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IN THE UNITED STATES DISTRICT COURT FOR THE

CENTRAL DISTRICT OF CALIFORNIA

UNITED STATES OF AMERICA, Plaintiff, v. ARNE R. RISTOL, Individually and d/b/a Kismet Trust, Defendant.	LACV03-7015 MMM (CTx) Civil No. **Complaint for Permanent Injunction**

Plaintiff, the United States of America, complains and alleges against the defendant, Arne R. Ristol, as follows:

Jurisdiction

1. This Court has jurisdiction over this action to enjoin Ristol from violating the Internal Revenue Code (I.R.C.), 26 U.S.C., pursuant to 28 U.S.C. §§ 1340 and 1345 and I.R.C. §§ 7402(a), 7407 and 7408.

Venue

2. Venue is proper in this Court pursuant to 28 U.S.C. §§ 1391 and 1396 because Ristol resides in this judicial district.

Nature of Action

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

4. The United States is bringing this complaint to permanently enjoin Ristol from the following actions:

(a) acting as an income tax return preparer (as defined in I.R.C. § 7701(a)(36));

(b) organizing or selling abusive tax shelters, plans, or arrangements that advise or encourage taxpayers to attempt to evade the assessment or collection of their correct federal tax;

(c) engaging in any activity subject to penalty under I.R.C. §§ 6700, 6701, or 6694; and

(d) engaging in conduct that substantially interferes with the enforcement of the internal revenue laws and from promoting any false tax scheme.

Defendant

5. Defendant Arne R. Ristol resides in Riverside County, California. He owns and operates a tax planning and return preparation service under the name of the Kismet Trust.

Defendant's Activities

6. Ristol sells "Private, Non-Statutory Associated Unincorporated Business Trust Organizations" ("UBTOs"), and prepares federal income tax returns for the trusts and trust purchasers.

7. Ristol advises his customers to transfer their personal and business assets to UBTOs established with Ristol's assistance.

8. Ristol advises his customers to obtain an IRS Employer Identification Number (EIN) for each trust and complete a form which is entitled "Trust Organization Indenture, Contract and Declaration of Trust" for each trust the customer desires to create.

9. As part of the trust arrangements, a purported UBTO is established to hold the taxpayer's principal business activity. The taxpayer's business equipment and other business assets are purportedly transferred to that trust in exchange for "Trust Certificate Units," which are also known as "Units of Beneficial Interest" ("UBI").

10. The trust recognizes no gain on the transfer described in the preceding paragraph because the equipment and assets are improperly valued using a "stepped-up" basis, *i.e.,* the fair market value of the assets on the transfer date.

11. Ristol advises his customers to appoint as trustees of the UBTOs persons other than themselves, such as a close friend or family member. Ristol is the trustee for the majority of the trusts which he creates.

12. The taxpayer who purchases the UBTOs from Ristol then contracts with the UBTO to act as the trust's "General Trust Manager." Ristol advises the manager to accept little or no compensation in order to reduce or eliminate the Manager's federal income and social security tax liability.

13. The "Manager's Agreement" expressly states that the Manager has the power to: (1) buy, sell, lease, or rent property; (2) make improvements or alterations to property; (3) subdivide property; (4) seek zoning, rezoning, or variance for property use; (5) hire employees, consultants, caretakers, property managers, etc.; and (6) open and be signatories on checking and savings bank accounts, and hold safety deposit boxes for the trust.

14. The beneficiaries of the UBTOs promoted and sold by Ristol are the "holders of the Trust Certificate Units in the Trust Organization."

15. The taxpayers who transfer their assets to UBTOs continue to use all of their personal and business property as their own. For example, the taxpayers continue to exercise sole signature authority and control over their businesses' bank accounts and other property.

16. Thereafter, at defendant's direction, the taxpayers' personal living expenses are deducted on federal income tax returns filed by the trusts (IRS Forms 1041). These personal living expenses include many items that individual taxpayers are not entitled to deduct, such costs of maintaining the customer's personal residence, utility bills, and the like.

17. Additionally, the federal income tax returns (IRS Forms 1040) filed by the defendant's customers report as income only the relatively nominal amounts purportedly received in connection with their "duties" as "General Trust Manager" of the "unincorporated business trust organizations."

18. By reporting these much smaller amounts, rather than the much greater income that the taxpayers actually receive from the operation of their businesses, the taxpayers who purchase UBTOs from the defendant underreport and underpay their true liability for federal income and self-employment taxes.

19. Ristol has made false or fraudulent statements regarding the tax advantages available to purchasers of these UBTOs. Some of these false or fraudulent statements are contained in the informational material included in the trust packages that the defendant sells. Examples of defendant's false or fraudulent statements in such materials includes the following:

- That customers could transfer their residences to trusts and deduct all expenses relating to the upkeep of those residences, including utilities, repairs, maintenance and depreciation;
- A taxpayer can obtain an "income-splitting advantage" by assigning the income from his business to a UBTO and remaining in a lower income tax bracket;
- That federal income and self-employment taxes could be reduced or eliminated by placing the customer's business and real property in a UBTO;
- That the assets transferred to their UBTOs would receive a stepped-up basis;
- "One of the most useful advantages of a trust is the reduction or elimination of income and estate taxes."
- That customers could exchange, tax-free, their assets for "Trust Certificate Units";
- The use of "Trust Certificate Units" or "Certificates of Capital Unit" eliminates the application of the gift tax; and
- That customers using the defendant's trusts could properly claim deductions for their personal medical expenses, personal automobile liability insurance, as well as other personal living expenses.

20. Ristol charges his clients a fee of approximately $5,000.00 for the trust package. His promotional materials advise potential clients and trust purchasers not to cooperate with the IRS, and the "trust" documents which he prepares impose substantial penalties on trustees who do so.

21. Ristol has prepared Form 1041 income tax returns for trusts that improperly claimed deductions and failed to report income based on his abusive

trust scheme. He has also underreported the capital gains realized by individual taxpayers by improperly increasing the basis of assets transferred by trust purchasers to their trusts.

22. Defendant has engaged in the preparation or presentation of a portion of a tax return or other document in connection with a matter arising under the internal revenue laws, knowing that such portion will be used in connection with a material matter arising under the internal revenue laws, and knowing that such portion (if so used), would result in an understatement of the liability for tax of another person. The defendant's conduct is thus subject to penalty under I.R.C. § 6701.

Harm to the Public

23. Ristol's customers have been harmed by his promoting abusive trusts and preparing false and fraudulent tax returns because his customers have paid him significant sums to establish worthless trusts and to prepare tax returns that understate their income tax liabilities.

24. The United States is harmed because Ristol's customers are not paying their fair share of taxes to the United States Treasury. To date, Ristol is known to have prepared a total of 319 federal income tax returns for the 2000 and 2001 tax years. Based upon the IRS audits to date, the Internal Revenue Service has projected a loss of more than $9 million in tax revenue to the Treasury. Moreover, some of those audit deficiencies may never be collected, resulting in a permanent loss to the United States Treasury.

25. The United States is also harmed because the IRS is forced to devote some of its limited resources to identifying and recovering this lost revenue from Ristol's customers, thereby reducing the level of service that the IRS can give to honest taxpayers. Moreover, given the IRS's limited resources, identifying and recovering all revenues lost from Ristol's scheme may be impossible.

26. In addition to the harm caused by his advice and services, Ristol's activities undermine public confidence in the fairness of the federal tax system and incite non-compliance with the internal revenue laws.

Count I

Injunction under I.R.C. § 7407

27. Plaintiff incorporates by reference the allegations in paragraphs 1 - 26.

28. Section 7407 of the Internal Revenue Code authorizes a district court to enjoin an income tax return preparer from:

> (a) engaging in conduct subject to penalty under I.R.C. § 6694 (which penalizes a tax return preparer who prepares or submits a return that contains an unrealistic position),
>
> (b) engaging in conduct subject to penalty under I.R.C. § 6695 (which penalizes a return preparer who fails to keep a list of clients or turn over the list to the IRS upon request),
>
> (c) misrepresenting his experience or education as a tax return preparer, or
>
> (d) 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 a preparer has continually or repeatedly engaged in such conduct, and the court finds that a narrower injunction (*i.e.*, prohibiting only that specific enumerated conduct would not be sufficient to prevent that person's interference with the proper administration of the internal revenue laws, the court may enjoin the person from further acting as a federal income tax return preparer.

29. Ristol has prepared more than 150 Form 1041 income tax returns claiming deductions (on behalf of trusts that he created for customers) for the nondeductible personal expenses of the customers who established the trusts.

30. Also, Ristol has prepared Form 1041 income tax returns for sham or grantor trusts which report the income that was actually earned by, or attributable to, the trust purchaser. In so doing, defendant asserted positions which he knew or should have known were unrealistic within the meaning of I.R.C. § 6694.

31. Specific examples of the unrealistic positions asserted by Ristol include (but are not limited to) the following:

a. Taxpayers in Colorado agreed to IRS proposed adjustments which increased their gross income by more than $140,000.00. Their Form 1040 income tax return, which was prepared by Ristol, understated the taxpayers' capital gains because the taxpayers' assets were improperly valued at their fair market value at the time they were transferred to " trusts" which the taxpayers purchased from Ristol.

b. Ristol sold four trusts and a limited partnership to Washington taxpayers and prepared returns for them which reduced their gross income from more than $800,000.00 to approximately $11,000.00 apiece. The total IRS proposed adjustments for one tax year exceeded $840,000.

32. Ristol has attempted to delay or obstruct the IRS investigation into his abusive trust scheme and the IRS audits of the Form 1041 income tax returns that he prepared, by refusing to provide financial records and information for the individual taxpayers who purchased his trusts, and by advising his clients not to provide the requested records and information to the IRS.

33. Ristol's actions, as described above, fall within I.R.C. §§ 7407(b)(1)(A) and (D), and are thus subject to injunction under Section 7407.

34. Ristol's repetition of conduct which was subject to injunction under I.R.C. § 7407, even after he was advised that his conduct was subject to penalty and that his positions were frivolous, combined with his other conduct described in this complaint, requires that he be permanently enjoined from acting as a federal income tax return preparer.

Count II

Injunction under I.R.C. § 7408

35. Plaintiff incorporates by reference the allegations in paragraphs 1 - 34.

36. I.R.C. § 7408(a) authorizes a district court to enjoin any person from engaging in conduct subject to penalty under Sections 6700 and 6701 of the Code, if injunctive relief is appropriate to prevent recurrence of that conduct.

37. I.R.C. § 6700 imposes a penalty on any person who, in connection with organizing, promoting, or selling a plan or arrangement, makes or furnishes a statement about the tax consequences of participating in the plan or arrangement which the person knows or has reason to know is false or fraudulent as to any material matter.

38. I.R.C. § 6701 imposes a penalty on any person who, among other conduct, knowingly aids or assists in the understatement of the tax liability of another person on a tax return, claim for refund, or other document.

39. The "trusts" that Ristol creates for his customers are sham trusts which are devoid of economic substance. Alternatively, the "trusts" (1) are grantor trusts that may be disregarded for federal income tax purposes; or (2) fail to comply with the requirements of California law.

40. Defendant knew or had reason to know that the trust arrangements or packages which he sold, as well as the other materials described above, contained false or fraudulent statements within the meaning of I.R.C. § 6700 because of his training and experience as a federal income tax return preparer.

41. Defendant has engaged in conduct subject to penalty under I.R.C. §§ 6700 and 6701in connection with the organization and promotion of the trust packages and arrangements described above, and prepared tax returns relating to the trusts.

42. Unless enjoined by this court, Ristol is likely to continue to engage in such conduct. Injunctive relief is therefore appropriate under I.R.C. § 7408.

Count III

Injunction under I.R.C. § 7402 for Unlawful Interference with Enforcement of the Internal Revenue Laws and Appropriateness of Injunctive Relief

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

44. I.R.C. § 7402 authorizes a court to issue orders of injunction as may be necessary or appropriate for the enforcement of the internal revenue laws.

45. Ristol, through the actions described above, has engaged in conduct that interferes substantially with the enforcement of the internal revenue laws.

46. The trust packages that the defendant sold instructed or encouraged taxpayers to file federal individual and trust income tax returns that improperly and illegally reduced their federal income, self-employment, and social security tax liabilities.

47. If Ristol is not enjoined, the United States will suffer irreparable harm because the loss caused by Ristol will continue to increase.

48. While the United States will suffer irreparable injury if Ristol is not enjoined, Ristol will not be harmed by being compelled to obey the law.

49. The public interest would be advanced by enjoining Ristol because an injunction will stop his illegal conduct and the harm that conduct is causing to the United States Treasury

50. If Ristol is not enjoined, he is likely to continue to interfere with the enforcement of the internal revenue laws.

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

A. That the Court find that Ristol has engaged in conduct subject to penalty under I.R.C. §§ 6700, 6701 and 6694, and that injunctive relief under I.R.C. §§ 7407 and 7408 is necessary and appropriate to prevent a recurrence of that conduct;

B. That the Court find that Ristol has engaged in conduct interfering with the enforcement of the internal revenue laws, and that injunctive relief is appropriate to prevent the recurrence of that conduct pursuant to the Court's inherent equity powers and under I.R.C. § 7402(a);

C. That this Court, pursuant to I.R.C. § 7407, enter a permanent injunction prohibiting Ristol from acting as a federal income tax return preparer;

D. That this Court, pursuant to I.R.C. §§ 7402(a) and 7408, enter a permanent injunction prohibiting Ristol, individually and doing business under any other name or using any other entity, and his representatives, agents, servants, employees, attorneys, and those persons in active concert or participation with him, from directly or indirectly, by means of false, deceptive, or misleading commercial speech:

a. Engaging in activity subject to penalty under I.R.C. § 6700, including organizing or selling a plan or arrangement and making a statement regarding the excludibility of income that he knows or has reason to know is false or fraudulent as to any material matter;

b. Engaging in activity subject to penalty under I.R.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;

c. Selling any type of asset protection device, including trusts, limited liability corporations, or similar arrangements, advocating noncompliance with the income tax laws or tax evasion, misrepresenting the tax savings realized by using the arrangement, or concealing the receipt of income or location of assets from the IRS;

d. Engaging in any other activity subject to penalty under I.R.C. §§ 6700 or 6701; and

e. Engaging in other conduct interfering with the enforcement of the internal revenue laws;

E. That this Court, pursuant to I.R.C. §§ 7402(a) and 7408, enter an injunction requiring Ristol to contact by mail all individuals who have purchased his abusive tax shelters, plans, arrangements, or programs, or any other shelter, plan, or program in which Ristol has been involved, and inform those individuals of the Court's findings concerning the falsity of Ristol's representations and attach a copy of the permanent injunction against Ristol;

F. That this Court, pursuant to I.R.C. §§ 7402(a) and 7408, enter an injunction requiring Ristol to produce to the United States any records in his possession or to which he has access, identifying by name, Social Security Number, address, and telephone number all individuals who have purchased his abusive tax plans, arrangements, or programs, or any other shelter, plan, or program in which Ristol has been involved;

G. That this Court retain jurisdiction over the defendant, Arne R. Ristol, individually and doing business as Kismet Trust, and this action for the purpose of enforcing any permanent injunction entered against defendant;

H. That the United States be entitled to conduct all discovery permitted under the Federal Rules of Civil Procedure for the purpose of monitoring defendant's compliance with the terms of any permanent injunction entered against defendant; and.

I. That this Court grant the United States such other relief, including costs, as is just and equitable.

Dated this 26th day of September, 2003.

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