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IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF NEVADA

UNITED STATES OF AMERICA, Plaintiff, v. GREGORY C. DIEDRICH and SAGINAW FINANCIAL, Defendants.	Case No. 2:19-cv-02134 **COMPLAINT FOR PERMANENT INJUNCTION AND OTHER RELIEF**

The United States of America, by and through undersigned counsel, hereby alleges as follows:

1. The United States brings this civil action under 26 U.S.C. §§ 7402(a) and 7407 to enjoin Gregory C. Diedrich and Saginaw Financial, and anyone in active concert with them (collectively, "Defendants") from:

a. Acting as a federal tax return preparer or requesting, assisting in, or directing the preparation or filing of federal tax returns for any person or entity other than themselves or a legal spouse;

b. Representing, or assisting in the representation of, any person or entity, other than themselves or a legal spouse, before the IRS;

c. Instructing, advising, or assisting, directly or indirectly, others to violate the tax laws, including to evade the payment of taxes;

d. Engaging in activity subject to penalty under 26 U.S.C. § 6694, such as preparing federal income tax returns that understate tax liabilities;

e. Engaging in activity subject to penalty under 26 U.S.C. § 6701, such as assisting in, procuring, or advising with respect to the preparation of any portion of a return, affidavit, claim, or other document, when knowing or having reason to believe that the relevant portion will be used in connection with a material matter arising under the internal revenue laws, and knowing that the relevant portion will result in the material understatement of another person's tax liability; and

f. Engaging in any other conduct that interferes with the administration and enforcement of the internal revenue laws.

2. The United States commences this action pursuant to 26 U.S.C. §§ 7402(a) and 7407 at the direction of the Attorney General of the United States, with the authorization of the Secretary of the Treasury, acting through his delegate, the Internal Revenue Service ("IRS") Chief Counsel.

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JURISDICTION AND VENUE

3. This Court has jurisdiction over this action under 28 U.S.C. §§ 1340 and 1345 and 26 U.S.C. §§ 7402(a) and 7407.

4. Venue is proper in the District of Nevada because a substantial part of the actions giving rise to this suit occurred within this judicial district, and Defendants reside or operate within this district.

DEFENDANTS

5. Defendant Gregory C. Diedrich resides in Las Vegas, Nevada. Since 2001, Mr. Diedrich has been a tax return preparer as defined under 26 U.S.C. § 7701(a)(36)(A). Mr. Diedrich operates his tax return preparation business through Saginaw Financial, which he solely owns.

6. Defendant Saginaw Financial ("Saginaw") has been a tax return preparer as defined under 26 U.S.C. § 7701(a)(36)(A) since at least 2001. Saginaw is located at 500 North Rainbow Boulevard, Suite 300, Las Vegas, Nevada, 89107. Saginaw has one location within this judicial district and has two full time employees, including Mr. Diedrich. Mr. Diedrich prepares tax returns at Saginaw and supervises the company's employees. Saginaw's customers rely on Mr. Diedrich for tax advice.

DEFENDANTS' ACTIVITIES

7. Diedrich is the sole shareholder of Saginaw and operates as a compensated federal income tax return preparer.

8. Saginaw's clients rely on Diedrich and Saginaw to prepare accurate tax returns.

9. Diedrich and Saginaw (collectively, "Defendants") have engaged in a pattern of claiming, on behalf of their clients, false or inflated business expense deductions (reported on

Schedule C to Form 1040) and itemized deductions (reported on Schedule A to Form 1040). In some cases, the expenses or deductions were claimed without the knowledge of the client.

10. The IRS has informed Defendants that their conduct is unlawful. Since 2011, the IRS has made multiple attempts to remind Defendants of their due diligence requirements as federal tax return preparers, including correspondence and personal visits. Tax preparers are required to complete IRS Form 8867, Paid Preparer's Due Diligence Checklist, certifying that they've taken appropriate steps, including making "reasonable inquiries to determine the correct, complete, and consistent information[.]" A copy of Form 8867 is available at www.irs.gov/pub/irs-pdf/f8867.pdf. Further due diligence requirements are contained under 26 U.S.C. § 6695.

11. Diedrich has been repeatedly penalized under 26 U.S.C. § 6695(g) for failing to conduct his due diligence as a tax preparer when determining his clients' eligibility for certain tax credits and benefits. The IRS assessed penalties under 26 U.S.C. § 6695(g) for the following tax years:

a. 2013: $44,000 assessed on June 8, 2015

b. 2016: $24,240 assessed on June 26, 2017

c. 2017: $28,050 assessed on May 21, 2018

12. Despites these efforts, Defendants have not shown any improvement in meeting their due diligence requirements as tax return preparers. As recently as 2018, Defendants have repeatedly filed federal income tax returns claiming phony business expenses and itemized deductions.

13. In 2016, Saginaw used its Electronic Filing Identification Number ("EFIN") to prepare 766 returns for the 2015 tax year. 93% of these returns resulted in a refund and 51%

claimed an Earned Income Credit ("EITC"). The EITC provides tax credits for eligible individuals with one or more qualifying children. *See* 26 U.S.C. § 32.

14. In 2015, Diedrich included his Preparer Tax Identification Number ("PTIN") on 591 returns for the 2014 tax year. 93% of these returns resulted in a refund. 46% claimed an EITC.

15. Similarly, in 2016, Diedrich included his PTIN on 766 returns for the 2015 tax year. 93% of these returns resulted in a refund and 51% claimed an EITC

16. By 2017, both Diedrich and Saginaw had already been assessed multiple penalties. That year, Saginaw included its EFIN on 744 returns for the 2016 tax year, but was listed as the preparer for only one return. Similarly, Diedrich's PTIN only appeared on one return. The IRS determined that while Defendants continued to file returns on behalf of their clients, they had failed to include themselves as the preparers on the returns.

17. In 2018, Saginaw included its EFIN on 657 tax returns for the 2017 tax year. 91% of these returns resulted in a refund and 41% claimed an EITC.

18. In 2018, Diedrich included his PTIN on 666 returns. 91% of these returns resulted in a refund and 41% claimed an EITC.

False Schedule C and Schedule A Deductions

19. Defendants prepared Schedule C (Form 1040), Profit or Loss from Business ("Schedule C"), on behalf of their clients but repeatedly failed to request supporting documentation or verify estimates provided by clients. Taxpayers use Schedule C to report income or losses made from a business or profession conducted as a sole proprietorship.

20. Similarly, Defendants prepared Schedule A (Form 1040), Itemized Deductions, on behalf of their clients but repeatedly failed to request supporting documentation or verify

estimates provided by clients. Taxpayers use Schedule A to report itemized deductions taken in lieu of the standard deduction. *See generally* 26 U.S.C. § 63.

21. In some cases, Defendants have included expenses or deductions beyond what the clients provided, reducing the clients' tax liability, and, in almost all cases, resulting in a larger tax refund.

22. As part of its investigation, the IRS randomly selected returns prepared by Defendants for review. Then, it followed up by interviewing the individual taxpayers connected to these returns. The IRS conducted 26 interviews, which resulted in adjustments of liability in all but 3 cases. The following paragraphs include summaries from some of these interviews.

23. **Customers 1 and 2** are a married couple who provided Defendants with their IRS Form W-2 Wage and Tax Statement ("W-2") in order to prepare their joint income tax return. Defendants prepared a joint federal income tax return that included a Schedule A claiming over $16,000 in false deductions for travel, mileage, and a cell phone. Customers 1 and 2 did not provide Defendants with any documentation to support these deductions. In an interview with an IRS Revenue Agent, Customers 1 and 2 denied that they had asked Defendants to claim these deductions.

24. **Customer 3** had a cosmetology business in 2017. She provided Defendants with W-2s as well as bank statements and receipts documenting income from her business. Defendants prepared a return with a Schedule C claiming approximately $13,000 in various auto, office, advertising, and rent expenses. Customer 3 did not provide Defendants with any documentation to support these expenses, and Defendants had no reason to believe that Customer 3 incurred such expenses.

25. **Customer 4** operated an online adult modeling business in 2017. She provided a Form 1099-MISC ("1099") to Defendants but no other documents. Defendants asked her about

her expenses but did not ask for any supporting documentation. When Customer 4 offered to give Defendants receipts, Defendants declined to take them. Customer 4's tax return included a Schedule C with approximately $1,744 in unsupported business expenses. Customer 4's return claimed both of her children as dependents even though at least one child received more income than Customer 4. Customer 4 told the IRS that Defendants never asked her whether she provided her children with financial support. Nevertheless, Customer 4's return claimed the EITC, which provides credits for eligible individuals with one or more qualifying children. 26 U.S.C. § 32.

26. As part of its investigation, the IRS determined that Defendants were not meeting their due diligence requirements in determining whether a client is eligible for the EITC. Defendants included ineligible dependents on their clients' returns, as they did for Customer 4, in order to maximize the credit received.

27. **Customer 5** operated a scrap metal business in 2017. She provided Defendants with receipts documenting her income. The return prepared for Customer 5 included $14,250 in business income reported on her Schedule C though she told the IRS she only earned approximately $4,000. The return also included Schedule C expenses that were not supported by any information or documents she gave to Defendants.

28. Customer 5's return also claimed the EITC. While she may have qualified for that EITC based on the $4,000 of income she reported in her IRS interview, the inflated figure on her tax return allowed her to maximize the credit. Due to the method used to calculate the EITC, an individuals with higher earned income are entitled to a larger credit than those with lower earned income. The amount of the credit increases as income increases between $1 and $14,000 and decreased as income increases beyond $18,350. Some tax preparers who manipulate reported income to maximize the EITC refer to this range of earned income corresponding to a maximum EITC as the "sweet spot" or "golden range."

29. **Customers 6 and 7** are a married couple who operate a vending machine business. They provided Defendants with W-2s and health insurance information. Customer 6 and 7's income tax return included $1,900 in Schedule C deductions for "contract labor." Defendants did not discuss "contract labor" expenses with Customer 6 or 7 and did not receive supporting documents to corroborate the deduction.

30. **Customer 8** is a professional gambler. He provided Defendants with W-2s, 1099s, a W-2g (used to report certain gambling winnings), and loss statements received from a Casino. Defendants failed to include $14,755 in casino winnings on Customer 8's tax return despite Customer 8 providing documentation regarding those winnings.

31. **Customer 9** is a contractor. He received a 1099 from the company he typically works for and uses his personal vehicle to travel from job to job. He provided Defendants with receipts for gasoline purchased in order to claim a deduction for that expense. However, Defendants included deductions for insurance, legal and professional fees, office expenses, repairs and maintenance, utilities, taxes, and licenses. Customer 9 did not provide any supporting information for these expenses and did not discuss them with Defendants.

32. **Customer 10** claimed $4,875 in non-cash charitable contributions. Customer 10 told the IRS that she did not provide any supporting documents to Defendants. Defendants only asked her questions about her contributions. Defendants prepared a return for Customer 10 claiming approximately $12,304 in inflated deductions on Schedule A, including charitable donations. Customer 10 told the IRS that she did not provide Defendants with documentation supporting the amount of these deductions.

33. **Customer 11** operated a home cleaning business in 2017. Defendants prepared her 2017 tax return, which claimed approximately $6,210 in deductions on Schedule A related to advertising, office expenses, utilities, taxes, and licenses. With the exception of a single letter

from the owners of a home Customer 11 cleaned, Customer 11 did not provide Defendants with any supporting documentation for the Schedule A deductions.

HARM CAUSED BY DEFENDANTS' CONDUCT

34. Defendants' unlawful tax preparation practices and other acts to obstruct tax administration have resulted in significant lost tax revenues to the United States.

35. The IRS conducted interviews with 26 of Defendants' clients for the 2017 tax year. As a result of these interviews, the IRS made adjustments to the examined returns, resulting in a total harm to the government of approximately $65,763.00.

36. This noncompliance cannot be attributable to random chance. Based on the adjustments made after the IRS conducted interviews, the average harm to the Government was $2,529.35 per return. If that rate of error noted as part of these 26 interviews is extrapolated to all returns resulting in a refund prepared by Defendants in 2018, the estimated harm to the government is approximately $1,528,840.31 for that year alone.

37. In addition to the direct harm caused by preparing tax returns that include false deductions, expenses, or dependents, Defendants' activities undermine public confidence in the administration of the federal tax system and encourage noncompliance with internal revenue laws. For example, misuse of Schedules A and C undermines public confidence in a tax system that incentivizes actions such as charitable giving and entrepreneurship. Abuse of the EITC, by claiming ineligible dependents, filing under a false status such as head of household, and/or inflating income to maximize the credit receive, damages public confidence in a statutory credit meant to encourage low-income workers with children to maintain employment.

38. Defendants' activities further harm the United States by forcing the IRS to devote its limited resources to identifying Defendants' customers, determining their correct tax

liability, recovering any refunds issued erroneously, and collecting any additional taxes and penalties.

39. Defendants' activities have also harmed their customers. While their customers paid them to prepare correct tax returns, Defendants prepared returns that understated tax liabilities or improperly created or inflated refunds. As a result of Defendants' actions, their customers have incurred unanticipated and significant financial burdens due to their liability for tax beyond the amount reported on their original returns in addition to penalties and statutory interest.

40. The IRS has taken increasingly aggressive measures to correct Defendants' behavior since 2011. These measures have failed, so it is necessary for this Court to permanently enjoin Defendants from acting as federal tax return preparers.

COUNT 1: INJUNCTION UNDER 26 U.S.C. § 7407

41. The United States incorporates by reference the allegations in paragraphs 1 through 40.

42. Among other things, 26 U.S.C. § 7407 authorizes the Court to enjoin a person from engaging in misconduct subject to penalty under 26 U.S.C. § 6694. Section 6694 penalizes a return preparer who prepares or submits a return or claim that contains a frivolous or unreasonable position, willfully attempts to understate a person's tax liability on a return or claim, or makes an understatement on a return due to reckless or intentional disregard of rules or regulations. Section 7407 also authorizes injunctive relief against other fraudulent or deceptive conduct that substantially interferes with the administration of the internal revenue laws.

43. If a preparer's misconduct is continual or repeated and the Court finds that a narrower injunction would not be sufficient to prevent the preparer's interference with the

administration of federal tax laws, the Court may enjoin the person from further acting as a return preparer.

44. Defendants have prepared federal tax returns that they knew contained inflated or fictitious credits or deductions. In addition, they have continually submitted returns that willfully understated their customers' tax liabilities and overstated their refunds. They therefore have engaged in conduct subject to penalty under 26 U.S.C. § 6694, as well as other improper conduct within the meaning of 26 U.S.C. § 7407.

45. Defendants knew or should have known that the returns they prepared for their customers contained unreasonable and false claims. There was no realistic possibility that these claims would be sustained on their merits. Likewise, no basis existed for a reasonable belief that these positions were more likely than not to be sustained.

46. Absent an injunction, Defendants are likely to continue to prepare improper federal income tax returns as described in this complaint. This likelihood is evident given that the IRS has previously instructed Mr. Diedrich to perform the required due diligence regarding Schedule A and C deductions as well as claimed dependents. Moreover, substantial penalties assessed against Defendants on three separate occasions have proved insufficient to correct their behavior. As an enrolled agent, Mr. Diedrich has been made aware of the Internal Revenue Code's requirements. Yet, Defendants continue to prepare tax returns that contain false information. Injunctive relief, therefore, is appropriate to prevent recurrence of this misconduct.

47. The Court should permanently enjoin Defendants, under 26 U.S.C. § 7407, from acting as federal tax return preparers because a more limited injunction would not stop them from interfering with the administration of the internal revenue laws.

COUNT 2: INJUNCTION UNDER 26 U.S.C § 7408

48. The United States incorporates by reference the allegations in paragraphs 1 through 477.

49. Among other things, 26 U.S.C. § 7408 authorizes the Court to enjoin a person from engaging in misconduct subject to penalty under 26 U.S.C. § 6701. Section 6701 imposes a penalty on any person who assists in, procures, or advises with respect to the preparation of any portion of a return affidavit, claim, or other document, who knows or has reason to believe that such portion will be used in connection with a material matter arising under the internal revenue laws, and who knows that such portion (if so used) would result in an understatement of another person's tax liability.

50. Defendants prepared tax returns containing false deductions on Schedule A, false business expenses on Schedule C, and claiming ineligible dependents for purposes of receiving the EITC. Defendants lacked corroborative support or any other reasoned basis to include these items in the tax returns they prepared.

51. Defendants engaged in this conduct knowing the falsity of the claimed credits.

52. Defendants prepared tax returns or assisted in the preparation of tax returns and other documents that were intended to be used, and were used, in connection with material matters arising under the internal revenue laws.

53. Defendants thus have engaged in conduct subject to penalty under 26 U.S.C. § 6701. The Court should permanently enjoin them under 26 U.S.C. § 7508 from further engaging in such conduct.

54. Absent a permanent injunction, Defendants are likely to continue to prepare tax returns that contain false information, including improper deductions and credits, resulting in further understatements of their customers' tax liability and further inflation of refunds. This

likelihood is evident given that the IRS has previously instructed Defendants to perform due diligence regarding the preparation of tax returns, penalized Mr. Diedrich for his failure to exercise such due diligence, and, as an enrolled tax preparer, Mr. Diedrich is aware of the Internal Revenue Code's requirements. Yet, Mr. Diedrich continues to prepare tax returns that contain false information. Injunctive relief is therefore appropriate to prevent further recurrence of this misconduct.

COUNT 3: INJUNCTION UNDER 26 U.S.C. § 7402

55. The United States incorporates by reference the allegations in paragraphs 1 through 54.

56. 26 U.S.C. § 7402(a) authorizes the Court to issue such orders of injunction as may be necessary or appropriate for the enforcement of the internal revenue laws, even if the United States has other remedies available for enforcing those laws.

57. Defendants, through the actions described above, have engaged in conduct that substantially interferes with the administration and enforcement of the internal revenue laws.

58. As a result of Defendants' misconduct, the IRS has received false tax returns that understate tax liability, and the IRS has issued refunds in error.

59. Defendants' misconduct has resulted in irreparable harm to the United States and the public for which no adequate legal remedy exists. It is not feasible (and in many cases too late) for the IRS to audit all of the returns that defendants have prepared over the years and to assert tax deficiencies, much less collect all of the undeserved refunds.

60. Defendants' misconduct interferes with tax administration.

61. The United States is entitled to relief under 26 U.S.C. § 7402(a) to prevent recurrence of this misconduct.

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

A. A determination that Gregory C. Diedrich and Saginaw Financial have continually engaged in conduct subject to penalty under 26 U.S.C. §§ 6694 and 6701 and that injunctive relief is appropriate under 26 U.S.C. §§ 7402, 7407, and 7408 to prohibit Gregory C. Diedrich and Saginaw Financial from acting as tax return preparers and from engaging in conduct subject to penalty under 26 U.S.C. §§ 6694 and 6701;

B. A determination that Gregory C. Diedrich and Saginaw Financial have engaged in conduct that substantially interferes with the enforcement and administration of the internal revenue laws, and that injunctive relief against them is necessary to prevent the recurrence of that misconduct pursuant to 26 U.S.C. §§ 7407(b) and 7402(a);

C. An order, pursuant to 26 U.S.C. §§ 7402, 7407, and 7408, against Gregory C. Diedrich and Saginaw Financial, permanently enjoining them from directly or indirectly:

1. Acting as a federal tax return preparer or requesting, assisting in, or directing the preparation or filing of federal tax returns for any person or entity other than themselves or a legal spouse;
2. Representing, or assisting in the representation of, any person or entity, other than themselves or a legal spouse, before the IRS;
3. Instructing, advising, or assisting, directly or indirectly, others to violate the tax laws, including to evade the payment of taxes;
4. Engaging in activity subject to penalty under 26 U.S.C. § 6694, such as preparing federal income tax returns that understate tax liabilities;
5. Engaging in activity subject to penalty under 26 U.S.C. § 6701, such as assisting in, procuring, or advising with respect to the preparation of any portion of a return, affidavit, claim, or other document, when knowing or having reason to believe that the relevant portion will be used in connection

with a material matter arising under the internal revenue laws, and knowing that the relevant portion will result in the material understatement of another person's tax liability; and

6. Engaging in any other conduct that interferes with the administration and enforcement of the internal revenue laws.

D. An order that Gregory C. Diedrich and Saginaw Financial shall (1) contact by mail (and by email if an email address is known) the persons and entities who, since January 1, 2016, have paid or otherwise retained them to prepare tax returns, and inform these customers of the Court's Order of Permanent Injunction, attaching a copy of the Order; and (2) file with the Court, within 30 days of the Order's entry, a certification signed under penalty of perjury stating that they have done so. The mailings shall include a cover letter in a form either agreed to by United States' counsel or approved by the Court, and shall not include any other documents or enclosures apart from the Order;

E. An order, pursuant to 26 U.S.C. §§ 7402(a), 7407, and 7408, requiring Gregory C. Diedrich and Saginaw Financial to produce to counsel for the United States, within 30 days of entry of the Court's Order, a list that identifies by name, social security number, address, email address, telephone number, and relevant tax periods all persons for whom they prepared federal tax returns or claims for refund for tax years 2015 through the present;

F. An order prohibiting Gregory C. Diedrich and Saginaw Financial from owning, controlling, or managing any business involving tax return preparation and/or tax advice, or from maintaining a professional presence in any premises, whether an office, place of business, dwelling, or other location, where tax returns are being prepared for a fee or professional tax services are being provided;

G. An order permitting the United States to conduct post-judgment discovery to ensure compliance with the permanent injunction;

H. An order retaining the Court's jurisdiction over this action for purposes of implementing and enforcing the permanent injunction;

I. An order awarding the United States its reasonable costs in bringing this action; and

J. An order granting the United States such other relief as the Court deems appropriate.

Dated: December 12, 2019.

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