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WESTERN DISTRICT OF WASHINGTON
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IN THE UNITED STATES DISTRICT COURT FOR THE
WESTERN DISTRICT OF WASHINGTON
CENTRAL DIVISION

UNITED STATES OF AMERICA, Plaintiff, v. RONALD M. PAUL, individually and d/b/a THE TAX CLINIC, Defendant.	CV04-0916 Civil No. **United States' Complaint For Permanent Injunction**

Plaintiff United States of America in its complaint against defendant Ronald M. Paul, individually and d/b/a The Tax Clinic, states as follows:

Nature of Complaint

1. This is a civil action brought by the United States of America pursuant to 28 U.S.C. §§ 1340 and 1345, and Internal Revenue Code (I.R.C.) §§ 7402, 7407, and 7408, to enjoin defendant Ronald M. Paul, individually and d/b/a The Tax Clinic, from:

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

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

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c. Engaging in conduct subject to penalty under 26 U.S.C. § 6695,including failing to sign returns prepared by him, failing to furnish his tax identification number as required by 26 U.S.C. § 6109(a)(4), and failing to provide his customer list;

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

e. Instructing or advising taxpayers to understate their federal income tax liabilities;

f. Promoting the frivolous theories that federal income tax can be reduced or eliminated through the use of fictitious home-based businesses or through 26 U.S.C. § 1341;

g. Engaging in any conduct that interferes with the proper administration and enforcement of the internal revenue laws through the preparation of false tax returns and/or representation of customers in front of the IRS;

h. Preparing or assisting in the preparation of any federal income tax return for any other person or entity;

i. Providing any tax advice or services for compensation, including, preparing returns, providing consultative services, or purported representation of customers;

Jurisdiction

2. This action has been requested by the Chief Counsel of the Internal Revenue Service, a delegate of the Secretary of the Treasury, and commenced at the direction of the Attorney General of the United States, pursuant to the provisions of I.R.C. §§ 7402, 7407, and 7408.

3. Jurisdiction is conferred on this Court by 28 U.S.C. §§ 1340 and 1345, and I.R.C. §§ 7402(a), 7407, and 7408.

Defendants

4. Ronald M. Paul resides at 1849 South 118th Street, Seattle, Washington 98168. Paul operates The Tax Clinic, an unincorporated business, from his residence.

Paul's Fraudulent Tax Preparation Scheme

5. Paul, doing business as The Tax Clinic, has been preparing fraudulent federal income tax returns since at least 1987.

6. Paul's scheme involves charging his customers up to $3,000 for preparing returns and guaranteeing that they will receive a large refund.

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7. Paul claims large refunds for his customers by fraudulently offsetting taxable income with fictitious deductions. Examples of fictitious deductions include:

a. *Fictitious or Excessive Charitable Contributions*: Paul fraudulently states on customers' Form 1040 Schedule A that his customers have given approximately 16-17% of their income to charity, thereby fraudulently reducing their taxable income;

b. *Sham Home-Based Business Deductions*: Paul offsets his customers' traditional income by deducting fictitious business expenses from either a legitimate or fictitious home-based business, thereby fraudulently reducing taxable income. Examples of fraudulent business expenses taken by Paul's customers include fictitious car and truck expenses, legal fees, supplies, and repairs.

c. *Fictitious Unreimbursed Employee Business Expenses*: Paul places fictitious unreimbursed employee business expense deductions on customers' federal tax returns to offset taxable income.

d. *Fictitious Education Credits*: Paul attaches fraudulent Forms 8863 to customers' tax returns claiming credit for tuition never paid.

8. Paul falsely tells customers that they do not need verification for their deductions because he uses the "tax estimate" method.

9. Beginning in late spring of 2003 the IRS began auditing Paul's customers and disallowing the fraudulent deductions, resulting in audit deficiencies.

10. In response to the IRS audits, Paul began amending his existing customers' fraudulent Forms 1040 by preparing fraudulent amended returns (Forms 1040X), claiming that his customers are entitled to a refund based on a tax-protester theory known as the "claim of right theory." Under this frivolous theory only "profit" is taxable, and an individual's wages are not taxable because wages cannot be considered profit. Paul prepares the Forms 1040X "free of charge," but requires the customer to pay him a percentage of the amount refunded.

Paul's other Fraudulent or Deceptive Conduct

11. Paul has failed to keep and turn over to the IRS upon request his customer lists or copies of prepared returns.

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12. Paul has misrepresented to his customers his education and his qualifications to prepare tax returns and to represent customers before the IRS. Paul has falsely represented to his customers that he is a Certified Public Accountant and that he worked for the IRS.

13. Paul has failed to sign tax returns he prepares for customers.

14. Paul has failed to place his tax identification number on tax returns he prepares for customers.

15. Paul has impeded the proper administration of the tax laws by advising his customers to ignore IRS correspondence and IRS summonses, and to falsely tell the IRS that they lost records required to substantiate deductions.

Paul's Knowledge of the Illegality of his Scheme

16. Paul knows or should know that his scheme is illegal.

17. Paul has taken classes in accounting at North Seattle Community College and Green River Community College. Paul has taken finance classes at City University.

18. Paul worked for The Boeing Company as an accountant.

19. Paul worked in various accounting positions, including temporary accounting work for Accountants on Call, and billing for Garvey, Schubert & Barber.

20. Paul has been preparing federal income tax returns for individuals and small businesses since at least 1987.

21. Paul has referred customers to Codebusters.com, a website that espouses frivolous tax theories.

Harm to the United States

22. Paul prepared 174 individual federal income tax returns for the 2000 tax year. Of those 174 returns, 84% (147) claimed refunds based on the frivolous positions described above.

23. Paul prepared 236 individual federal income tax returns for the 2001 tax year. Of those 236 returns, 84% (199) claimed refunds based on the frivolous positions described above.

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(202) 307-0170

24. Paul prepared 157 individual federal income tax returns for the 2002 tax year. Of those 157 returns, 92% (145) claimed refunds based on the frivolous positions described above.

25. Of the 567 tax returns Paul prepared for the 2000, 2001, and 2002 tax years 391 have either been audited, are under audit, or are scheduled to be audited.

26. Preliminary audit results of 63 of these returns show total tax understatements of $212,344, or an average of $3,371 per return based on the frivolous positions described above. Based on these early estimates, understated tax liability resulting from Paul's preparation of 2000 through 2002 Forms 1040 is estimated at $1,318,061(3,371 x 391). The per-return average does not include tax returns of Paul's higher-income customers or customers with returns for multiple years, because those audits take more time. Thus, the estimated harm likely understates the actual harm. Some of the tax understatements may never be recovered by the IRS.

27. The IRS has also identified 78 Paul-prepared Form 1040X amended income tax returns, all of which claim a refund based on the frivolous claim of right theory. The total amount claimed from the 78 amended returns is $344,617. The IRS erroneously paid some of the 78 claimed refunds and may never be able to recover them.

28. Combining original and amended returns, the total understated tax liability caused by Paul's improper return-preparation services is conservatively estimated at $1,662,678 ($1,318,061 + $344,617).

29. Paul continues to prepare federal income tax returns. The IRS has received Paul-prepared federal income tax returns for the 2003 tax year.

Count I: Injunction Under 26 U.S.C. § 7408 for Violation of 26 U.S.C. § 6701

30. The United States incorporates by reference the allegations contained in paragraphs 1 through 29 above.

31. Section 7408 authorizes this Court to enjoin persons who have engaged in conduct subject to penalty under 26 U.S.C. § 6701 from engaging in further such conduct if the Court

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PO Box 7238
Washington, DC 20001
(202) 307-0170

finds that injunctive relief is appropriate to prevent recurrence of the conduct. Section 6701 imposes a penalty on any person who aids in the preparation of any portion of a return or other document, having reason to know that the portion will be used to assert a position under the internal revenue laws, and knowing the portion will result in an understatement of another person's tax liability.

32. Paul has prepared federal income tax returns that he knows will result in the understatement of another person's federal income tax liabilities. Unless enjoined by this Court, Paul is likely to continue to engage in this conduct. Injunctive relief is appropriate under 26 U.S.C. § 7408.

Count II: Injunction under § 7407

33. Plaintiff incorporates by reference the allegations contained in paragraphs 1 through 29 above.

34. 26 U.S.C. § 7407 authorizes a district court to enjoin an income tax return preparer from:

a. engaging in conduct subject to penalty under 26 U.S.C. § 6694 (which penalizes a return preparer who knowingly prepares or submits a return that contains an unrealistic position);

b. engaging in conduct subject to penalty under 26 U.S.C. § 6695 (which penalizes a return preparer who wilfully fails to sign a return when required, who fails to furnish an identifying number as required, or who fails to keep a customer list as required by 26 U.S.C. § 6107(b));

c. misrepresenting his experience or education as an income tax return preparer;

d. guaranteeing the payment of any tax refund or the allowance of any tax credit; or

e. engaging in any other fraudulent or deceptive conduct that substantially interferes with the proper administration of the internal revenue laws;

if the Court finds that injunctive relief is appropriate to prevent recurrence of such conduct. Additionally, if the Court finds that the preparer has continually or repeatedly engaged in such misconduct and if the Court finds that a narrower injunction (*i.e.*, prohibiting only that specific

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enumerated conduct) would not be sufficient to prevent that person's interference with the proper administration of the federal tax laws, the Court may enjoin the person from further acting as a federal income tax return preparer.

35. Paul has engaged in conduct subject to penalty under 26 U.S.C. § 6694 by preparing returns (Forms 1040) and claims for refund (Forms 1040X) based on frivolous and fraudulent deductions and the frivolous "claim of right" theory. The positions Paul asserts on income tax returns are frivolous and fraudulent. Paul knows that these positions do not have a realistic possibility of being sustained on the merits.

36. Paul has engaged in conduct subject to penalty under 26 U.S.C. § 6695 by failing to keep (and turn over to the IRS upon request) a customer list or copies of customer returns as is required by 26 U.S.C. § 6107(b).

37. Paul has engaged in conduct subject to penalty under 26 U.S.C. § 6695 by failing to sign all returns and place his tax identification number on all returns that he prepares for customers.

38. Paul has misrepresented his education and experience as an income tax return preparer by claiming to have worked for the IRS.

39. Paul has guaranteed to customers that he will get them tax refunds.

40. Paul has engaged in fraudulent and deceptive conduct that substantially interferes with the proper administration of the internal revenue laws. Paul has told his customers to lie to IRS agents concerning documentation to corroborate deductions taken on their Forms 1040.

41. Paul's actions described above fall within 26 U.S.C. §§ 7407(b)(1)(A), (B), (C), and (D), and are thus subject to injunction under § 7407.

42. Because of Paul's continual and repeated conduct subject to injunction under 26 U.S.C. § 7407 he should be permanently enjoined from acting as an income tax return preparer.

Count III: Injunction Under 26 U.S.C. § 7402

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Washington, DC 20001
(202) 307-0170

43. The United States incorporates herein by reference the allegations in paragraphs 1 through 42 above.

44. Paul, through the conduct described above, has engaged in conduct that interferes substantially with the administration and enforcement of the internal revenue laws. Unless enjoined by this Court he is likely to continue to engage in such conduct. His conduct causes irreparable injury to the United States for which the United States has no adequate remedy at law. The United States is entitled to injunctive relief under 26 U.S.C. § 7402(a) to prevent such conduct.

Appropriateness of Injunctive Relief

45. Unless enjoined, Paul is likely to continue to engage in the conduct described in paragraphs 1 through 44 above.

46. Paul's conduct, as described in paragraphs 1 through 44 above, causes irreparable harm to the United States and the United States has no adequate remedy at law. Specifically, Paul's conduct is causing and will continue to cause substantial revenue losses to the United States Treasury, some of which may never be recovered, thus resulting in a permanent loss. Unless Paul is enjoined, the IRS will have to devote substantial amounts of its limited resources to detecting and auditing future fraudulent Paul-prepared returns, thereby reducing the level of service that the IRS can give honest taxpayers.

47. If Paul is not enjoined, he likely will continue to engage in conduct subject to penalty under 26 U.S.C. §§ 6701, 6694, and 6695.

48. If Paul is not enjoined, he likely will continue to engage in conduct that interferes substantially with the administration and enforcement of the internal revenue laws.

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

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A. That the Court find that defendant Ronald M. Paul, individually and d/b/a The Tax Clinic engaged in conduct subject to penalty under 26 U.S.C. § 6701 and that injunctive relief is appropriate under 26 U.S.C. § 7408 to prevent Paul from engaging in any further such conduct;

B. That the Court find that defendant Ronald M. Paul, individually and d/b/a The Tax Clinic, engaged in conduct subject to penalty under 26 U.S.C. §§ 6694 and 6695, and that injunctive relief is appropriate under 26 U.S.C. § 7407 to prevent Paul from acting as an income tax return preparer;

C. That the Court find that defendant Ronald M. Paul, individually and d/b/a The Tax Clinic, misrepresented his eligibility and qualifications to practice before the IRS and that injunctive relief is appropriate under 26 U.S.C. § 7407 to prevent Paul from engaging in further such conduct;

D. That the Court find that defendant Ronald M. Paul, individually and d/b/a The Tax Clinic, guaranteed the refund of federal income tax to his customers, and that injunctive relief against Paul is appropriate pursuant to 26 U.S.C. § 7407;

E. That the Court find that defendant Ronald M. Paul, individually and d/b/a The Tax Clinic, failed to sign and place his tax identification number on all income tax returns he prepares for customers, and that injunctive relief against Paul is appropriate pursuant to 26 U.S.C. § 7407.

F. That the Court find that defendant Ronald M. Paul, individually and d/b/a The Tax Clinic, engaged in conduct that interferes with the enforcement of the internal revenue laws, and that injunctive relief against Paul is appropriate pursuant to 26 U.S.C. § 7402(a) and 26 U.S.C. § 7407 to prevent recurrence of that conduct;

G. That the Court, pursuant to 26 U.S.C. § 7407, enter a permanent injunction prohibiting defendant Ronald M. Paul, individually and d/b/a The Tax Clinic, from acting as an income tax return preparer;

U.S. Department of Justice
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H. That the Court, pursuant to 26 U.S.C. § 7402, enter a permanent injunction prohibiting defendant Ronald M. Paul, individually and d/b/a The Tax Clinic, from providing any tax advice or services for compensation, including preparing or helping to prepare returns for others, providing consultative services, or representation of customers before the IRS;

I. That the Court, pursuant to 26 U.S.C. § 7408 enter a permanent injunction prohibiting defendant Ronald M. Paul, d/b/a The Tax Clinic, from directly or indirectly further engaging in any conduct subject to penalty under 26 U.S.C. § 6701, *i.e.*, assisting others in the preparation of any tax forms or other documents to be used in connection with any material matter under the internal revenue laws that Paul knows, if so used, will result in the understatement of another person's tax liability;

J. That the Court, pursuant to 26 U.S.C. §§ 7402 enter an injunction requiring Paul to contact all persons for whom he prepared federal income tax returns or any other federal tax forms after January 1, 2000 and inform those persons of the entry of the Court's findings concerning the falsity of his representations, the falsity of the tax returns prepared on their behalf, the possibility of the imposition of penalties against them, the possibility that the United States may seek to collect any additional federal income taxes, penalties, and interest which they may owe, and the entry of the permanent injunction against Paul;

K. That the Court, pursuant to 26 U.S.C. §§ 7402 and 7407 enter an injunction requiring Paul to turn over to the United States all copies of returns or claims for refund and the name and taxpayer identification number of all customers for whom he prepared returns or claims for refund after December 31, 1999;

L. That the Court enter an injunction ordering that the United States, to monitor Defendant's compliance with this injunction, may engage in post-judgment discovery in accordance with the Federal Rules of Civil Procedure; and

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M. That the Court grant the United States such other and further relief as the Court deems appropriate.

Dated: April 20, 2001

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