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CLERK U.S. DISTRICT COURT
CENTRAL DIST. OF CALIF.
LOS ANGELES

UNITED STATES DISTRICT COURT

FOR THE CENTRAL DISTRICT OF CALIFORNIA

UNITED STATES OF AMERICA, Plaintiff, v. N.C.K. SERVICES, INC., CARLA D. BERRY; KAREN D. BERRY; VALERIE M. DIXON; and IVAN T. JOHNSON, Defendants.	No. ED CV 04-1566 VAP(SGLx) COMPLAINT FOR PERMANENT INJUNCTION AGAINST THE PREPARATION OF TAX RETURNS AND OTHER EQUITABLE RELIEF

COMPLAINT

The United States of America, by and through its counsel of record, alleges as follows:

NATURE OF ACTION

1. This is a civil action brought pursuant to Title 26 U.S.C. Sections 7401, 7402(a), 7407, and Title 28 U.S.C. Sections 1340 and 1345.

2. This action is to obtain a permanent injunction against the above-named defendants prohibiting them from further: (1) acting as income tax return preparers, (2) engaging in conduct subject to penalty under Sections 6694 and 6695 of Title 26 of the United States Code, or any criminal conduct prohibited by Title 26 of the United States Code, and (3) engaging in any other fraudulent or deceptive conduct which substantially interferes with the proper administration of the Internal Revenue laws.

JURISDICTION

3. This Court has jurisdiction over this action pursuant to Title 26 U.S.C. Sections 7401, 7402(a), 7407, and Title 28 U.S.C. Sections 1340 and 1345.

4. This suit has been properly authorized pursuant to Title 26 U.S.C. Section 7401.

DEFENDANTS

5. Defendant N.C.K. Services, Inc. ("NCK") is a California corporation with a principal place of business in Rialto, California, which is within the Central District of California. NCK is in the business of providing income tax return preparation services. The tax return preparation business was started by Norma Jean Berry ("Norma Berry"), who passed away in January 2004. Thereafter, Norma Berry's tax preparation business was

taken over and renamed NCK by her daughters, Carla D. Berry ("Carla Berry") and Karen D. Berry ("Karen Berry"), and Valerie M. Dixon ("Dixon"), who operate NCK with the assistance of a former neighbor of Norma Berry's, Ivan T. Johnson ("Johnson").

6. Defendant Carla Berry resides in Rialto, California, which is within the Central District of California. She currently works as a paid income tax return preparer for NCK and is listed as the registered agent for NCK on its corporate documents.

7. Defendant Karen Berry resides in Rialto, California, which is within the Central District of California. She currently works as a paid income tax return preparer for NCK and is listed as the owner of NCK on its corporate documents.

8. Defendant Dixon resides in Rialto, California, which is within the Central District of California. She currently works as a paid income tax return preparer for NCK.

9. Defendant Johnson resides in San Bernardino, which is within the Central District of California. He currently works as a paid income tax return preparer for NCK.

DEFENDANTS' ACTIVITIES

10. NCK is a tax return preparation business. Each of the individual defendants, Carla Berry, Karen Berry, Dixon, and Johnson (sometimes collectively referred to herein as "the return preparers") currently offers tax return preparation services to individuals (sometimes referred to herein as "customers") through NCK. Each of the individual defendants currently is preparing

income tax returns as a paid preparer for NCK.

11. Each individual defendant has continually or repeatedly engaged in conduct subject to penalty under Section 6694, Title 26 U.S.C., in that each has, among other things, (1) taken unrealistic and unsustainable positions on customers' tax returns, resulting in understatements of tax due, and (2) willfully or recklessly understated the tax due (and, in nearly every case, overstated the refund due) on customers' tax returns.

12. Each defendant has continually or repeatedly engaged in conduct subject to penalty under Section 6695(c), Title 26 U.S.C., in that each has failed to comply with regulations that require the return preparer to sign the return and in that each has failed to furnish a correct identifying number for NCK on each return prepared under the auspices of NCK.

13. Further, each individual defendant has continually or repeatedly engaged in fraudulent and deceptive conduct which has substantially interfered with the proper administration of internal revenue laws in that each defendant has, among other things, improperly and purposefully reduced and understated customers' tax liabilities by claiming false and inflated itemized deductions for mortgage interest and unreimbursed employee business expenses resulting, in most cases, in an undeserved refund.

14. Search warrants, obtained in connection with a criminal investigation into the defendants' conduct, were executed on NCK's offices in April 2003 and April 2004 and resulted in the

seizure of books and records revealing the fraudulent and improper tax preparation services being performed by the defendants.

15. Each defendant is aware that their conduct is improper and illegal; however, it is believed that each defendant has continued to prepare improper tax returns.

SPECIFIC ALLEGATIONS REGARDING DEFENDANTS' CONDUCT

How the NCK return-preparation scheme worked

16. At all times relevant hereto, the defendants' typical customers were individuals with various income levels, including police officers and retirees. Advertising was by word of mouth. Customers typically were referred by friends or relatives who had received tax refunds through the defendants' tax preparation business. Based on a government sample, over 95 percent of the Form 1040 tax returns the defendants prepared resulted in a refund.

17. NCK operated a high-volume business. From the 2000 return season (i.e., tax returns for 1999) to the 2004 return season (i.e., tax returns for 2003), the IRS identified more than 10,000 individuals for whom returns were prepared through the defendants' tax preparation business.

18. The defendants generally prepared each return during a single conference with the customer at Norma Berry's residence or, after the business location moved, at NCK's offices in Rialto, California. The conferences with customers sometimes lasted only a few minutes. During the conference, the return

preparers typically told customers that there was a change in the tax law that permitted higher deductions on Schedule A of the U.S. individual income tax return for home mortgage interest deductions and for unreimbursed employee business expenses. Returns were typically prepared manually and were usually not signed by the preparers.

19. The customer was told to bring the customer's Form W-2 to the meeting. Spouses typically were advised to file their returns separately instead of jointly regardless of the customers' income level and, sometimes, spouses were advised to file as single despite their married status.

20. On some occasions, customers would receive completed returns prepared by the defendants at the conclusion of the customer conference. On other occasions, customers were asked to come back to the offices to pick up the completed returns. Generally, the return preparers did not discuss any of the Form 1040 line items with the customers other than the tax refund amount.

21. In most cases, the customer did not pay as much mortgage interest as was stated on Schedule A of the Forms 1040 that were prepared by the defendants. In some cases, no mortgage interest was paid by the customer at all. Nonetheless, the defendants claimed fictitious or inflated mortgage interest payment amounts to reduce customers' taxable income.

22. In many cases, the defendants set forth fictitious amounts for unreimbursed employee expenses on Schedule A of the

Forms 1040.

23. The defendants did not point out or explain these bogus deductions to the customers.

24. In nearly every case, the defendants appear to have improperly generated false deductions large enough to create a refund.

25. The defendants charged fees ranging from $80 to $150 per return.

26. After a return was completed, the defendants would make a copy and give the copy and the original return to the customer, who would then sign the original and mail the return to the IRS.

Particular customers' experiences

27. In 2002, one customer, referred to Norma Berry's tax preparation business by a co-worker, called the defendants' business and made an appointment to have his 2001 income tax returns prepared. He was told over the phone to bring his current Form W-2, the previous year's tax return, and $100 cash. In about January 2002, he went to the defendants' office, which was then located in a residence, and met with Carla Berry. Carla Berry prepared his return in approximately 15 minutes. Carla Berry did not ask about or discuss any of the Form 1040 line items other than the refund amount. Carla Berry told the customer that her mother, Norma Berry, had worked for the Internal Revenue Service ("IRS") and that all the return preparers at the business knew all the legal shortcuts. The customer did not own a home and had paid no mortgage interest

during the year, yet Carla Berry prepared a tax return for the customer that claimed bogus mortgage interest of $27,069. The return prepared by Carla Berry also claimed bogus employee business expenses of $5,369.00. The customer paid $100 cash for the tax return. Carla Berry did not sign the return as the paid preparer. The customer initially received a refund based on the return prepared by Carla Berry. The customer returned to defendants' tax preparation business to have his income tax returns prepared for 2002 and 2003. The process was essentially the same each year. The 2003 returns were prepared at the defendants' new business office location. Since the time that customer's last return was prepared by the defendants' business, the customer has filed amended returns to remove the bogus deductions initially claimed on the returns prepared by Carla Berry. The amended returns reveal that Carla Berry understated the taxes due on the customer's 2001, 2002, and 2003 returns by a total of more than $20,000.

28. In 2002, another customer went to the defendants' business, which was then located in a residence, and asked to have her 2001 tax return prepared. She met with Karen Berry, who prepared her return in approximately 30 minutes. Karen Berry asked the customer no questions about home ownership and did not ask about or discuss any of the Form 1040 line items with the customer other than the refund amount. The customer and her spouse had paid mortgage interest in the amount of $19,477, yet Karen Berry prepared a tax return for the customer that claimed

bogus mortgage interest of $21,699. The customer's spouse's return, which was prepared by another return preparer for NCK, claimed mortgage interest in the amount of $26,515. The return prepared by Karen Berry also claimed bogus employee business expenses of $4,235. The customer and her spouse each paid approximately $80 cash for the tax returns. Karen Berry did not sign the return as the paid preparer. The customer initially received a refund based on the return prepared by Karen Berry. The customer returned to defendants' tax preparation business to have her income tax returns prepared for 2002 and 2003. The process was essentially the same each year, except that the customer made an appointment before going to the defendants' office. The 2003 returns were prepared at the defendants' new business office location. Since the time that the customer's last return was prepared by the defendants' business, the customer has filed amended returns to remove the bogus deductions initially claimed on the returns, including the 2001 return prepared by Karen Berry.

29. Another customer, referred to Norma Berry's tax preparation business by a neighbor, used the defendants' tax preparation business to prepare his 2000, 2001, 2002, and 2003 income tax returns, each of which contained bogus mortgage interest deductions totaling more than $87,000. When he initially went to the defendants' business to have his 2000 tax return prepared, Norma Berry told the customer that she had worked for the IRS for many years, that she knew tax law, and

that she never had a problem with the IRS. The customer most recently used the defendants' business for the preparation of his 2003 tax return. The customer's 2003 return was prepared by Valerie Dixon. When Dixon prepared the customer's 2003 return, the customer did not own a home and had not paid any mortgage interest during the 2003 year. Nevertheless, Dixon prepared a tax return for the customer that claimed bogus mortgage interest of $19,720. The return prepared by Dixon also claimed bogus employee business expenses of $5,377. The customer paid $120 cash for the tax return prepared by Dixon. Dixon did not sign the return as the paid preparer. The customer initially received a refund based on the return prepared by Dixon. Since then, the customer has filed an amended return for 2003 to remove the bogus deductions initially claimed on the returns prepared by Dixon. The amended return reveals that Dixon understated the taxes due on the customer's 2003 return by more than $5,000.

30. Another customer and his spouse heard about Norma Berry's tax preparation business approximately five years ago. He and his spouse used the defendants' tax preparation business to prepare their 2000, 2001, 2002, and 2003 income tax returns each of which contained bogus mortgage interest deductions totaling more than $125,000. The customer most recently used the defendants' business for the preparation of his 2003 tax return. The customer's 2003 return was prepared by Ivan Johnson. When Johnson prepared the 2003 return, the customer and his spouse did not own a home and had not paid any mortgage interest during the

2003 year. Nevertheless, Johnson prepared a tax return for the customer and his spouse that claimed bogus mortgage interest of $27,997. The return prepared by Johnson also claimed bogus employee business expenses of $5,979. The customer and his spouse paid $100 cash for the tax return prepared by Johnson. Johnson did not sign the return as the paid preparer. The customer and his spouse initially received a refund based on the return prepared by Johnson. Since then, the customer and his spouse have filed an amended return for 2003 to remove the bogus deductions initially claimed on the returns prepared by Johnson. The amended return reveals that Johnson understated the taxes due on the customer's and his spouse's 2003 return by more than $3,000.

31. Another customer went to the defendants' business to have her 2001 tax return prepared. Karen Berry prepared the return, which set forth itemized deductions for mortgage interest in the amount of $23,096 even though the customer did not own a home and had paid no mortgage interest during the year. In December 2003, the customer received a letter from the IRS regarding her 2001 income tax return. In January 2004, the customer brought the IRS's letter to the defendants' business. Norma Berry's former spouse, Matthew Berry, who works at the defendants' business, told the customer that he would create all the receipts that she needed for the IRS audit and directed the customer not to inform the IRS as to how she obtained the receipts. The customer refused Berry's offer to provide the IRS

with falsified receipts. The IRS audit eventually resulted in an additional tax due of $3,901.

INJURY TO THE UNITED STATES

32. The IRS has interviewed fourteen former customers of NCK and has reviewed the returns prepared for those customers by the defendants for years 2000 through 2003. Every one of the approximately 45 tax returns reviewed by the IRS sets forth inflated or fictitious mortgage interest deductions. 100 percent of those returns generated a refund. This percentage is higher than the overall percentage of Form 1040 returns claiming refunds nationally.

33. The errors contained in the returns prepared by the defendants cannot be automatically detected by cross-checking information reported to the IRS by employers or other third parties. Time-intensive audits by revenue agents, including interviews with the taxpayer-customers, are usually necessary to ferret out the bogus deductions claimed by the defendants.

34. The IRS is currently examining approximately 2,441 tax returns of the more than 10,000 returns prepared by the defendants for the 2000-2004 tax seasons (i.e., returns for years 1999-2003). Of the 2,441 returns being audited, 1,908 are from the 2002 tax year and 533 are from the 2003 tax year. It is anticipated that at least another 1,600 returns prepared by the defendants will be audited.

35. Based on a comparison of the mortgage interest reported on the returns currently being audited and the mortgage interest

reported on Forms 1098 submitted to the IRS, the mortgage interest deduction was overstated on 96% of the 2002 returns being audited and on 90% of the 2003 returns being audited.

36. Of the 2,441 returns currently being examined, the IRS selected 50 from the 2002 tax year and 50 from the 2003 tax year to analyze. Based on the IRS's analysis, the average loss per return for the 2002 tax year is $2,722 and the average loss per return for the 2003 tax year is $2,230. Applying that average loss per return to all of the returns being audited, the estimated tax loss to the government from the 2,441 returns being audited will be over $5 million for 2002 and over $1.1 million for 2003.

37. Assuming that 90 percent of the approximately 10,000 returns prepared by the defendants for tax years 1999 through 2003 contained understatements of tax, and assuming further an average tax loss per return of $2,230 (which represents the lesser of the two averages calculated by the government with respect to the samples from returns currently being audited), the IRS estimates the aggregate tax loss at $20 million.

INJURY TO THE DEFENDANTS' CUSTOMERS

38. As a result of the defendants' improper actions, acting either in concert or individually, many of their customers have been required to file amended returns or undergo audits by the IRS. They have incurred severe, and in most cases unanticipated, financial burdens due to their liability for additional tax beyond the amount reported on their original returns, plus

statutory interest.

39. As a result of the defendants' improper actions, acting either in concert or individually, many of their customers will be required to file amended returns or undergo audits by the IRS. They will incur severe financial, and in most cases unanticipated, financial burdens due to their liability for additional tax beyond the amount reported on their original returns, plus statutory interest (and perhaps civil penalties).

COUNT I

(Engaging in Conduct Prohibited by Sections 6694 and 6695)

40. Plaintiff realleges and incorporates by reference paragraphs 1 through 39 of the Complaint.

41. The defendants, by reason of their preparation, or assistance in the preparation, of federal income tax returns for which they were compensated, are income tax return preparers within the meaning of Section 7701(a)(36) of the Internal Revenue Code ("the Code"), Title 26, U.S.C.

42. The defendants have continually or repeatedly engaged in conduct subject to penalty under Section 6694 of the Code by either (a) recklessly or intentionally disregarding rules and regulations in preparing the return of another person, resulting in an understatement of federal tax liability for that person; or (b) willfully or recklessly understating the federal tax liability of another person in preparing the return of that person; or both.

43. The defendants have continually or repeatedly engaged

in conduct subject to penalty under Section 6695 of the Code in that they have failed to consistently furnish the correct identifying number for NCK on the returns they have prepared under the auspices of NCK.

44. Unless enjoined by the Court, the defendants will continue to engage in the above-described conduct.

45. The defendants must be enjoined from further acting as income tax return preparers because an injunction prohibiting their engaging in conduct subject to penalty under Sections 6694 and 6695 of the Code would not be sufficient to prevent their further interference with the proper administration of the tax laws.

COUNT II

(Unlawful Interference with the Internal Revenue Laws)

46. Plaintiff realleges and incorporates by reference paragraphs 1 through 45 of the Complaint.

47. The defendants' fraudulent and deceptive conduct as set forth above has the effect of substantially interfering with the proper administration of the Internal Revenue laws by causing the filing of improper and illegal tax returns or claims for refunds, as well as the filing of tax returns containing improper and illegal deductions, all of which contributes to undermining the respect for, and deterring voluntary compliance with, the federal tax laws.

48. Unless enjoined by this Court, the defendants will continue to engage in this conduct.

APPROPRIATENESS OF INJUNCTIVE RELIEF

49. Injunctive relief is appropriate under Sections 7407 and 7402 of the Code for the following reasons:

a. Proscribed Conduct. The defendants, in the course of preparing income tax returns on behalf of their customers, have continually or repeatedly engaged in conduct subject to penalty under Sections 6694 and 6695 of the Code and which otherwise interferes with the proper administration of the Internal Revenue laws.

b. Likelihood of Recurrence. If the defendants are not enjoined from preparing federal income tax returns, it is likely that they will continue to do so, since they have engaged in a pattern and practice of abuse extending over a number of years.

c. Irreparable Injury. The defendants, by their continual or repeated violations of the internal revenue laws, have caused a substantial revenue loss to the United States Treasury as well as a severe drain of government administrative resources in identifying and examining the returns the defendants prepared and in attempting to collect the monies owed. The IRS lacks sufficient resources to examine all of the returns the defendants have prepared to date and are continuing to prepare. In addition, the resulting and potential litigation relating to the tax returns prepared by the defendants will place a heavy burden on the judicial system.

d. Public interest. Members of the public whom the defendants aided, advised, or assisted have been harmed because such persons paid the defendants for their services in preparing tax returns, and if their returns are examined by the IRS, they will likely be assessed with deficiencies in tax, be required to pay statutory interest on the tax deficiencies resulting from the defendants' improper preparation, and may also be subject to civil penalties resulting from the deficiencies. Moreover, the defendants' behavior encourages a reckless disregard for the internal revenue laws and erodes public confidence in the fairness of the federal income tax system, thus causing irreparable injury to the government and the nation as a whole.

RELIEF REQUESTED

WHEREFORE, plaintiff, the United States of America, prays for the following:

1. That the Court find that the defendants, NCK, Carla Berry, Karen Berry, Dixon, and Johnson, have continually or repeatedly engaged in conduct subject to penalty under Sections 6694 and 6695; that an injunction prohibiting such conduct would not be sufficient to prevent the defendants' interference with the proper administration of Title 26; and that the defendants therefore should be permanently enjoined from acting as income tax return preparers pursuant to Sections 7407 and 7402 of the Internal Revenue Code.

2. That the Court find that the defendants, NCK, Carla

Berry, Karen Berry, Dixon, and Johnson, have continually or repeatedly engaged in fraudulent or deceptive conduct that substantially interferes with the proper administration and enforcement of the internal revenue laws by the IRS; that an injunction prohibiting such conduct would not be sufficient to prevent the defendants' interference with the proper administration of Title 26; and that the defendants therefore should be permanently enjoined from acting as income tax return preparers pursuant to Sections 7407 and 7402 of the Internal Revenue Code.

3. That the Court enter a Final Judgment of Permanent Injunction enjoining the defendants, NCK, Carla Berry, Karen Berry, Dixon, and Johnson, and all other persons in active concert or participation with them, directly or indirectly, by use of any means or instrumentality, from:

a. Acting as income tax return preparers within the meaning of Section 7701(a)(36) of the Code;

b. Taking any action in furtherance of aiding, assisting, advising, or preparing for compensation tax returns of third-party taxpayers;

c. Further engaging in conduct subject to penalty under Sections 6694 and 6695 of the Code; or

d. Substantially interfering with and/or impeding the proper administration of the internal revenue laws.

4. That this Court further order and decree, as part of its permanent injunctive relief, that the defendants notify, in

writing, all persons whose tax returns they have prepared from January 1, 1999 to the date of the Court's order, of the findings and relief ordered by the Court, including in such notice to each person a copy of the Complaint and of the Court's Final Order of Permanent Injunction; and that the defendants file with the Court and provide to plaintiff's attorneys a list of the names, Social Security numbers, addresses, e-mail addresses, and telephone numbers of all persons so notified within thirty (30) days of the date the Order is entered.

5. That this Court retain jurisdiction of this action for the purpose of implementing and enforcing the final judgment and all additional decrees and orders necessary and appropriate to the public interest.

6. That this Court award plaintiff all its costs in prosecution of this action.

Respectfully submitted,

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Dated: December 15, 2004

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