

IN THE UNITED STATES DISTRICT COURT  
FOR THE EASTERN DISTRICT OF VIRGINIA  
NORFOLK DIVISION

UNITED STATES OF AMERICA,	)	
	)	
Plaintiff,	)	Case No. 2:19-cv-653
	)	
v.	)	
	)	
FRANCHISE GROUP INTERMEDIATE	)	
L 1, LLC, d/b/a LIBERTY TAX SERVICE,	)	
	)	
Defendant.	)	
_____	)	

**COMPLAINT**

The United States brings this Complaint pursuant to 26 U.S.C. (the Internal Revenue Code (“I.R.C.”)) § 7402(a) for entry of an order requiring Defendant, Franchise Group Intermediate L 1, LLC, doing business as Liberty Tax Service and formerly operated within sub-entities of Liberty Tax, Inc. and JTH Holding, Inc. (“Liberty Tax”), and all those in active concert or participation with Liberty Tax, to refrain from specific acts, to enact and/or maintain specific controls to prevent the preparation of false or fraudulent tax returns at Liberty Tax Service stores, and to prevent the transmission of false or fraudulent tax returns by Liberty Tax to the IRS.

**Jurisdiction and Venue**

1. Jurisdiction is conferred on this Court by 26 U.S.C § 7402(a), granting that “[t]he district courts of the United States at the instance of the United States shall have such jurisdiction to make and issue in civil actions, writs and orders of injunction ... and such other orders and processes, and to render such judgments and decrees as may be necessary or appropriate for the enforcement of the internal revenue laws.”

2. Venue is proper in this Court pursuant to 28 U.S.C. § 1391(b) because a substantial portion of the events giving rise to this action occurred within this judicial district, and Liberty Tax conducts business in this judicial district.

**Defendant**

3. Franchise Group Intermediate L 1, LLC (“Liberty Tax”) is a subsidiary of Franchise Group, Inc., a publicly traded, Delaware corporation headquartered in Virginia Beach, Virginia.

4. Liberty Tax markets tax return preparation services throughout the United States and Canada. Among its operations, Liberty Tax owns Liberty Tax Service-branded store locations and contracts with others as a franchisor of tax preparation stores branded as Liberty Tax Service (or operating as other brands).

5. John T. Hewitt established the Liberty Tax Service brand, founded the company, and opened its first store locations in the United States in 1998. Hewitt served as the Chief Executive Officer of the company up to 2017. Until 2018, Hewitt was Chairman of the company’s Board of Directors and controlling shareholder with the authority to select a majority of the board members.

6. To expand the business, Liberty Tax engages third parties, known as “area developers,” to sell the rights to franchise territories throughout the United States. According to Liberty Tax, these area developers, in addition to having responsibility for selling Liberty Tax Service franchises, also serve as a “mentor and coach” responsible for “assist[ing]” other owners of Liberty Tax Service franchises within defined geographic areas with “all facets of [their] business, including office site selection and operational guidance, including marketing, training,

and staffing.” Area developers typically receive 50% of both the franchise fee and royalties owed by franchisees under Liberty Tax Service franchise agreements.

7. According to the annual report filed by Liberty Tax, Inc. with the SEC in 2019, Liberty Tax has more than 2,800 franchise and company-owned tax return preparation offices in the United States. Liberty Tax also directly owns tax preparation stores. However, most Liberty Tax Service stores throughout the United States operate as franchisees in over 1,400 separate franchise territories, which in some instances include multiple store locations. Between 2015 and 2019, through the stores it owned directly and franchised throughout the United States, Liberty Tax filed approximately 1.3 to 1.9 million tax returns each year on behalf of its customers, making it one of the largest tax preparation businesses in the United States.

8. Typically, tax return preparers at Liberty Tax franchise and company-owned stores prepare federal income tax returns at individual store locations using Liberty Tax software, which transmits each tax return electronically to Liberty Tax. Liberty Tax, in turn, electronically files each federal tax return with the IRS.

9. For tax years from 2012 to 2018, over 88% of the electronically filed federal income tax returns prepared at stores Liberty Tax owned directly or franchised in the United States included a claim for a tax refund. In total, those income tax returns claimed over \$28 billion in federal tax refunds.

10. In addition to direct control of company-owned stores, under terms of its franchise agreements, operations manuals, and other written guidelines created by Liberty Tax, Liberty Tax maintains a substantial degree of control over operations at Liberty Tax Service franchise locations by, *inter alia*:

- A. Mandatory use by franchisees of tax preparation software designed by Liberty Tax that the company distributes to Liberty Tax Service stores.
- B. Requiring franchisees to use computers and other equipment that Liberty Tax selects and to consent to Liberty Tax monitoring of franchisee computer systems.
- C. Providing hardcopy forms to franchisees for use in collecting information from customers to report on federal income tax returns.
- D. Requiring franchisees to establish a management structure at their Liberty Tax Service stores to supervise tax return preparers employed by franchisees.
- E. Requiring franchisee store locations to maintain specific hours of operation set by Liberty Tax.
- F. Mandatory adherence by franchisees to guidelines established by Liberty Tax for how Liberty Tax Service stores market services to the public and use Liberty Tax trademarks.
- G. Requiring franchisees to comply with a common physical layout and appearance for Liberty Tax Service stores, as determined by Liberty Tax.
- H. Requiring Liberty Tax franchisees to obtain approval from Liberty Tax for any store location.
- I. Mandatory disclosures by franchisees to Liberty Tax of financial information involving store locations (*e.g.* gross receipt reports, profit and loss statements).
- J. Requiring franchisees to disclose to Liberty Tax the existence of any IRS or government investigation or audit of their stores and any results of the investigation or audit.

K. Offering financial products approved by Liberty Tax for sale to customers at franchisee-owned Liberty Tax Service stores (and prohibiting use of alternative financial products).

L. Mandatory customer service requirements and adherence to customer service policies by franchisees, as determined by Liberty Tax.

M. Providing loans and funding to franchisees for the operation of their Liberty Tax Service stores.

N. Both mandatory and optional operations and tax preparation training to franchise owners and their employees, including “Tax School” classes designed to train individuals to prepare federal income tax returns.

11. Liberty Tax also maintains control over disbursement of federal tax refunds and distribution of fees charged to customers from the preparation of federal tax returns. Through its franchise and company-owned stores, Liberty Tax offers customers the ability to defer payment of fees charged by Liberty Tax Service stores. For these customers, Liberty Tax obtains custody over federal tax refunds after the IRS disburses them (before franchisees or customers receive any portion of them) and collects fees from the proceeds of the refunds. Typically, Liberty Tax then: (1) retains portions of the refund, either as royalties owed to the company as the franchisor, or as fees owed by customers from the preparation of tax returns at company-owned stores; (2) distributes any portion of the refund due to franchisees as fees owed by the customers from the preparation of the tax return, or applies those fees to outstanding debt owed by the franchisee to Liberty Tax; and (3) disburses any remaining amount of the refund to customers (either directly to the customer or through a Liberty Tax Service location).

12. Liberty Tax's internal systems and the structure of its franchise operation also give the company the control and capability to prevent the filing of potentially false or fraudulent federal tax returns with the IRS. For example:

A. Through use of its tax preparation software and internal analytic tools, Liberty Tax evaluates information reported on federal tax returns prepared at Liberty Tax Service stores, both before and after transmission to the IRS. Liberty Tax can identify tax returns that contain anomalous patterns or potentially false or fraudulent claims, including through use of an alert system that issues "red flag" or "fraud alerts" both internally at Liberty Tax and to store locations.

B. Because store locations prepare tax returns using Liberty Tax software, which transmits each tax return to Liberty Tax prior to filing with the IRS, Liberty Tax has the capability to prevent electronic filing of federal tax returns that it identifies as containing potentially false or fraudulent information.

C. Liberty Tax has the capability to prevent electronic filing of federal tax returns prepared by individual tax return preparers working at store locations it owns or owned by its franchisees, if the tax return includes the correct Preparer Identification Number ("PTIN") of the preparer as required by federal law. Therefore, Liberty Tax can bar individuals from filing tax returns through its systems that it identifies as having filed improper, false, or fraudulent federal tax returns in the past, or identifies as high risk for filing improper, false, or fraudulent federal tax returns.

13. Liberty Tax Service franchise agreements also provide multiple grounds for Liberty Tax to terminate franchise agreements without notice or opportunity to cure. Grounds for termination include a determination by Liberty Tax that a franchisee, or any person under its

supervision and control, has committed a material violation of any law, rule, or regulation of a government agency associated with the operation of the franchise.

**Fraud and Misconduct at  
Liberty Tax Service Franchise Locations**

14. Between 2013 and 2018, the United States filed 10 separate civil law enforcement actions in U.S. District Courts throughout the United States against 12 franchisees of Liberty Tax, or their owners, former owners, or former managers, including:

A. *United States v. Doletzky et al.*, Case No: 8:18-cv-00780-CEH-CPT (M.D. Fla.) (the “Doletzky Litigation”): pending lawsuit against Steven Doletzky, who was a franchisee, Liberty Tax Service area developer, officer of a Liberty Tax insurance subsidiary, and nationwide trainer of Liberty Tax Service franchisees. The Complaint also names Michael Garno and Michael Bass (as well as a company he owned to operate Liberty Tax Service stores) as additional Defendants, each of whom operated separate Liberty Tax Service franchises in the St. Petersburg, Florida area.

B. *United States v. Davis et al.*, Case No: 2:17-cv-10055-DPH-MKM (E.D. Mich.) (the “Davis Litigation”): judgment entered in favor of the United States in September 2017 against a former Liberty Tax Service store manager in Detroit, Michigan;

C. *United States v. Comer et al.*, Case No: 2:16-cv-10299-PDB-SDD (E.D. Mich.) (the “Comer Litigation”): judgment entered in favor of the United States in November 2016 against a Liberty Tax Service franchisee who operated in Detroit, Michigan.

D. *United States v. Haynes*, Case No: 3:16-cv-00373-MGL (D.S.C.) (the “Haynes Litigation”): judgment entered in favor of the United States in October 2016 against a Liberty Tax Service area developer and franchisee in Columbia, South Carolina.

E. *United States v. Kone et al.*, Case No: 1:16-cv-02441-JFM (D. Md.) (the “Kone Litigation”): judgment entered in favor of the United States in August 2016 against a Liberty Tax Service franchisee shortly after her criminal conviction by the State of Maryland arising from her operation of Liberty Tax Service stores in Baltimore.

F. *United States v. Sanchez*, Case No: 8:16-cv-00083-JVS-DFM (C.D. Cal.) (the “Sanchez Litigation”): judgment entered in favor of the United States in March 2016 against a Liberty Tax Service franchisee operating in central California.

G. *United States v. Ahmed, et al.*, Case No: 2:15-cv-11461-GAD-EAS (E.D. Mich.) (the “Ahmed Litigation”): judgment entered in favor of the United States in November 2015 against a Liberty Tax Service franchisee who operated multiple Liberty Tax Service stores in Illinois and Michigan.

H. *United States v. Hueble*, Case No: 8:15-cv-02213-HMH (D.S.C.) (the “Hueble Litigation”): judgment entered in favor of the United States in October 2015 against a franchisee operating Liberty Tax Service stores in South Carolina.

I. *United States v. Brock*, Case No: 1:14-cv-00157-LG-JMR (S.D. Miss.) (the “Brock Litigation”): judgment entered in favor of the United States in April 2014 against a Liberty Tax Service franchisee operating in Mississippi and Florida.

J. *United States v. Leger, et al.*, Case No: 1:13-cv-03153-TWT (N.D. Ga.) (the “Leger Litigation”): judgment entered in favor of the United States in January 2014 against a Liberty Tax Service franchisee in Georgia.



*Earned Income Tax Credit Fraud*

15. The Earned Income Tax Credit (“EITC”) is a benefit for working taxpayers with low to moderate income. The amount of the EITC for which taxpayers may qualify increases in relation to their “earned income” until they reach a certain threshold, over which they become ineligible to claim the EITC. The EITC of a qualifying taxpayer increases with each additional eligible dependent claimed, up to three dependents. Therefore, under some circumstances, a taxpayer may improperly qualify for the EITC by reporting fictitious income.

16. Income that can qualify a taxpayer for the EITC includes:

A. Wage income by employers as reported on federal Forms W-2 and line 7 on Form 1040 federal income tax returns (“W-2 Income”);

B. Income earned by individuals who do business as sole proprietorships, which taxpayers report on Schedule C on Form 1040 federal income tax returns (“Schedule C Income”). Individuals with Schedule C Income are subject to self-employment taxes; and

C. Wages earned from household work (“HSH Income”), such as housekeeping, babysitting, gardening, and other services, when the taxpayer’s annual income is less than an amount that the IRS requires employers to report on a Form W-2. Taxpayers who properly report HSH Income are not subject to self-employment taxes.

17. Unlike W-2 Income, the IRS does not receive independent verification from an employer of the existence and amount of a taxpayer’s Schedule C Income or HSH Income. Therefore, the accuracy of Schedule C Income and HSH Income reported on a federal income tax return used to claim the EITC depends upon the taxpayer and his/her tax return preparer.

18. The IRS estimates that between 21% and 26% of EITC claims are paid in error – both due to unintentional error as well as intentional disregard of the law. Given the potential for abuse in claiming the EITC, Congress authorized the Secretary of the Treasury to impose due diligence requirements on federal tax return preparers claiming the EITC for their customers. Due diligence requirements mandate that a tax return preparer must conduct an inquiry to verify whether his/her customer qualifies for the EITC amount claimed and must not know, or have reason to know, that any information used by the tax return preparer in determining the taxpayer's eligibility for, or the amount of, the EITC is incorrect. To verify compliance with due diligence requirements, a due diligence questionnaire must be submitted to the IRS along with any claim for the EITC.

19. In addition, federal law requires tax return preparers to retain records of individuals for whom they prepare federal tax returns, including copies of documents the preparer relied upon when preparing a federal tax return that claims the EITC. Liberty Tax Service stores typically retain these records in hardcopy customer files located either at each store or storage locations near each store.

20. A substantial portion of the tax returns prepared at Liberty Tax franchise and company-owned store locations and electronically filed with the IRS by Liberty Tax claim the EITC. For tax years from 2012 to 2018, approximately 41% of federal income tax returns that Liberty Tax electronically filed with the IRS included a claim the EITC – more than double the proportion compared against all other federal income tax returns electronically filed with the IRS during that period. In total, the EITC claimed by federal tax returns electronically filed by Liberty Tax during this timeframe exceeded \$12 billion.

21. At the Liberty Tax Service stores operated by 10 of the 12 individuals sued in the civil law enforcement actions commenced by the United States referenced above, including against Doletzky, Garno, Bass, Davis, Comer, Haynes, Kone, Sanchez, Ahmed, and Hueble, tax return preparers committed EITC fraud and violations of earned income due diligence requirements when reporting Schedule C Income on federal income tax returns. Specifically, during a period from 2010 to as recently as 2016, employees of Liberty Tax Service stores owned or operated by these Liberty Tax Service franchisees (and in some instances, these individuals personally) prepared federal income tax returns for customers that claimed false EITCs by:

- A. Reporting Schedule C Income for businesses that did not exist.
- B. Reporting inflated Schedule C income for customers who had Schedule C businesses in order to increase the amount of the claimed EITC.
- C. Ignoring earned income due diligence requirements by failing to ask questions to customers appearing on due diligence forms, reporting false responses to due diligence questions, or otherwise failing to make reasonable inquiries as to whether the Schedule C Income as well as Schedule C expenses reported on the tax return were accurate or existed.
- D. Failing to comply with federal law requiring retention of customer records within Liberty Tax Service customer files to support claims for the EITC, including documents that preparers reported on federal income tax returns as records they relied upon to claim the EITC.

E. Completing blank forms provided by Liberty Tax with false information to include in customer files to give the appearance that preparers interviewed customers to reconstruct Schedule C Income when customers lacked business records.

22. Similarly, at four of the Liberty Tax franchisees sued by the United States (Kone, Doletzky, Bass, and Garno), employees of these Liberty Tax Service stores (and in some instances, these individuals personally) prepared federal income tax returns that reported false HSH Income in order to claim the EITC for customers. Each of these four Liberty Tax franchisees recruited customers, including homeless individuals, and then prepared fraudulent federal income tax returns on their behalf that reported fake HSH Income to claim the EITC or incorrectly reported Schedule C Income as HSH Income, thereby evading self-employment taxes. For example:

A. In 2015, the Liberty Tax Service franchise owned and operated by Kone prepared over 1,000 tax returns that claimed HSH Income and the EITC. The fraudulent tax returns included over 350 tax returns that each reported the exact same amount of HSH Income (\$6,400) and over 300 tax returns that each reported exactly \$7,200 of HSH Income.

B. At Liberty Tax Service stores operated by Doletzky, as a result of instructions he gave to his employees, during 2014 over 20% of federal income tax returns (*i.e.*, over 800 tax returns) prepared at his offices claimed HSH Income and the EITC. Doletzky's employees: (a) concocted non-existent HSH Income to report on tax returns and claim the EITC without the customers' knowledge; (b) claimed HSH Income on tax returns to qualify the customer for the EITC for work that should have been reported as Schedule C Income subject to self-employment taxes; and (c) reported HSH

Income and claimed the EITC on tax returns for customers who signed blank HSH forms that included no information as to the amount or source of *any* income.

23. Liberty Tax transmitted tax returns to the IRS, prepared at Liberty Tax Service stores operated by Doletzky, Garno, Bass, Davis, Comer, Haynes, Kone, Sanchez, Ahmed, and Hueble, that reported false Schedule C and/or HSH Income and made fraudulent claims for the EITC. Liberty Tax had notice (or should have had notice) of EITC fraud involving Schedule C and HSH Income at Liberty Tax Service franchise locations, but failed to take adequate measures to stop the practice. For example:

A. Liberty Tax tracked data showing anomalous patterns involving Schedule C and EITC claims on tax returns prepared at Liberty Tax Service franchise locations that the United States later sued in U.S. District Court, including risk assessments of potential fraud. In response to these reports, however, Liberty Tax neither conducted sufficient inquiries, such as onsite reviews of these store locations, to stop Schedule C/EITC fraud, nor otherwise required these franchisees to provide Liberty Tax with support to verify claims for the EITC based on Schedule C Income.

B. Federal tax returns prepared at locations owned by these Liberty Tax Service franchisees that claimed false HSH Income used nearly identical forms that franchisees distributed among themselves. Liberty Tax neither required franchisees to obtain approval for these forms, nor adequately examined practices at these Liberty Tax Service franchisees involving these forms. A review of customer files at franchisee locations by Liberty Tax, including these HSH forms, would have revealed the fraudulent nature of HSH Income/EITC claims at Liberty Tax Service stores because: (1) non-compliance with EITC due diligence requirements and the absence of documentation

substantiating reported HSH Income was evident from the HSH forms and associated customer files; (2) the forms often reported income that, even if valid, could not qualify as HSH Income because the income did not derive from household work, was in fact Schedule C Income, and thereby evaded customer payment of self-employment taxes; and (3) the use of these identical or near-identical forms across multiple Liberty Tax Service franchisees revealed a pattern of their misuse and improper claims of HSH Income across multiple Liberty Tax Service franchisees.

C. In early January 2014, Liberty Tax, including its CEO at the time, John T. Hewitt, received complaints that franchisees had prepared tax returns with potentially false HSH Income/EITC claims. Despite these complaints, the number of e-filed tax returns transmitted to the IRS by Liberty Tax claiming HSH Income rose and the problem continued throughout the 2014 and later tax seasons. Specifically:

(i) EITC fraud involving HSH Income continued at Liberty Tax Service stores owned by Kone and Doletzky after Hewitt received complaints in 2014, continued as recently as 2015 at the Liberty Tax Service franchise owned by Garno, and as recently as 2016 at Liberty Tax Service stores owned by Bass (through his company).

(ii) As early as 2014, Liberty Tax programed its alert system to issue “fraud” or “red flag” alerts internally at Liberty Tax and to franchisees to identify franchisees that transmitted tax returns to Liberty Tax with abnormally high claims of HSH Income that included EITC claims, but the problem continued to at least 2016.

(iii) For the 2013 tax year (typically tax returns prepared in 2014), by the end of that tax season in April 2014, the number of tax returns Liberty Tax transmitted to the IRS that claimed HSH Income grew by 35% compared against e-filed tax returns for the 2012 tax year (typically tax returns prepared in 2013). Even as late as the 2014 tax year (typically tax returns prepared in 2015), the number of tax returns Liberty Tax transmitted to the IRS that claimed HSH Income was 24% above the volume filed for the 2012 tax year.

D. Although Liberty Tax had the right to terminate franchisees for violation of federal tax laws and regulations without notice under its franchise agreements, Liberty Tax failed to exercise this right, even in circumstances when it identified violations involving the EITC. In 2016, for example, Liberty Tax conducted an onsite compliance review of Garno's customer files, found errors in over 80% of the reviewed customer files that claim the EITC, and gave Garno an overall EITC compliance grade of "F." Nevertheless, Liberty Tax only terminated Garno as a Liberty Tax franchisee after the United States initiated a civil enforcement action against him in 2018.

*Improper Dependent Claims, False Expenses, Fraudulent Claims  
for Refundable Education Credits, and PTIN Violations*

24. In addition to inflating income to claim improper EITC refunds, a pattern of additional misconduct existed at Liberty Tax Service franchisees that included the 12 franchisees, owners, former owners, or former managers sued by the United States in the civil enforcement actions described above. From as early as 2012 to as recently as 2017, these Liberty Tax Service franchisees prepared federal income tax returns that included improper dependent claims, false claims for expenses, fraudulent claims for refundable education credits, and violations of federal Preparer Tax Identification Number (“PTIN”) regulations as follows:

A. Nine of the 12 Liberty Tax franchisees or franchisee managers that the United States filed civil enforcement actions against, referenced above, also claimed improper dependents on federal income tax returns (Doletzky, Garno, Bass, Davis, Comer, Haynes, Sanchez, Ahmed, and Hueble). Typically, these claimed dependents had a relationship to the customer, but the preparer at the Liberty Tax franchise location either knew that the dependent did not qualify for that status, or failed to make sufficient inquiries to determine whether the claimed dependent qualified for that status. These dependent claims, in turn, resulted in erroneous tax refunds for tax returns claiming improper head-of-household filing status, child tax credits, or inflated EITC refunds.

B. Fraudulent claims for expenses reported on tax returns prepared at Liberty Tax Service stores occurred at 8 of the 12 Liberty Tax franchisees/franchisee managers listed above (Doletzky, Garno, Davis, Comer, Haynes, Sanchez, Ahmed, and Hueble). These expenses improperly reduced the federal income tax liabilities of Liberty Tax customers. In each instance, tax return preparers employed at the Liberty Tax franchised stores either reported bogus expenses on Schedule A of federal tax returns (*e.g.*,



unreimbursed employee expenses, medical expenses, mileage expenses in connection to employment), or fictitious losses from a sole proprietorship reported on Schedule C of federal income tax returns.

C. For 6 of the 12 Liberty Tax franchisees referenced above (Doletzky, Garno, Bass, Ahmed, Brock, and Leger), their employees prepared federal income tax returns that included false claims for refundable education credits. These credits were available to taxpayers with qualified education expenses at eligible educational institutions. Because these credits were refundable, if the credit reduced the tax to less than zero, the taxpayer received a tax refund. For example, customer tax returns prepared at Liberty Tax Service stores owned by Doletzky, Bass, and Garno (either individually or through their companies) claimed over 1,200 false education credits between 2013 and 2015 from educational institutions that never reported those expenses on IRS Forms 1098-T, which colleges and universities use to report education expenses to the IRS.

D. Preparer Tax Identification Number (“PTIN”) violations occurred at multiple Liberty Tax franchises. Anyone who prepares or assists in preparing federal tax returns for compensation must have a valid PTIN issued by the IRS. Paid preparers must include their PTIN on each tax return they prepare and file with the IRS, and the IRS prohibits individuals from sharing PTINs. PTINs serve as an essential part of tax administration and the Government’s effort to ensure compliance with the internal revenue laws by allowing the IRS to identify paid tax preparers on tax returns. At Liberty Tax Service stores owned or operated by five of the Liberty Tax franchisees referenced above (Doletzky, Garno, Bass, Comer, and Haynes), each improperly

employed individuals without PTINs to prepare tax returns and/or allowed employees to share PTINs.

25. Liberty Tax was capable of tracking (or in fact did track) each form of misconduct described in Paragraph 24 and had the ability, both in practice and legally under its franchise agreements, to take additional measures to prevent violations of federal law or terminate franchisees for those violations. For example:

A. Liberty Tax issued “red flag” or “fraud alerts” for franchisees that prepared unusually high numbers of tax returns that claimed refundable education credits. Nevertheless, Liberty Tax either took no action or took insufficient additional measures in response, such as onsite reviews of Liberty Tax Service stores. Onsite reviews or even remote reviews of customer files would have revealed the presence of unreliable (including incomplete and blank) “Education Expenses Detail Sheets” distributed among Liberty Tax franchisees to purportedly substantiate education credits in place of Forms 1098-T.

B. Liberty Tax’s systems tracked PTIN use. For example, in 2014, from those systems, Liberty Tax’s compliance personnel knew that at one of Doletzky’s Liberty Tax Service stores, of 1,597 tax returns prepared during that year, implausibly, 1,528 (*i.e.*, nearly 97%) of those returns identified two individuals as the only preparers of the returns.

C. Similarly, had Liberty Tax taken measures to review customer files located at these Liberty Tax Service stores, the company would have discovered the absence of required supporting documentation for claimed expenses reported on tax returns to improperly reduce customers’ federal income tax liabilities. These steps would

have also revealed inconsistent or lack of any documentation to support dependent claims reported on tax returns.

**“Elite 18” and “Million Dollar Club” Franchisees**

26. Liberty Tax marketed franchisees it considered top performers in the Liberty Tax Service system as examples for other franchisees to follow, including at meetings and events held by Liberty Tax for its franchisees.

27. Liberty Tax designated certain franchisees as the “Elite 18” of the Liberty Tax Service system. In April 2012, according to Liberty Tax, this status was “reserved” for top franchisees and “was created to recognize a special category of franchisees who’s [sic] performance and attitude have set the standard for the [Liberty Tax Service] organization.” Liberty Tax invited franchisee members of the “Elite 18” to attend special events, such as retreats led by senior executives of Liberty Tax.

28. Similarly, Liberty Tax created what it designated as the “Million Dollar Club” and selected franchisees to be its members. In September 2013, according to Liberty Tax, “[t]his club was formed to provide specialized trainings to select franchisees who have demonstrated an elevated pattern of success in the hopes that they will join the exclusive rank of ‘Elite 18,’ a group of franchisees who represent [the] highest revenue producing entities.” Liberty Tax informed franchisees that “[p]articipants of the Million Dollar Club [would] be invited to attend specialized training and conference calls held throughout the year,” including meetings with Liberty Tax’s then “CEO, John Hewitt and other franchisees producing at their level to discuss issues they deem important.”

29. Liberty Tax focused on the financial performance of franchisees when designating franchisees as “Elite 18” members or members of the “Million Dollar Club,” while failing to

maintain adequate controls to scrutinize the tax return preparation practices of those franchisees and/or failing to timely terminate franchisees despite indications of improper or fraudulent tax return preparation practices.

30. Of the 12 Liberty Tax franchisee Defendants referenced above, Liberty Tax designated 6 of them as members of the “Elite 18” or the “Million Dollar Club,” including Doletzky (Elite 18), Comer (Elite 18), Haynes (Million Dollar Club), Kone (Million Dollar Club), Sanchez (Elite 18), and Ahmed (Elite 18).

#### **Necessity for an I.R.C. § 7402(a) Order**

31. Liberty Tax’s annual report filed in 2019 admitted that the company “did not maintain effective internal control over financial reporting as of April 30, 2019,” and “[t]he control environment, risk assessment, control activities, information and communication, and monitoring controls were not effective. ‘Tone at the top’ issues contributed to an ineffective control environment.” Moreover, that annual report also disclosed weaknesses in “contemplating fraud risks,” “identifying and assessing changes in the business that could impact the system of internal controls,” and:

[M]aterial weakness relating to: (i) commitment to integrity and ethical values, (ii) the ability of the Board of Directors to effectively exercise oversight of the development and performance of internal control, as a result of failure to communicate relevant information within the organization and, in some cases, withholding information, (iii) appropriate organizational structure, reporting lines, and authority and responsibilities in pursuit of objectives, (iv) commitment to attract, develop, and retain competent individuals, and (v) holding individuals accountable for their internal control related responsibilities.

32. As described in detail above, common forms of tax fraud and tax law violations occurred across Liberty Tax Service franchisees, including the following (with an “X” indicating a common form of fraud/tax law violation):

	<i>Earned Income Tax Credit Fraud (fake income)</i>	<i>Fabricated Expenses (Schedule A or Schedule C)</i>	<i>False or Improper Dependents</i>	<i>Fraudulent Claims for Education Credits</i>	<i>PTIN Violations</i>
<i>Doletzky Litigation (Doletzky)</i>	<b>X</b>	<b>X</b>	<b>X</b>	<b>X</b>	<b>X</b>
<i>Doletzky Litigation (Garno)</i>	<b>X</b>	<b>X</b>	<b>X</b>	<b>X</b>	<b>X</b>
<i>Doletzky Litigation (Bass)</i>	<b>X</b>		<b>X</b>	<b>X</b>	<b>X</b>
<i>Davis Litigation</i>	<b>X</b>	<b>X</b>	<b>X</b>		
<i>Comer Litigation</i>	<b>X</b>	<b>X</b>	<b>X</b>		<b>X</b>
<i>Haynes Litigation</i>	<b>X</b>	<b>X</b>	<b>X</b>		<b>X</b>
<i>Kone Litigation</i>	<b>X</b>				
<i>Sanchez Litigation</i>	<b>X</b>	<b>X</b>	<b>X</b>		
<i>Ahmed Litigation</i>	<b>X</b>	<b>X</b>	<b>X</b>	<b>X</b>	
<i>Hueble Litigation</i>	<b>X</b>	<b>X</b>	<b>X</b>		
<i>Brock Litigation</i>				<b>X</b>	
<i>Leger Litigation</i>				<b>X</b>	

33. In sum, Liberty Tax's failure to maintain adequate controls over financial reporting extended to controls over tax returns prepared by its franchisees that it transmitted to the IRS. For each of the forms of fraud or improper claims reported on federal income tax returns addressed above, Liberty Tax tracked information that revealed anomalies that warranted further investigation or action by Liberty Tax. Liberty Tax, however, failed to take sufficient measures to prevent fraud and errors on tax returns prepared at its stores. In many cases, Liberty

Tax only terminated franchisees that filed fraudulent federal tax returns after the United States or other law enforcement agencies commenced actions against the franchisee. Liberty Tax knew or should have known of misconduct at Liberty Tax Service franchisees and failed to timely or to effectively act to prevent the continued filing of false or fraudulent federal income tax returns. For these reasons, an Order issued by this Court under I.R.C. § 7402(a) requiring Liberty Tax to take specific tax law compliance measures and implement and/or maintain specific controls to prevent the filing of false or fraudulent federal tax returns is “necessary or appropriate for the enforcement of the internal revenue laws.”

34. Moreover, the scope of the resources spent by the United States to date to enforce tax law compliance at Liberty Tax Service stores, as well as the harm discovered as a result, provide further support for the necessity and appropriateness of an Order by this Court under I.R.C. § 7402(a). Specifically:

A. For tax years from 2012 to 2016, the IRS has examined thousands of tax returns prepared at Liberty Tax Service stores and assessed over 25,000 separate penalties against tax return preparers for tax returns prepared at Liberty Tax’s franchises and company-owned tax return preparation stores.

B. For tax years from 2012 to 2017, the IRS conducted over 28,000 audits of Liberty Tax Service customer tax returns (excluding audits where a taxpayer failed to respond to the IRS’s notification of the audit). The IRS found that over 20,000 of their federal tax returns (*i.e.*, over 70%) prepared at Liberty Tax Service stores required changes to correct false or incorrect items reported on each return.

C. Since 2012, IRS agents spent over 20,000 hours investigating Liberty Tax Service franchisees for potential referrals to the Department of Justice to commence civil

enforcement actions against them, or otherwise supported Department of Justice attorneys in filed civil actions in U.S. District Courts.

D. Since 2012, litigation teams at the Tax Division of the Department of Justice spent over 8,000 hours to date on the 10 individual franchise cases filed in U.S. District Courts (referenced above) on both pre-suit matters and post-filing of complaints.

35. As addressed above, Liberty Tax Service files over 1 million tax returns each year and is one of the largest tax preparation companies in the United States. Liberty Tax has the capacity to maintain and, ultimately, improve controls to prevent the filing of false or fraudulent federal tax returns with the IRS. At the same time, the United States, including the IRS, has finite resources to detect false or fraudulent federal income tax returns, recoup improper tax refunds, and initiate civil enforcement actions in U.S. District Courts. Therefore, court-ordered enhancements to Liberty Tax's tax law compliance measures through an Order under I.R.C. § 7402(a) are "necessary or appropriate for the enforcement of the internal revenue laws."

**REQUESTED RELIEF UNDER I.R.C. § 7402(a)**

36. The United States incorporates by reference paragraphs 1 through 35.

37. Under I.R.C. § 7402(a), this District Court has "such jurisdiction to make and issue in civil actions, writs and orders of injunction ... and such other orders and processes, and to render such judgments and decrees as may be necessary or appropriate for the enforcement of the internal revenue laws."

38. Unless the Court enters an order pursuant to I.R.C. § 7402(a) that requires Liberty Tax to refrain from specific acts and to enact and/or maintain specific controls to prevent the preparation of false or fraudulent tax returns at Liberty Tax Service stores, Liberty Tax Service stores are likely to continue to engage in improper conduct, including the preparation of false or

fraudulent federal income tax returns. Without an I.R.C. § 7402(a) order, the United States will suffer irreparable injury by wrongfully providing federal income tax refunds to individuals not entitled to receive them.

39. The irreparable injury posed by the United States if the Court does not enter an I.R.C. § 7402(a) order outweighs the harm to Liberty Tax – in this instance the financial cost of maintaining and enhancing Liberty Tax’s controls to prevent the preparation of false or fraudulent tax returns at Liberty Tax Service stores.

40. An order pursuant to I.R.C. § 7402(a) is in the public interest because, backed by the Court’s contempt power if needed, it will cause Liberty Tax to refrain from specific acts and to enact and/or maintain specific controls to prevent the preparation of false or fraudulent tax returns at Liberty Tax Service stores. The impact of an I.R.C. § 7402(a) order, and the resulting benefit to the public fisc from the filing of accurate federal income tax returns is a particularly compelling public interest given the size of Liberty Tax’s business – transmitting over 1 million federal income tax returns to the IRS each year.

41. Pursuant to I.R.C. § 7402(a), the Court should enter an order requiring Liberty Tax, and all those in active concert or participation with Liberty Tax, to enact and/or maintain specific controls to prevent the preparation of false or fraudulent tax returns at Liberty Tax Service stores and to prevent the transmission of false or fraudulent tax returns by Liberty Tax to the IRS.

WHEREFORE, the United States seeks, *inter alia*, a Section 7402(a) Order that:

- A. Permanently bars Liberty Tax from hiring or otherwise engaging John T. Hewitt, founder and former chief executive officer of Liberty Tax, as an executive, advisor, consultant, employee, area developer, or franchisee of Liberty Tax as well as from



- nominating John T. Hewitt to Liberty Tax's board of directors (or the board of directors of any parent entity or entities of Liberty Tax) or granting John T. Hewitt any options or other rights to acquire any equity interest in Liberty Tax (or any parent entity or entities of Liberty Tax).
- B. Requires Liberty Tax to fully disclose in writing to the United States the content and findings of any internal or external review or investigation within the past sixty (60) months of officers or employees of Liberty Tax that found violations under Title 26 of the U.S. Code by the officer or employee or any willful, reckless, or negligent failure by the officer or employee to prevent violations of Title 26 of the U.S. Code.
- C. Permanently bars Liberty Tax from hiring or otherwise engaging as officers or employees of Liberty Tax any individual who:
1. Violated Title 26 of the U.S. Code or willfully, recklessly, or negligently failed to prevent violations of Title 26 of the U.S. Code according to any internal or external review or investigation conducted by Liberty Tax;
  2. Liberty Tax terminated in whole or in part due to a failure, individually or through ownership of any entity, to comply with federal tax laws; and
  3. Based on inquiry by Liberty Tax had an Electronic Filing Identification Number ("EFIN") revoked by the IRS (that was not subsequently reinstated by the IRS), had a Preparer Tax Identification Number ("PTIN") revoked by the IRS (that was not subsequently reinstated by the IRS), was assessed penalties under Titles 26 or 31 of the U.S. Code, or has more than \$5,000 of outstanding federal tax liabilities and has not entered into an installment plan with the IRS to pay such outstanding liabilities.

- D. Requires Liberty Tax to disclose findings of any conduct potentially subject to penalty under 26 U.S.C. §§ 6694, 6695, and/or 6701 and/or any potential criminal violation of the federal laws by tax return preparers at Liberty Tax Service stores to a law enforcement official designated to serve in that capacity by the United States for sixty (60) months.
- E. Requires Liberty Tax to maintain sufficient resources to monitor, detect, and report non-compliance with federal law, tax laws, and regulations, as well as to ensure effective quality control over tax return preparation throughout the Liberty Tax Service system.
- F. Requires Liberty Tax to implement onsite compliance measures at Liberty Tax Service stores, including, for no less than sixty (60) months, a minimum number of reviews of the content of customer files that examine specific items identified in any Order issued by this Court and a minimum number of mystery shopper visits that test compliance with the tax laws at Liberty Tax Service stores.
- G. Requires Liberty Tax to implement specific internal tax compliance enhancements to its training programs, to terms in its franchise agreements, and to its internal controls, including to Liberty Tax's: (1) internal red flag/fraud alert system; (2) procedures to blacklist individuals as tax return preparers who are a higher risk for preparing false or fraudulent federal tax returns; (3) controls to prevent unauthorized changes to federal tax returns prepared at Liberty Tax Services stores; (4) systems to automatically hold transmission of tax returns to the IRS prepared at Liberty Tax Service stores that have a high risk of false or fraudulent claims; and (5) minimum qualifications for individuals who work at Liberty Tax Service stores, train Liberty

- Tax Service preparers, serve as area developers on behalf of Liberty Tax, or manage tax compliance staff at Liberty Tax.
- H. Requires Liberty Tax to enact specific substantiation requirements at Liberty Tax Service stores for tax returns that claim itemized deductions (Schedule A of a Form 1040 federal income tax return) or report income from a sole proprietorship (Schedule C of a Form 1040 federal income tax return) used to claim the Earned Income Tax Credit (EITC).
  - I. Requires Liberty Tax to maintain a whistleblower program to encourage employees, franchisees, and franchisee employees to report suspected fraudulent activity.
  - J. Requires Liberty Tax to notify any prospective purchaser of a franchise territory of information in its possession regarding the tax compliance history at pre-existing Liberty Tax Service stores in the franchise territory and any resulting actions taken by Liberty Tax regarding any related findings prior to the purchase.
  - K. Imposes restrictions on Liberty Tax financial products and financial incentives to Liberty Tax Service customers.
  - L. Requires Liberty Tax, at its own expense, to engage an independent monitor approved by the United States, to review, evaluate, and report to a civil law enforcement official designated by the United States: (1) Liberty Tax controls to prevent the preparation of false or fraudulent federal income tax returns at Liberty Tax Service stores; (2) Liberty Tax's controls to prevent the transmission of false or fraudulent tax returns by Liberty Tax to the IRS; and (3) Liberty Tax's compliance with all terms contained in any Order issued by this Court under I.R.C. § 7402(a) as result of this Complaint.

- M. Includes any additional requirements as the Court deems necessary or appropriate for the enforcement of the internal revenue laws pursuant to I.R.C. § 7402(a).

Dated: December 3, 2019.

Respectfully submitted,

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