or should have known of such position; and (4) the position is either frivolous or not disclosed as provided in the law.

In this case, defendants prepared and submitted federal tax returns claiming business expenses for people without businesses. Deductions for "ordinary and necessary" expenses paid for carrying on activities are allowable under I.R.C. § 162(a) when the activities constitute a trade or business of the taxpayer, or under I.R.C. § 212(1) when the activities are for the production or collection of income. An activity does not fall within the meaning of either section, however, unless the taxpayer can demonstrate that she engaged in the activity "for the primary purpose and dominant hope and intent of realizing a profit."[5] The Supreme Court noted that a "sporadic activity, a hobby, or an amusement diversion does not qualify."[6] In the context of this required profit motive, "profit" means economic profit, independent of tax savings.[7]

If a lack of profit motive precludes deduction under Sections 162 and 212 for a specific activity, I.R.C. § 183(b) permits limited deductions to individuals for expenses related to that activity. That section prevents the *net* loss from activities not engaged in with a profit motive

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[5] *Hayden v. Commissioner*, 889 F.2d 1548, 1552 (6th Cir. 1989). *See also* 26 C.F.R. § 1.183-2(a) (2005) ("The determination whether an activity is engaged in for profit is to be made by reference to objective standards, taking into account all of the facts and circumstances of each case. Although a reasonable expectation of profit is not required, the facts and circumstances must indicate that the taxpayer entered into the activity, or continued the activity, with the objective of making a profit.").

[6] *Commissioner v. Groetzinger*, 480 U.S. 23, 35 (1987).

[7] *Hayden*, 889 F.2d at 1552.

from being deducted against income from other activities, however.[8] This is designed to relieve the taxpaying public of the burden of subsidizing an individual taxpayer's profitless, personal pursuits through income tax deductions.[9] The reporting of these expenses also differs. Expenses for activities engaged in for profit are reported on Schedule C of the Form 1040 individual income tax return.[10] Expenses under Section 183 are reported on Schedule A.[11]

1. Defendants submitted returns that contained understatements of liability.

Defendants prepared returns that contained understatements of taxable income, and, thus, understatements of tax liability, because defendants claimed large deductions for business expenses and depreciation on Schedule C when their customers did not have businesses at all or businesses operated with the required profit motive. These false deductions caused the Schedule C to show a loss, which was then carried to the main part of the return to offset other income. This caused an understatement because the expenses claimed did not relate to any for-profit

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[8] Section 183(b)(1) permits the deduction of expenses that are otherwise deductible whether or not incurred in a profit-driven activity. *Antonides v. Commissioner*, 893 F.2d 656, 658 (4th Cir. 1990); *Mills v. United States*, 699 F. Supp. 1245, 1246 (N.D. Ohio 1988). For example, if an activity undertaken without a profit motive involved real property, Section 183(b)(1) would permit deduction in full of the related local real property taxes attributed to the activity because I.R.C. § 164(a)(1) permits deduction of local real property taxes. *See* 26 C.F.R. § 1.183-1 (2005). Section 183(b)(2) permits the deduction of other expenses attributable to an activity undertaken without a profit motive, but only to the extent that the income derived from that activity exceeds the deductions allowed by the first exception. *Antonides*, 893 F.2d at 658. Continuing on the previous example, utility expenses attributed to the activity would be deductible only to the extent that the real property taxes did not exceed the income from the activity, because utility expenses are not otherwise deductible.

[9] See *Siegel v. Commissioner*, 63 T.C.M. (CCH) 3127, 3127-10 n.17 (1992).

[10] I.R.C. § 62 (calculating "adjusted gross income" as gross income subtracted by enumerated deductions including those attributable to a trade or business).

[11] *Id*. § 63 (defining "taxable income" as gross income subtracted by all deductions permitted by Chapter 1 for individuals who itemize their deductions).

business activity, and the Section 183 rules prevent carrying forward a net loss to offset other income when no profit motive exists. Deducting amounts unrelated to any business or income-producing activity similarly understates tax liability.

2. The position supporting these deductions cannot reasonably be sustained.

Defendants prepared returns for customers containing these deductions even when their customer expressed no profit-seeking motivation. For example, defendants reported car expenses for Louie David Garcia, despite Garcia telling them that he used the car for personal purposes only. Further, defendants fabricated expense amounts when customers such as Frances Bergmann could not recall how much was spent. Defendants were also undeterred by the lack of an actual business. They sought out activities currently performed by their customers, such as fixing cars, or enrolled them into home-based businesses for an additional fee. Defendants prepared the return as if the customer had been operating this business in the prior calendar year. When customers returned in subsequent years, defendants would continue to prepare Schedule C returns for these "businesses," despite being told by customers such as Jo Ann Garcia that they had not actually operated the business in the taxable year.

3. Defendants knew or should have known that their position was not proper.

Because defendants created the business expenses and often the purported businesses themselves without any substantiating input from their customers, defendants clearly knew or should have known that deducting these expenses was improper. Moreover, because defendants and subordinates have prepared over 640 returns for the 2002 and 2003 tax years claiming business expenses, they cannot claim an isolated mistake. Each of the 68 returns prepared by defendants and selected by the IRS for examination has been adjusted due to errors on the return, primarily as a result of the home-based business scheme described above. Defendants nevertheless continued filing these returns, despite being contacted by the IRS and despite knowing that the IRS had audited customers and made significant adjustments.

Further, defendants hold themselves out as tax "experts" and "widely known in the industry," especially in the area of home-based businesses, and describe themselves as more knowledgeable than accountants. They understand the tax laws sufficiently to publish a monthly newsletter that reports on tax law. A modicum of research, however, would have led defendants to the Internal Revenue Code sections mentioned above and to IRS publications such as Publication 535, *Business Expenses*, or Publication 4035, *Home-Based Business Tax Avoidance Schemes*. Defendants clearly distort the very tax provisions in which they claim expertise.

4. Defendants did not disclose the underlying realities of their customers' activities.

The returns prepared by defendants did not disclose the realities of the customers' "businesses." Filing a Schedule C, in fact, states the opposite—that the business is run with the requisite profit motive and that the expenses were ordinary and necessary.

B. <u>Defendants interfere substantially with the administration of the tax laws.</u>

The activities described above substantially interfere with the administration of the tax laws. Defendants' customers are not reporting and paying the correct amount of tax to the United States. In addition, because the returns defendants prepare for customers appear facially correct, the IRS is required to expend significant effort to investigate and determine that defendants' statements are false or fraudulent. Moreover, the IRS must devote additional limited resources to attempting to recover the revenue lost as a result of the scheme, and may not ever recover it all.

C. Because an injunction prohibiting only these violations would be insufficient to prevent further injury, defendants should be barred from preparing any tax returns.

The Government requests that defendants be enjoined not merely from the violations described above, but from preparing any tax returns for others, because a narrower injunction prohibiting only specific misconduct would likely not deter defendants from their abusive return-preparation activities. Because defendants have continued to prepare returns despite knowing that the IRS has repeatedly rejected the positions they take on returns they prepare, there is no assurance that, if they are merely barred from one fraudulent practice, they will not come up with another. Their refusal to meet with the IRS to discuss the returns they prepared also demonstrates that they are not interested in preparing honest tax returns.

The IRS lacks the resources to review every document prepared or filed by preparers who have repeatedly displayed their willingness to disregard and distort federal tax law. A narrower injunction—such as barring only future violations of I.R.C. § 6694—will be ineffective. To protect the public and the public fisc, defendants should be barred from the return-preparation business.

II. Defendants' false or fraudulent statements in their SusanTax Membership Program and preparation of tax returns claiming false and fabricated home-based businesses and deductions demonstrate that the United States will likely succeed in proving that defendants should be enjoined under I.R.C. § 7408.

Internal Revenue Code Section 7408 also authorizes a federal district court to enjoin any person engaging in conduct subject to penalty under I.R.C. §§ 6700 or 6701 from engaging in such conduct or any conduct subject to penalty under the Internal Revenue Code if the court finds that injunctive relief is appropriate to prevent the recurrence of such conduct. Although the legislative history shows that Sections 6700, 6701, and 7408 were enacted to give the IRS more effective tools to deal with "the growing phenomenon of abusive tax shelters," these statutes do not apply only to typical investment tax shelters, but also to "other abusive tax avoidance schemes."[12] Because Section 7408 sets forth specific criteria for injunctive relief, the United States need only meet those statutory criteria and need not demonstrate the traditional equitable factors to obtain a permanent injunction.[13]

A. The sale of the SusanTax Membership Program subjects defendants to penalty under I.R.C. § 6700 and injunctive relief is appropriate to prevent the recurrence of the conduct.

Internal Revenue Code Sections 7408 and 6700 require the Government to demonstrate five requirements by a preponderance of the evidence to obtain an injunction:

> (1) the defendant organized or sold, or participated in the organization or sale of, an entity, plan, or arrangement; (2) he made or caused to be made, false or fraudulent statements concerning the tax benefits to be derived from the entity, plan, or arrangement; (3) he knew or had reason to know that the statements were false or fraudulent; (4) the false or fraudulent statements pertained to a material matter; and (5) an injunction is necessary to prevent recurrence of this conduct.[14]

1. Defendants sell a plan or arrangement.

In conjunction with the preparation of income tax returns, defendants have created and currently sell and promote a separate tax package that sets forth the same scheme used on the returns. The tax package, entitled the SusanTax Membership Program ("the Program"), consists of a daily record keeping book, audio cassette, computer software, and monthly newsletters. They sell the Program at seminars held around the country where they also prepare tax returns.

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[12] S. Rep. No. 97-494, at 266 (1982), *reprinted in* 1982 U.S.C.C.A.N. 781, 1014. *See United States v. White*, 769 F.2d 511, 515 (8th Cir. 1985); *United States v. Buttorff*, 761 F.2d 1056, 1063 (5th Cir. 1985).

[13] *Estate Pres. Servs.*, 202 F.3d at 1098.

[14] *United States v. Gleason*, 432 F.3d 678, 682 (6th Cir. 2005)

2. Defendants make false or fraudulent statements regarding the tax benefits associated with their plans or arrangements.

The promotional materials for the Program state the general themes of defendants' tax preparation scheme. The Program falsely advises customers that they can lower their taxes by deducting personal expenses that they are already incurring, as part of a "home-based business," which defendants will also sell. The Program repeatedly makes these claims of "converting" expenses, without discussing in any more than brief detail the nuanced requirements for business deductions, including profit motive and connection to income-producing activities. The Program falsely leads customers to believe that supporting children or having a receipt for an expense is tantamount to establishing deductibility. These statements are not properly qualified by stating that a home-based businesses must have a business purpose and the intent to make a profit, and that business expenses must be necessary and related to the business purpose.[15]

3. Defendants knew or had reason to know that their tax statements were false or fraudulent.

The "knew or had reason to know" standard of Section 6700 includes "what a reasonable person in the [defendants'] . . . subjective position would have discovered."[16] This determination is guided by three factors: (1) the extent of the person's reliance upon knowledgeable professionals; (2) the person's level of sophistication and education; and (3) the person's familiarity with tax matters.[17]

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[15] *Id*. at 682-83.

[16] *Estate Pres. Servs.*, 202 F.3d at 1103 (alterations and omissions in original) (quoting *Sanders v. United States*, 509 F.2d 162, 166 (5th Cir. 1975)).

[17] *Gleason*, 432 F.3d at 683.

Here, defendants hold themselves out as tax preparers for small-business owners. As discussed above, a modicum of research, however, would lead defendants to the Internal Revenue Code sections or IRS publications discussing these topics. Defendants claim to be more knowledgeable than other tax professionals, and Sperl boasts over 17 years of experience. Defendants sell their services by encouraging potential customers to avoid bad advice from accountants, "a lot of [whom] don't keep up with the ever changing tax laws to maximize your tax advantages and write offs, your home business is provided you with." Further, defendants demonstrate a familiarity with tax matters. They prepare and distribute monthly newsletters and have created a "simplified" tax program. Finally, defendants persist in preparing returns similar to returns that they know previously triggered an IRS investigation and that they know have caused customers significant adjustments after audits.

4. Defendants' false or fraudulent statements were material.

In proving materiality, the Government need not demonstrate that a customer has relied on the misrepresentations.[18] Rather, "a matter is considered material to the arrangement 'if it would have a substantial impact on the decision making process of a reasonably prudent investor.'"[19] Statements pertaining to the "availability of tax deductions, credits, or to other mechanisms for reducing tax liability . . . clearly qualify as 'material'" under I.R.C. § 6700.[20]

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18 *Estate Pres. Servs.*, 202 F.3d at 1099.

19 *Buttorff*, 761 F.2d at 1062 (quoting S. Rep. No. 97-494, at 267 (1982), reprinted in 1982 U.S.C.C.A.N. 781, 1015).

20 *United States v. Estate Pres. Servs.*, 38 F. Supp. 2d 846, 855 (E.D. Cal. 1998), *aff'd* 202 F.3d 1093 (9th Cir. 2000).

The Program instructs customers how to “convert” non-deductible personal expenses into deductible business expenses to lower taxes. Defendants advertise that customers will be able to claim business losses while suffering only a “paper loss.” The primary purpose of the Program is the understatement of taxable income for the purpose of improperly reducing tax liability. As such, the statements made in promoting the Program certainly are material.

5. An injunction is appropriate and necessary to prevent future violations of I.R.C. § 6700.

The Sixth Circuit has adopted the following factors as relevant in determining the likelihood of future violations of Section 6700, and, thus, the need for an injunction under Section 7408:

> (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 defendant’s occupation would place him in a position where future violations would be anticipated.[21]

These factors are satisfied here.

First, the harm caused to customers, the United States, and the public is grave. Customers have been harmed by the plan because they pay monthly fees to defendants to follow a plan that causes them to understate their income tax liabilities and potentially subjects them to additional interest, penalties, and criminal prosecution. The United States is harmed because defendants’ customers are not paying and may never repay the correct amount of tax to the United States Treasury. The IRS estimates that defendants’ 2002 and 2003 returns have understated tax liability by $4 million. The public is harmed because the IRS is forced to devote

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[21] *Gleason*, 432 F.3d at 683.

its limited resources to identifying and attempting to recover revenue lost as a result of defendants' activities.

Second, the extent of defendants' participation is broad—extending to customers in 22 states. They are the driving force behind the plan and business. Third, with regard to scienter, defendants research tax law to publish monthly newsletters and promote themselves as knowledgeable about tax law. They also persisted in promoting the Program even after the IRS informed them of its investigation, and did not avail themselves of the opportunity to discuss the views they promote with the IRS.

Further, the conduct is recurrent. Defendants continue to sell the Program and publish newsletters despite knowing that the IRS has audited their customers and made significant adjustments. They also use the Program to recruit customers for their tax-return preparation business. Given that defendants remain in business and could collect large fees for the Program and related services, future violations are anticipated.

B. The preparation of tax returns claiming fabricated home-based businesses subjects defendants to penalty under I.R.C. § 6701 and injunctive relief is appropriate to prevent the recurrence of such conduct.

I.R.C. § 6701 imposes a penalty if (1) the defendants aided or assisted in the preparation of any portion of a tax return, claim for refund, or other document that (2) they knew or had reason to believe would be used in connection with any material matter arising under the internal revenue laws; and that (3) they knew that, if used, would result in an understatement of tax liability of another person.

Because defendants prepare for customers tax returns that they sign as preparers, their activities meet the first requirement of aiding and assisting in the preparation of a tax return.

These activities also demonstrate 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.

With regard to the third requirement of the Section 6701 penalty, defendants' activities also demonstrate that they knew the returns would result in understatements of customers' tax liabilities, because they knew that their statements were false or fraudulent. Defendants promoted their home-based business scheme to hundreds of customers who lacked any background in business or even any desire to operate a home-based business. When these customers told defendants that they were not operating businesses for profit, defendants ignored them and prepared returns that included Schedule C business deductions. Defendants simply fabricated the needed business purpose and, often, the underlying business expenses. They continued to do this even after learning that the returns they prepared had been adjusted by the IRS during audits.

Injunctive relief is appropriate to prevent further violations of Section 6701. Defendants' return preparation harms both their customers and the United States. By preparing and filing the tax returns, they participate fully in the process. As discussed above, they hold themselves out as knowledgeable, yet promote a false reading of the law. The hundreds of returns they prepare demonstrate the recurring nature of their violations, and the large fees they charged for return preparation demonstrates that future violations are reasonably anticipated.

III. Defendants' interference with the enforcement of the internal revenue laws demonstrate that the United States will likely succeed in proving that defendants should be enjoined under I.R.C. § 7402.

I.R.C. § 7402(a) grants federal district courts broad authority to issue injunctions to enforce the internal revenue laws. Because Section 7402(a) expressly provides that the injunction remedy is "in addition to and not exclusive of" other remedies, the United States need not establish that it has no adequate remedy at law. Rather, Section 7402(a) manifests "a Congressional intention to provide the district courts with a full arsenal of powers to compel compliance with the internal revenue laws,"[22] and "has been used to enjoin interference with tax enforcement even when such interference does not violate any particular tax statute."[23] The legislative history of Section 7408 explicitly states that "the court will continue to have full authority [under Section 7402] and will continue to possess the great latitude inherent in equity jurisdiction to fashion appropriate equitable relief."[24]

Here, defendants are interfering with the administration of the internal revenue laws by preparing tax returns that fabricate home-based businesses and that improperly attribute personal expenses to those business to falsely or fraudulently reduce their customers' federal income tax liabilities in violation of I.R.C. §§ 6694 and 6701. They also violate I.R.C. § 6700 in marketing

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[22] *Brody v. United States*, 243 F.2d 378, 384 (1st Cir. 1957).

[23] *United States v. Ernst & Whinney*, 735 F.2d 1296, 1300 (11th Cir. 1984) ("the statute has been relied upon to enjoin activities of third parties that encourage taxpayers to make fraudulent claims"). *See United States v. Kaun*, 633 F. Supp. 406, 409 (E.D. Wis. 1986) ("federal courts have routinely relied on [Section 7402(a)] to preclude individuals . . . from disseminating their rather perverse notions about compliance with the Internal Revenue laws or from promoting certain tax avoidance schemes"), *aff'd*, 827 F.2d 1144 (7th Cir. 1987); *United States v. May*, 555 F. Supp. 1008, 1009-1011 (E.D. Mich. 1983) (enjoining defendant who promoted filing of tax returns that omitted wages from income under Section 7402(a)).

[24] S. Rep. No. 97-494, at 269 (1982), *reprinted in* 1982 U.S.C.C.A.N. 781, 1017.

their Program instructing customers how to make these false or fraudulent claims. As described above, an injunction prohibiting defendants from engaging in such conduct is both necessary and appropriate.

In addition to barring defendants from engaging in these activities, the Court should order that defendants notify their customers of the Court's findings and concerning the falsity of their prior representations and to enclose a copy of the preliminary injunction order. The Court should also order defendants to produce to the United States a list identifying their customers so that the IRS may begin the process of undoing the damage defendants have caused and may also monitor defendants' compliance with the injunction. This affirmative relief is authorized by I.R.C. § 7402(a), which grants this Court broad authority to fashion relief to prevent interference with the internal revenue laws.[25] Other courts have granted the United States similar affirmative relief in both preliminary and permanent injunctions.[26] The Internal Revenue Code already mandates that return preparers furnish customer lists or copies of returns to the United States on demand.[27].

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[25] *United States v. First Nat'l City Bank*, 379 U.S. 378, 383-84 (1965) ("[O]ur review of the [temporary] injunction as an exercise of the equity power granted by [Section 7402(a)] must be in light of the public interest involved: 'Courts of equity may, and frequently do, go much farther both to give and withhold relief in furtherance of the public interest than they are accustomed to go when only private interests are involved.'") (quoting *Virginian Ry. Co. v. Sys. Fed'n No. 40*, 300 U.S. 515, 552 (1937)).

[26] *E.g.*, *United States v. Bell*, 414 F.3d 474, 485 (3d Cir. 2005) (affirming customer-list requirement ordered by court in preliminary and permanent injunctions); *United States v. Cohen*, 222 F.R.D. 652, 659 (W.D. Wash. 2004) (ordering tax-return preparer to notify customers and produce customer list to United States as part of preliminary injunction); *United States v. Stephenson*, 313 F. Supp. 2d 1054, 1061 (W.D. Wash. 2004) (same).

[27] I.R.C. § 6107(b) ("Any person who is an income tax return preparer . . . shall . . . retain a completed copy of such return or claim, or retain, on a list, the name and taxpayer identification

(continued...)

IV. The United States has demonstrated that the irreparable harm to the Government and the benefit to the public of a preliminary injunction outweigh the harm to defendants.

If the Court does not preliminarily enjoin defendants, the United States will be irreparably harmed because defendants will continue to prepare fraudulent federal income tax returns that understate their customers' tax. Defendants will likely prepare another 300 returns this tax season, as they have in each of the prior three years. Because the returns defendants prepare for their customers appear facially correct, the United States may not ever identify and recover all of the under-reported tax. Moreover, defendants' continued preparation of returns would require the IRS to expend its limited resources examining the returns and attempting to collect the unpaid taxes. The public interest would be served by preventing this harm to the United States and any related direct harm to defendants' customers.

An order requiring that defendants be barred from the tax-return business is a serious action, but Congress provided such a strong remedy in I.R.C § 7407, because it recognized there are situations where a lesser remedy is inadequate. This is such a case. Preparers have been barred from the business for similar misconduct.[28]

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[27] (...continued)
number of the taxpayer for whom such return or claim was prepared, and . . . make such copy or list available for inspection upon request by the Secretary [of the Treasury]."). *See also* I.R.C. § 6695(d) (penalizing failure to comply with I.R.C. § 6107(b)).

[28] *United States v. Baxter*, 372 F. Supp. 2d 1326 (M.D. Ala. 2005) (imposing permanent injunction barring all return preparation against a preparer who knowingly inflated business expenses and claimed fictitious charitable deductions and income); *United States v. Paul*, No. C04-0916L, 2004 WL 3250168 (W.D. Wash. Sept. 17, 2004) (imposing preliminary injunction barring all return preparation against a preparer who claimed fictitious business losses, charitable contributions, and unreimbursed employee business expenses and used a frivolous theory to eliminate tax liability); *United States v. Bailey*, 789 F. Supp. 788, 790 (N.D. Tex. 1992)
(continued...)

CONCLUSION

Immediate injunctive relief to prevent defendants from preparing tax returns and selling the Program is necessary and appropriate. Because another tax-preparation season is underway, the United States requests that the Court issue a preliminary injunction in accordance with the proposed order submitted with this motion.

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[28] (...continued)
(imposing permanent injunction barring all return preparation against a preparer who created fictitious deductions not claimed by customers).