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UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF WASHINGTON
AT SEATTLE

UNITED STATES OF AMERICA Plaintiff, v. RONALD M. PAUL, individually and d/b/a/ THE TAX CLINIC Defendant.	Case No. C04-0916L ORDER GRANTING PLAINTIFF'S MOTION FOR A PRELIMINARY INJUNCTION AND DENYING DEFENDANT'S MOTION TO STAY ALL PROCEEDINGS

I. Introduction

This matter comes before the Court on the Government's motion for a preliminary injunction (Dkt. # 9) to enjoin the Defendant from preparing federal income tax returns or assisting or advising others in preparing returns while this lawsuit is pending. The Government's motion was noted for August 20, 2004. While the pro se Defendant has not filed a response to the Government's motion, he has filed a motion to stay all proceedings in objection to the appearance of Kristin Hodges (Dkt. # 20), counsel for the Government. For the reasons set forth in this Order, the Government's motion for a preliminary injunction is GRANTED and

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Defendant's motion to stay all proceedings is DENIED.[1]

II. Background

The Government has alleged that the Defendant is an unlicensed and unenrolled tax return preparer who guarantees customers big refunds, which he secures through fraudulent tax returns. (Motion at 2.) According to Defendant's Airborne Express employment application completed in November 2003, he has been self-employed as a personal and small business tax practitioner since 1987. (Ustaris Decl. Ex. 1.) In addition, he has received a wide variety of skills, training and education as an accountant for the businesses "Accountants on Call" and "Accounting Quest," both in Seattle, Washington. (Ustaris Decl. Ex. 1.) The Government claims that Defendant, doing business as the Tax Clinic, is responsible for over $1.5 million in understated tax liability. (Motion at 7.) The Government has supported its accusations by declarations of Mr. Paul's former customers, which allege that their tax returns were fraudulently prepared by the Defendant, who deducted non-existent business expenses and charity contributions without their knowledge. (Childers Decl. at 2; Shonko Decl. at 2.) Defendant denies that he has knowingly prepared federal income tax returns which would result in the understatement of another person's federal income tax liabilities. (Answer at 5.)

III. Discussion

A. Motion to Stay Proceedings

Defendant has asked this Court stay all proceedings until Kristin H. Hodges, counsel for the Government, has produced her authority to act on behalf of the Government. (Motion at 4.)

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[1] The Government requested oral argument in accordance with Local CR 7(b)(4). Having considered the motion and supporting materials, the Court finds that resolution of this matter without oral argument is appropriate.

In support of this motion, Defendant points to 28 U.S.C. § 530B, which requires Government attorneys to be subject to state laws and rules. He contends that pursuant to 28 U.S.C. § 530B, Ms. Hodges is subject to Washington Court Admission to Practice Rule 8. However, Washington's Admission to Practice Rules do not apply in federal courts. "Admission to practice law before a state's courts and admission to practice before the federal courts in that state are separate, independent privileges. The two judicial systems of courts . . . have autonomous control over the conduct of their officers, among whom, in the present context, lawyers are included." In re Poole, 222 F.3d 618, 620 (9th Cir. 2000). Pursuant to General Rule 2(b) of the Local Rules for Western District of Washington:

> An attorney who is a member in good standing of the Washington State Bar, and any attorney who is a member in good standing of the bar of any state and who is employed by the United States or one of its agencies in a professional capacity and who, while being so employed may have occasion to appear in this court on behalf of the United States or one of its agencies, is eligible for admission to the bar of this court.

Ms. Hodges is not required to apply to appear before the Court *pro hac vice* as she is a member of the bar of this Court. Furthermore, the Defendant has cited no authority for the proposition that Ms. Hodges must present him with evidence that she is properly credentialed to speak on behalf of the United States, and has presented no evidence that would cause this Court to doubt Ms. Hodges' authority to do so.[2]

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[2] Defendant has cited RCW 2.44.030, which gives Washington state court judges authority to require an attorney to produce authority under which she appears, on a motion of either party showing reasonable grounds for the request. (Motion at 3.) Without resolving whether that statute grants federal judges such authority, the Court sees no reason to place this additional burden on either of the parties.

B. Motion for Preliminary Injunction

"The purpose of a preliminary injunction is merely to preserve the relative positions of the parties until a trial on the merits can be held." University of Texas v. Camenisch, 451 U.S. 390, 395 (1981). Generally speaking, a party is not required to prove its entire case at this stage of the litigation, but rather to present enough evidence to demonstrate "either: (1) a likelihood of success on the merits and the possibility of irreparable injury; or (2) that serious questions going to the merits were raised and the balance of hardships tips sharply in [their] favor." United States v. Schiff, 397 F.3d 621, 625 (9th Cir. 2004) (internal quotation and citation omitted). However, in this case the Government has asked for an injunction pursuant to 26 U.S.C. §§ 7407, 7408, and thus a more specialized standard applies. Id. Section 7408 authorizes an injunction "to enjoin any person from further engaging in conduct subject to penalty under . . . section 6701 (relating to penalty for aiding and abetting understatement of tax liability)."[3] The Ninth Circuit has held that "[t]he traditional requirements for equitable relief need not be satisfied since Section 7408 expressly authorizes the issuance of an injunction." United States v. Estate Preservation Serv., 202 F.3d 1093, 1098 (9th Cir. 2000). In order to be granted a preliminary injunction, the Government must prove each element of the alleged offense by a

[3] 26 U.S.C. § 6701 provides: "Any person - (1) who aids or assists in, procures, or advises with respect to, the preparation or presentation of any portion of a return, affidavit, claim, or other document, (2) who knows (or has reason to believe) that such portion will be used in connection with any material matter arising under the internal revenue laws, and (3) who knows that such portion (if so used) would result in an understatement of the liability for tax of another person, shall pay a penalty with respect to each document in the amount determined under subsection (b)."

preponderance of the evidence, and must also show that injunctive relief is appropriate to prevent recurrence of such conduct. See id.; Schiff, 397 F.3d at 625.[4] The Ninth Circuit has set forth factors for courts to consider when determining the likelihood of future violations, and thus the necessity of an injunction:

> (1) [T]he gravity of the harm caused by the offense; (2) the extent of the defendant's participation, (3) the defendant's degree of scienter; (4) the isolated or recurrent nature of the infraction; (5) the defendant's recognition (or non-recognition) of his own culpability; and (6) the likelihood that the defendant's occupation would place him in a position where future violations could be anticipated.

Id. (internal quotations omitted).

Pursuant to 26 U.S.C. § 7407, a court may issue an injunction against an income tax preparer who has:

> (A) [E]ngaged in any conduct subject to penalty under section 6694 [penalizing knowing understatements due to undisclosed, unrealistic positions] or 6695 [penalizing failure to sign returns, provide an identifying number, or keep and provide a list of clients], or subject to any criminal penalty provided by this title, (B) misrepresented his eligibility to practice before the Internal Revenue Service, or otherwise misrepresented his experience or education as an income tax return preparer, (C) guaranteed the payment of any tax refund or the allowance of tax credit, or (D) engaged in any other fraudulent or deceptive conduct which substantially interferes with the proper administration of the Internal Revenue laws[.]

A court may only issue the injunction if it is "appropriate to prevent the recurrence of such conduct." 26 U.S.C. § 7407(b)(2). Section 7407 gives courts the power either to 1) enjoin the

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[4] Schiff and Estate Preservation Services were cases involving violations of 26 U.S.C. § 6700. The analysis for determining whether an injunction is appropriate for violations of sections 6700 and 6701 is substantially the same since both fall under the same requirements of 26 U.S.C. § 7408.

preparer from engaging in the unlawful conduct, or to 2) issue a more comprehensive injunction, enjoining the person from acting as an income tax return preparer. The latter option is only appropriate if the past violations were recurrent and an injunction enjoining only unlawful actions would not be sufficient "to prevent such person's interference with the proper administration of this title." Id.

In this case the Government has presented sufficient undisputed evidence that the defendant violated 26 U.S.C. § 6701. The Government has submitted declarations and tax returns which detail Defendant's alleged offenses including preparing tax returns which claim fictitious business losses, charitable contributions, and unreimbursed employee business expenses. (Herrmann Decl. ¶ 8.) In addition, Defendant, in preparing returns, has used a fraudulent "claim of right" theory which has been clearly denounced as "frivolous" by the IRS in a clarification of the tax code.[5] (Herrmann Decl. Ex. 1.) While Defendant does present some affirmative defenses in his answer, and denies having prepared fraudulent income tax returns, he does not refute the Government's specific allegations. For example, he does not deny having prepared the tax returns of Kathy Childers and Damian Shonko, which the Government provided for the Court, and which both Ms. Childers and Mr. Shonko claim contain fraudulent information. (Childers Decl. at 2; Shonko Decl. at 2.)

The Government has further produced sufficient evidence to satisfy the Court that an

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[5] IRS Revenue Ruling 2004-29: "This ruling emphasizes to taxpayers, and to promoters and return preparers who assist taxpayers with frivolous tax schemes, that there is no 'claim of right' doctrine that permits an individual to take the position that either the individual or the individual's income is not subject to federal income tax."

injunction is necessary to prevent future misconduct. (1) The Government has alleged over $1,318,061 in understated tax liabilities. (Herrmann Decl. ¶ 14.) That significant number is supported by the sworn declaration of Barbara Herrmann, an Internal Revenue Service (IRS) tax compliance officer who investigated the Defendant. Id. (2) The Government further alleges that the Defendant was responsible for that understated tax liability since he personally prepared the fraudulent tax returns. This is supported not only by Ms. Herrmann, but also by declarations from Defendant's clients who claim that they had no knowledge that Defendant was claiming the unsubstantiated deductions. Id. ¶ 8; Childers Decl. ¶¶ 6-10; Shonko Decl. ¶¶ 12-16. (3) Defendant's level of education and experience strongly suggest that his conduct was knowing and willful. According to Defendant's Airborne Express job application, he has taken accounting classes at both North Seattle and Green River Community College, and has held no less than three accounting positions. (Ustaris Decl. Ex. 1.) Defendant's knowledge and willfulness is also exemplified by accusations by his former client that he told her to disregard examination letters from the IRS. (Childers Decl. ¶¶ 15-16.) (4) As the IRS has identified 391 suspicious Paul-prepared returns, the Court must conclude that the conduct was not isolated, but rather recurrent. (Herrmann Decl. ¶ 13.) (5) Defendant has not recognized any personal culpability. (Answer at 5.) (6) Finally, Defendant's chosen occupation as an accountant places him in a position where future violations can certainly be anticipated.[6]

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[6] In addition to meeting the preliminary injunction standards of 26 U.S.C. § 7408, the Government has also shown a likelihood of success on the merits, and the possibility of irreparable harm. The Government has produced a number of declarations detailing the alleged offenses, from fraudulent claims of business losses to unsubstantiated charitable deductions. (Childers Decl. ¶ 7; Shonko Decl. ¶ 12.) Aside from Defendant's denials of any wrong-doing,

The Government has met its burden for a preliminary injunction under both section 7407 and section 7408. The Court finds that the Government has proven, by a preponderance of the evidence, that Defendant has engaged in activity which violates 26 U.S.C § 6701. In addition, the Court finds that enjoining Defendant from engaging in conduct which violates 26 U.S.C. § 6701 would not be sufficient to prevent his interference with the proper administration of title 26. Thus, a preliminary injunction pursuant to 26 U.S.C. § 7407, enjoining Defendant from acting as an income tax return preparer, is necessary to prevent further violations and harm to both the Government and potential clients. The Court does not find it appropriate to order Defendant to contact all of his past clients, as it is not necessary for the enforcement of the internal revenue law as required by 26 U.S.C. § 7402.

For all of the foregoing reasons, the Government's motion for a preliminary injunction (Dkt. # 9) is GRANTED and Defendant's motion to stay all proceedings (Dkt. # 20) is DENIED.[7]

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he has not set forth any specific evidence countering the Government's allegations. If the Defendant continues with the allegedly illegal conduct, it is highly probable that not only the Government, but also any future clients, will be irreparably harmed.

[7] The Government has requested that the Court award costs and attorney's fees expended in defense of Defendant's motion to stay. (Response at 2.) While the Defendant is not represented by counsel, the motion was clearly frivolous. The Court will take the matter under advisement and reserve judgment on the issue of fees until it can be determined whether the frivolous motion was an isolated incident.

IV. Conclusion and Preliminary Injunction

Defendant Ronald M. Paul is preliminarily enjoined and prohibited during the pendency of this action, individually and through any entity, from directly or indirectly:

1. Preparing or assisting in the preparation of any federal income tax returns for any other person for compensation;

2. Providing any tax advice or services for compensation, including providing consultative services or purported representation of customers before the IRS;

3. Engaging in activity subject to penalty under 26 U.S.C. § 6694, including preparing any part of a return or a claim for refund that includes an unrealistic or frivolous position;

4. Engaging in activity subject to penalty under 26 U.S.C § 6701, including advising with respect to, preparing, or assisting in the preparation of a document related to a material matter under the internal revenue laws that includes a position he knows will result in an understatement of tax liability;

5. Misrepresenting his qualifications and eligibility to practice before the IRS and his experience or education as an income tax return preparer;

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

Furthermore, if Defendant is contacted by any of his past customers, he is ORDERED to disclose to them the contents of this Order and notify them of the possibility that their returns are

being investigated by the IRS.

DATED this 17th day of September, 2004.

Robert S. Lasnik,
United States District Judge