

IN THE UNITED STATES COURT FOR THE
WESTERN DISTRICT OF MICHIGAN

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UNITED STATES OF AMERICA,

Plaintiff,

v.

JOYCE M. STONE,
CHARLES J. FREED,
STONE & ASSOCIATES, and
JULIE SHAFFER,

Defendants.

Civil No. 1:06 CV 0157

Richard Alan Enslen
Senior, U.S. District Judge

COMPLAINT

At the request of the Secretary of the Treasury and at the direction of the Attorney General of the United States, the United States of America, by its attorney, Margaret M. Chiara, United States Attorney for the Western District of Michigan, brings this action pursuant to 26 U.S.C. §§ 7402(a) and 7407 to enjoin defendants Joyce M. Stone, Charles J. Freed, Stone & Associates, and Julie Shaffer from:

- a. preparing or assisting in the preparation of any federal income tax return, or any other federal tax return, for any other person or entity;
- b. engaging in any conduct subject to penalty under 26 U.S.C. § 6694;
- c. engaging in any fraudulent or deceptive conduct that substantially interferes with the proper administration or enforcement of the internal revenue laws; and
- d. engaging in any other conduct that substantially interferes with the proper administration or enforcement of the internal revenue laws;

In support thereof, the United States alleges as follows:

Jurisdiction, Venue, and Parties

1. Jurisdiction over this action is conferred upon this Court under 28 U.S.C. §§ 1340 and 1345 and 26 U.S.C. §§ 7402(a) and 7407.
2. Venue is proper in the United States District Court for the Western District of Michigan pursuant to 28 U.S.C. § 1391(b) and 26 U.S.C. § 7407(a).
3. Joyce M. Stone resides in Hillsdale, Michigan, within the jurisdiction of this Court.
4. Charles J. Freed resides in Hillsdale, Michigan, within the jurisdiction of this Court. Freed is Stone's son.
5. Stone and Associates is a business owned and operated by Stone and/or Freed. It is an unincorporated entity, and is operated out of Stone's and Freed's home.
6. Julie Shaffer resides in Hillsdale, Michigan, within the jurisdiction of this Court.

Defendants' Tax-Return Preparation Schemes

7. Defendants Stone, Freed, Stone & Associates, and Shaffer are in the business of providing income-tax-return preparation services.
8. Stone is a tax-return preparer within the meaning of 26 U.S.C. § 7701(a)(36).
9. Freed is a tax-return preparer within the meaning of 26 U.S.C. § 7701(a)(36).
10. Shaffer is tax-return preparer within the meaning of 26 U.S.C. § 7701(a)(36).
11. Stone and Associates is a business that provides tax-return preparation services, and is a tax-return preparer within the meaning of 26 U.S.C. § 7701(a)(36).

12. From at least the 1990s until at least 2005, Stone has worked as a tax-return preparer, in which capacity she prepared and assisted in the preparation of federal income tax returns for individual taxpayers.

13. From at least the 1990s until at least 2005, Freed has worked as a tax-return preparer, in which capacity he prepared and assisted in the preparation of federal income tax returns for individual taxpayers.

14. From at least the 1990s until at least 2005, Shaffer has worked as a tax-return preparer, in which capacity she prepared and assisted in the preparation of federal income tax returns for individual taxpayers.

15. Operating their business, Stone and Associates, from their home, Stone and Freed prepared individual income tax returns for tax years from at least the 1990s through 2004.

16. Operating her business from her home, Shaffer prepared individual income tax returns for tax years from at least the 1990s through 2004. In addition, Shaffer is believed to have electronically filed returns prepared by Stone and Freed during some years during that period.

17. From 2001 to at least 2005, Stone prepared individual income tax returns, IRS Forms 1040, for tax years 2000 through 2004, on which she willfully, recklessly, or due to an unrealistic position understated the taxpayers' federal income tax liabilities.

18. From 2001 to at least 2005, Freed prepared individual income tax returns, IRS Forms 1040, for tax years 2000 through 2004, on which he willfully, recklessly, or due to an unrealistic position understated the taxpayers' federal income tax liabilities.

19. From 2001 to at least 2005, Stone and Associates, acting through Stone or Freed, prepared individual income tax returns, IRS Forms 1040, for tax years 2000 through 2004 on which it willfully, recklessly, or due to an unrealistic position understated the taxpayers' federal income tax liabilities.

20. From 2002 until at least 2005, Shaffer prepared individual income tax returns, IRS Forms 1040, for tax years 2001 through 2004, on which she willfully, recklessly, or due to an unrealistic position understated the taxpayers' federal income tax liabilities.

21. The individual income tax returns for the 2000 through 2004 tax years Stone prepared represented that certain taxpayers were entitled under the provisions of the internal revenue laws to claim certain expenses and other deductions. Stone knew or reasonably should have known that said taxpayers were not entitled to claim such expenses and other deductions.

Examples of the improper deductions claimed on the tax returns Stone prepared include:

- a. fictitious or inflated charitable contributions;
- b. fictitious or inflated unreimbursed employee expenses, including improper expenses for such items as family meals, children's sporting expenses, work clothes and uniforms, and business mileage;
- c. fraudulent educational credits and expenses; and
- d. fictitious or inflated rental income or expenses

22. The individual income tax returns for the 2000 through 2004 tax years Freed prepared represented that certain taxpayers were entitled under the provisions of the internal revenue laws to claim certain expenses and other deductions. Freed knew or reasonably should

have known that said taxpayers were not entitled to claim such expenses and other deductions.

Examples of the improper deductions claimed on the tax returns Freed prepared include:

- a. fictitious or inflated charitable contributions;
- b. fictitious or inflated unreimbursed employee expenses, including improper expenses for such items as family meals, children's sporting expenses, work clothes and uniforms, and business mileage;
- c. fraudulent educational credits and expenses; and
- d. fictitious or inflated rental income or expenses.

23. The individual income tax returns for the 2000 through 2004 tax years Stone and Associates, acting through Stone or Freed, prepared represented that certain taxpayers were entitled under the provisions of the internal revenue laws to claim certain expenses and other deductions. Stone and Associates knew or reasonably should have known that said taxpayers were not entitled to claim such expenses and other deductions. Examples of the improper deductions claimed on the tax returns Stone and Associates prepared include:

- a. fictitious or inflated charitable contributions;
- b. fictitious or inflated unreimbursed employee expenses, including improper expenses for such items as family meals, children's sporting expenses, work clothes and uniforms, and business mileage;
- c. fraudulent educational credits and expenses; and
- d. fictitious or inflated rental income or expenses.

24. The individual income tax returns for the 2001 through 2004 tax years Shaffer prepared represented that certain taxpayers were entitled under the provisions of the internal

revenue laws to claim certain expenses and other deductions. Shaffer knew or reasonably should have known that said taxpayers were not entitled to claim such expenses and other deductions.

Examples of the improper deductions claimed on the tax returns Shaffer prepared include:

- a. fictitious or inflated business income or expenses;
- b. understated income from a business (done to enable the taxpayer to improperly claim the earned income credit);
- c. improperly claiming head-of-household filing status.

Defendants' Knowledge of the Illegality of their Conduct

25. Stone knows or should know of the illegality of her conduct, as alleged in this complaint.

26. Stone has been involved in the tax-return-preparation business since 1962. She has taken a course in federal taxation and has attended Michigan State Tax seminars.

27. Freed knows or should know of the illegality of her conduct, as alleged in this complaint.

28. Freed has learned the income tax return preparation business from his mother.

29. Shaffer knows or should know of the illegality of her conduct, as alleged in this complaint.

30. Shaffer has taken classes in tax-return preparation.

31. The principals of Stone and Associates, Freed and Stone, know or should know of the illegality of their conduct, as alleged in this complaint, for the reasons set forth above.

32. All of the defendants have access, either from on-line sources or from local libraries or local IRS offices, to IRS publications regarding the preparation of tax returns.

Harm to the United States, the Public, and Defendants' Customers

33. Freed, Stone, Stone & Associates, and Shaffer have filed hundreds of income tax returns for tax year 2000 or thereafter.

34. Collectively, Freed and Stone have about 1,000 clients for whom they prepare income tax returns. In addition, Shaffer has over 1,000 clients for whom she prepares income tax returns.

35. The government has not determined the exact number of income tax returns each defendant prepared, largely because Defendants Stone and Freed arranged to have Shaffer electronically file some tax returns they prepared for tax years 2000 and thereafter.

36. As a result of the defendants' preparation of returns understating their customers' tax liabilities, the United States has suffered significant tax losses.

37. Based on projections made from audits of 115 income tax returns Stone, Freed or Shaffer prepared, the Internal Revenue Service estimates that the returns Stone and Freed prepared for the 2000 through 2003 tax years cost the Federal Treasury more than \$25,000,000.

38. As a result of the defendants' preparation of returns understating their customers' tax liabilities, the Internal Revenue Service is forced to devote its limited resources to identifying and recovering lost tax revenues from their customers, thereby reducing the level of service that the Internal Revenue Service can give to other taxpayers.

39. Some of the revenue losses caused by the defendants' preparation of returns understating their customers' tax liabilities may never be recovered, resulting in permanent loss.

40. As a result of the defendants' preparation of returns understating their customers' tax liabilities, some of their customers have had to undergo audits and have incurred

unanticipated financial burdens due to their liability for tax beyond the amount reported on their original returns, plus statutory interest, and penalties.

41. As a result of the defendants' preparation of returns understating their customers' tax liabilities, some of their customers will have to file amended returns or undergo audits and will incur unanticipated financial burdens due to their liability for tax beyond the amount reported on their original returns, plus statutory interest, and penalties.

Count I: Injunction under 26 U.S.C. § 7407

42 The United States incorporates by reference the allegations contained in paragraphs seven through forty-one above.

43. Section 7407 of the Internal Revenue Code provides that a court may enjoin an income tax return preparer from engaging in, among other things:

- a. conduct subject to penalty under Section 6694 of the Internal Revenue Code (understatement of a taxpayer's liability due to an unrealistic position, willful understatement of a taxpayer's liability, or understatement of a taxpayer's liability due to a reckless or intentional disregard of the rules or regulations); or
- b. any fraudulent or deceptive conduct which substantially interferes with the proper administration of the Internal Revenue laws,

if the court finds that the income tax preparer has engaged in such conduct and that injunctive relief is appropriate to prevent the recurrence of such conduct. Section 7407 further

provides that if the court finds that an income tax return preparer has continually or repeatedly engaged in such conduct and that an injunction prohibiting such conduct would not be sufficient to prevent the tax return preparer's interference with the proper administration of the Internal Revenue Code, the court may enjoin the preparer from acting as a federal income tax return preparer.

44. Stone has continually or repeatedly engaged in conduct subject to penalty under 26 U.S.C. § 6694(a) by preparing income tax returns in which she understated taxpayers' liabilities based on undisclosed, frivolous positions which she knew or reasonably should have known did not have a realistic possibility of being sustained on the merits.

45. Stone has continually or repeatedly engaged in conduct subject to penalty under 26 U.S.C. § 6694(b) by preparing income tax returns in which she understated taxpayers' liabilities willfully or in reckless or intentional disregard of rules or regulations.

46. Stone has continually or repeatedly engaged in fraudulent or deceptive conduct which substantially interferes with the proper administration of the Internal Revenue laws by preparing income tax returns in which she understated taxpayers' liabilities by claiming fictitious or inflated deductions.

47. Injunctive relief against Stone is appropriate to prevent the recurrence of the conduct described in paragraphs forty-four through forty-six.

48. An injunction merely prohibiting the conduct described in paragraphs forty-four through forty-six would not be sufficient to prevent Stone's interference with the proper administration of the Internal Revenue Code.

49. Freed has continually or repeatedly engaged in conduct subject to penalty under 26 U.S.C. § 6694(a) by preparing income tax returns in which he understated taxpayers' liabilities based on undisclosed, frivolous positions which he knew or reasonably should have known did not have a realistic possibility of being sustained on the merits.

50. Freed has continually or repeatedly engaged in conduct subject to penalty under 26 U.S.C. § 6694(b) by preparing income tax returns in which he understated taxpayers' liabilities willfully or in reckless or intentional disregard of rules or regulations.

51. Freed has continually or repeatedly engaged in fraudulent or deceptive conduct which substantially interferes with the proper administration of the Internal Revenue laws by preparing income tax returns in which he understated taxpayers' liabilities by claiming fictitious or inflated deductions.

52. Injunctive relief against Freed is appropriate to prevent the recurrence of the conduct described in paragraphs forty-nine through fifty-one.

53. An injunction merely prohibiting the conduct described in paragraphs forty-nine through fifty-one would not be sufficient to prevent Freed's interference with the proper administration of the Internal Revenue Code.

54. Shaffer has continually or repeatedly engaged in conduct subject to penalty under 26 U.S.C. § 6694(a) by preparing income tax returns in which she understated taxpayers' liabilities based on undisclosed, frivolous positions which she knew or reasonably should have known did not have a realistic possibility of being sustained on the merits.

55. Shaffer has continually or repeatedly engaged in conduct subject to penalty under 26 U.S.C. § 6694(b) by preparing income tax returns in which she understated taxpayers' liabilities willfully or in reckless or intentional disregard of rules or regulations.

56. Shaffer has continually or repeatedly engaged in fraudulent or deceptive conduct which substantially interferes with the proper administration of the Internal Revenue laws by preparing income tax returns in which she understated taxpayers' liabilities by claiming fictitious or inflated deductions.

57. Injunctive relief against Shaffer is appropriate to prevent the recurrence of the conduct described in paragraphs fifty-four through fifty-six.

58. An injunction merely prohibiting the conduct described in paragraphs fifty-eighth through sixty would not be sufficient to prevent Shaffer's interference with the proper administration of the Internal Revenue Code.

59. Stone and Associates, acting through Stone, Freed, or Shaffer, has continually or repeatedly engaged in conduct subject to penalty under 26 U.S.C. § 6694(a) by having its principals or agents prepare income tax returns in which its principals or agents understated taxpayers' liabilities based on undisclosed, frivolous positions which its principals or agents knew or reasonably should have known did not have a realistic possibility of being sustained on the merits.

60. Stone and Associates, acting through Stone, Freed, or Shaffer, has continually or repeatedly engaged in conduct subject to penalty under 26 U.S.C. § 6694(b) by having its principals or agents prepare income tax returns in which its principals or agents understated taxpayers' liabilities willfully or in reckless or intentional disregard of rules or regulations.

61. Stone and Associates, acting through Stone, Freed, or Shaffer, has continually or repeatedly engaged in fraudulent or deceptive conduct which substantially interferes with the proper administration of the Internal Revenue laws by having its principals or agents prepare income tax returns in which its principals or agents understated taxpayers' liabilities by claiming fictitious or inflated deductions.

62. Injunctive relief against Stone and Associates is appropriate to prevent the recurrence of the conduct described in paragraphs fifty-nine through sixty-one.

63. An injunction merely prohibiting the conduct described in paragraphs fifty-nine through sixty-one would not be sufficient to prevent the interference with the proper administration of the Internal Revenue Code caused by Stone and Associates, its principals, or agents.

Count II: Injunction under 26 U.S.C. § 7402

64. The United States incorporates by reference the allegations contained in paragraphs seven through sixty-three.

65. Section 7402 of the Internal Revenue Code authorizes the court to issue orders of injunction as may be necessary or appropriate for the enforcement of the Internal Revenue laws.

66. Through the conduct described above, Stone has engaged in conduct that substantially interferes with the administration and enforcement of the internal revenue laws. Her conduct causes significant injury to the United States. Injunctive relief against Stone is appropriate to prevent the recurrence of such conduct.

67. Through the conduct described above, Freed has engaged in conduct that substantially interferes with the administration and enforcement of the internal revenue laws. His

conduct causes significant injury to the United States. Injunctive relief against Freed is appropriate to prevent the recurrence of such conduct.

68. Through the conduct described above, Shaffer has engaged in conduct that substantially interferes with the administration and enforcement of the internal revenue laws. Her conduct causes significant injury to the United States. Injunctive relief against Shaffer is appropriate to prevent the recurrence of such conduct.

69. Through the conduct described above, Stone and Associates, acting through its principals or agents, has engaged in conduct that substantially interferes with the administration and enforcement of the internal revenue laws. The conduct of Stone and Associates, acting through its principals or agents, causes significant injury to the United States. Injunctive relief against Stone and Associates is appropriate to prevent the recurrence of such conduct.

WHEREFORE, plaintiff United States of America requests the following relief:

A. That the Court find that each of the defendants continually or repeatedly engaged in conduct subject to penalty under 26 U.S.C. § 6694 and in fraudulent or deceptive conduct which substantially interferes with the proper administration of the Internal Revenue laws; that injunctive relief is appropriate under 26 U.S.C. § 7407 to prevent each defendant from engaging in such conduct; that an injunction only prohibiting such conduct would not be sufficient to prevent each defendant's interference with the proper administration of the internal revenue laws; and that an injunction under 26 U.S.C. § 7407 to prevent each defendant from acting as an income tax return preparer is appropriate.

B. That the Court find that each of the defendants engaged in conduct that substantially interferes with the administration and enforcement of the internal revenue laws and

that injunctive relief is appropriate under 26 U.S.C. § 7402 to prevent each defendant from engaging in such conduct.

C. That the Court enter a permanent injunction pursuant to 26 U.S.C. §§ 7402 and 7407 against each defendant and any persons acting in concert with any of the defendants enjoining them from:

- 1) preparing or assisting in the preparation of any federal income tax return, or any other federal tax return, for any other person or entity;
- 2) engaging in any conduct subject to penalty under 26 U.S.C. § 6694;
- 3) representing any taxpayer in any proceeding before the Internal Revenue Service;
- 4) engaging in any fraudulent or deceptive conduct which substantially interferes with the proper administration or enforcement of the internal revenue laws; and,
- 5) engaging in any other conduct which substantially interferes with the proper administration or enforcement of the internal revenue laws;

D. That the Court, pursuant to 26 U.S.C. § 7402(a), enter an order requiring the defendants, within 11 days after entry of the Court's order, at their own expense, to send by certified mail, return receipt requested, a copy of the Court's injunction order, along with a court-approved letter, to all persons for whom they have, since January 1, 2001, prepared or assisted in the preparation of federal tax returns;

E. That the Court, pursuant to 26 U.S.C. § 7402(a), enter an order requiring the defendants, within 11 days after entry of the Court's order, to provide to the United States a list of the names, telephone and taxpayer identification numbers and mailing and e-mail addresses of

all individuals for whom they prepared or assisted in the preparation of federal tax returns since January 1, 2001, identifying for each individual the extent of the preparation or assistance;

F. That the Court, pursuant to 26 U.S.C. § 7402(a), enter an order requiring each defendant to file an affidavit with the Court certifying compliance with the requirements described in paragraphs D and E;

G. That the Court enter an order permitting the government to engage in post-judgment discovery in order to monitor each defendant's compliance with the injunction against him or it; and,

H. That the Court grant the United States such other and further relief as the Court deems just and proper;

Respectfully submitted,

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