

**FILED COPY**

1 DEBRA W. YANG  
 2 United States Attorney  
 3 SANDRA BROWN  
 4 Assistant United States Attorney  
 5 Chief, Tax Division  
 6 EVAN J. DAVIS (SBN pending)  
 7 Assistant United States Attorney  
 Federal Building, Room 7211  
 300 North Los Angeles Street  
 Los Angeles, California 90012  
 Telephone: (213) 894-2400  
 Facsimile: (213) 894-0115  
 E-mail: [evan.davis@usdoj.gov](mailto:evan.davis@usdoj.gov)

8 MICHAEL R. PAHL  
 Mn. Bar. No. 0234539  
 9 MICHAEL J. ROESSNER  
 N.J. Bar No. 016912000  
 10 Trial Attorney, Tax Division  
 U.S. Department of Justice  
 11 Post Office Box 7238  
 Washington, D.C. 20044  
 12 Telephone: (202) 514-6488  
 Facsimile: (202) 514-6770  
 13 E-mail: [michael.r.pahl@usdoj.gov](mailto:michael.r.pahl@usdoj.gov)  
 E-mail: [michael.j.roessner@usdoj.gov](mailto:michael.j.roessner@usdoj.gov)

Attorneys for the United States

IN THE UNITED STATES DISTRICT COURT  
FOR THE CENTRAL DISTRICT OF CALIFORNIA

18 UNITED STATES OF AMERICA,

19 Plaintiff,

20 v.

21 STEPHEN DRAKE,  
 individually and doing business as,  
 22 BENECORP, LLC,

23 and

24 KENNETH SORENSON,  
 individually and doing business as,  
 25 BENECORP, LLC, and  
 SORENSON & SORENSON, CPAs,

26 Defendants.

27 *Complaint*

28 1681393.7

2006 AUG -2 PM 4: 24

CLERK U.S. DISTRICT COURT  
CENTRAL DIST. OF CALIF.  
LOS ANGELES

BY \_\_\_\_\_

06CV06-4831

JSI

VBA

**Complaint for  
Permanent Injunction**

Civ. No.

1  
2 This is a civil action brought by the United States to permanently enjoin  
3 Stephen Drake, individually and doing business as Benecorp, LLC, from  
4 promoting a tax-fraud scheme by which members of the Santa Ynez Band of the  
5 Chumash Indian Tribe illegally take false deductions and pay federal income tax  
6 owed on their per capita distributions of casino proceeds. The suit also seeks to  
7 permanently enjoin Kenneth Sorenson, individually and doing business as  
8 Benecorp, LLC, and as an accountant for Sorenson & Sorenson, CPAs, from  
9 promoting that tax-fraud scheme and from preparing and filing false federal  
10 income tax returns and forms for the Band and for Band members based on the  
11 scheme.

### 12 Nature of Action

13 1. The Santa Ynez Band of the Chumash Indian Tribe operates the  
14 Chumash Casino Resort in Santa Ynez, California. Defendants Drake and  
15 Sorenson promote and operate a scheme (hereafter referred to as "the Benecorp  
16 tax-fraud scheme") that helps some members of the Santa Ynez Band claim bogus  
17 federal income tax deductions. The defendants cause their customers to use sham  
18 entities (limited liability companies, also known as "LLCs") and sham transactions  
19 to create a circular flow of funds of the customers' casino distributions from the  
20 Santa Ynez Band through the customers' sham LLCs, through the defendants'  
21 bank accounts, and back to the customers. The defendants also cause the Santa  
22 Ynez Band to improperly fail to withhold required federal taxes from per capita  
23 distributions paid to defendants' customers. The fees the defendants retain from  
24 the fraudulent round-trip flow of funds skim off most of the customers' purported  
25 tax savings.

1           2. Under the Benecorp tax-fraud scheme the defendants help each of their  
2 customers set up a single-member LLC. Then defendants cause the Santa Ynez  
3 Band to pay each customer's annual per capita casino-gaming distribution directly  
4 to the customer's sham LLC, rather than to the customer. Defendants also  
5 illegally caused the Santa Ynez Band to not withhold most of the federal income  
6 tax required by law to be withheld from the distribution.

7           3. After the Band makes the per capita distribution to the customer's LLC,  
8 defendants cause the LLC to pay the entire distribution to Drake and Sorenson's  
9 company, Benecorp. Part of this payment to Benecorp is purportedly a  
10 "consulting fee" to Benecorp for its purported "management" of the customer's  
11 LLC. In fact the customers' LLCs are shams that do not engage in any business,  
12 and Benecorp provides no real management services for the LLCs, other than  
13 handling the circular flow of funds. The defendants and their customers make no  
14 attempt to justify why the remaining part of the customer's per capita distribution  
15 (*i.e.*, the part exceeding the purported consulting fee) is paid to Benecorp.

16           4. As part of the Benecorp tax-fraud scheme, defendants cause their  
17 customers to deduct the purported management fees as business expenses on their  
18 federal income tax returns, thereby offsetting most of the customers' taxable  
19 income from the per capita distributions. Defendants cause Benecorp to transfer  
20 to their customers the casino-distributions that the customers' LLCs transferred to  
21 Benecorp, less fees that the defendants retain for operating the scheme.  
22 Defendants falsely claim that part of the transfer to the customers is a loan.  
23 Defendants are unable to explain the reason for the transfer of the remaining part  
24 of the funds to the customers

25           5. Thus, under the scheme each customer receives his or her per capita  
26 distribution, less the amount defendants retain as fees and less any taxes that are  
27

1 withheld. But by claiming (at defendants' direction and with defendants'  
2 assistance) a bogus tax deduction for the sham management fee that the LLC  
3 purportedly pays to Benecorp, the customer fails to pay federal income tax on  
4 most of his or her per capita distribution. The customer's purported federal  
5 income tax saving from the bogus deduction exceeds the fees retained by  
6 defendants. And when the Band failed to withhold required taxes on the per capita  
7 distributions, the customer got the purported tax savings immediately, without  
8 having to wait to file his or her federal income tax return.

9 6. In 2003 and 2004, 32 of the 156 Santa Ynez Band members who receive  
10 per capita distributions participated in the Benecorp tax-fraud scheme.

11 7. This suit is brought to enjoin Drake from:

- 12 a. organizing or selling tax shelters, plans, or arrangements that  
13 advise or assist customers to attempt to evade the assessments  
14 or collection of their correct federal tax, including the  
15 Benecorp tax-fraud scheme described below;  
16 b. engaging in activity subject to penalty under I.R.C. §§ 6694,  
17 6700, 6701, or any other penalty provision of the IRC; and  
18 c. engaging in other conduct that interferes with the  
19 administration or enforcement of the internal revenue laws.

20 8. This suit is brought to enjoin Sorenson from:

- 21 a. organizing or selling tax shelters, plans, or arrangements that  
22 advise or assist customers to attempt to evade the assessments  
23 or collection of their correct federal tax, including the  
24 Benecorp tax-fraud scheme described below;  
25 b. preparing or filing federal income tax returns, amended returns,  
26 or other related documents and forms for others based on the  
27 Benecorp tax-fraud scheme;  
28 c. assisting in the preparation of federal income tax returns or  
forms that he knows will, if used, result in understating other  
persons' federal tax liability;

- 1 d. engaging in activity subject to penalty under I.R.C. §§ 6694,  
2 6700, 6701, or any other penalty provision of the IRC; and  
3 e. engaging in other conduct that interferes with the  
4 administration or enforcement of the internal revenue laws.

#### Jurisdiction and Venue

5 9. Jurisdiction is conferred on this Court by 28 U.S.C. §§ 1340 and 1345  
6 and Internal Revenue Code (IRC) (26 U.S.C.) §§ 7401, 7402(a), 7407, and 7408.

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

#### Defendants

11  
12 11. Defendant Kenneth Sorenson resides in Buellton, California, within this  
13 district.

14 12. Sorenson conducts business as a certified public accountant through  
15 Sorenson & Sorenson, CPAs, in Solvang, California, within this district.

16 13. Defendant Stephen Drake, a certified public accountant and certified  
17 financial planner, resides in Prescott, Arizona and conducts business through  
18 Benecorp, LLC, in Prescott, Arizona and Solvang, California, within this district.

19 14. Drake and Sorenson's customers are members of the Santa Ynez Band  
20 of Chumash Indians, who reside at the Santa Ynez Reservation in Santa Barbara  
21 County, California, within this district.

22 15. Because Sorenson resides in this district, Drake and Sorenson conduct  
23 business in this district, Drake and Sorenson's customers who participated in the  
24 Benecorp tax-fraud scheme reside in this district, and a substantial part of the  
25 events giving rise to this case occurred in this district, venue is proper in this  
26 Court under 28 U.S.C. §§ 1391 and 1396.

## **The Santa Ynez Band's Per Capita Distribution of Casino Proceeds**

16. The Santa Ynez Band owns and operates the Chumash Casino Resort and makes per capita distributions of casino earnings to band members.

17. In 2005, the Santa Ynez Band distributed \$428,969 in casino earnings to each band member. In 2004 it distributed \$340,704 to each member.

18. Under the Internal Revenue Code, Native Americans are required to pay federal income tax on distributions of casino proceeds and tribes are required to withhold federal income tax when making distributions of casino proceeds.

19. Under the Benecorp tax-fraud scheme, Drake and Sorenson falsely advised Santa Ynez Band members that they could legally reduce federal income tax on distributions of casino proceeds by claiming deductions for sham management.

### **Drake and Sorenson's CapNet7 Plan**

20. In 2003 defendants Drake and Sorenson developed a purported deferred-income plan to be offered by Benecorp to members of Native American tribes. In 2003 defendants and Benecorp began promoting that plan, known as the "CapNet7 plan" to Native American tribes and tribe members.

21. Drake is the president and Sorenson is the vice president of Benecorp, LLC.

22. Drake and Sorenson told Native American tribes and tribe members that they could use the CapNet7 plan to maximize tribe members' income (derived largely or exclusively from per capita distributions), by deferring their

1 current income from casino-gaming distributions and thereby reducing their  
2 current federal income tax.

3 23. Drake and Sorenson promote the CapNet 7 plan at their website,  
4 www.CapNet7.com, in articles in *Indian Gaming*, and at National Indian Gaming  
5 Association and other conferences of interest to Native American tribes and tribe  
6 members.  
7

8 24. Drake and Sorenson's CapNet7 plan requires tribe members to defer  
9 receipt of a portion of their per capita distribution until some point in the future or  
10 until after death.

11 25. Under Drake and Sorenson's CapNet7 plan, the deferred income  
12 is paid to the tribe member or his beneficiary after the tribe member dies or after a  
13 prearranged deferral period expires.  
14

15 26. Drake and Sorenson assert that under the CapNet7 plan, the deferred  
16 portion of the per capita distribution is not taxable to the tribe member until it is  
17 distributed to the tribe member or his or her beneficiary.

18 27. Under the Indian Gaming Regulatory Act, because Native American  
19 tribes, not individual tribe members, have the exclusive authority to determine  
20 how to distribute casino proceeds, individual tribe members are not able to use the  
21 CapNet7 plan unless the plan is approved and implemented by the tribal  
22 government.  
23

24 28. In late 2003 and early 2004, Drake and Sorenson presented the  
25 CapNet7 plan to the Santa Ynez Band.

26 29. On information and belief, the Santa Ynez Band refused to adopt the  
27

1 CapNet7 plan because, among other reasons, it had not been approved by the IRS.

2 . 30. On information and belief, as part of the promotion of the CapNet7  
3 plan to the Santa Ynez Band and other Native American tribes, Drake and  
4 Sorenson falsely stated that individual Band members could legally reduce their  
5 federal income taxes and increase their monthly cash flow from per capita  
6 distributions by participating in the Benecorp tax-fraud scheme discussed below.  
7

### 8 **Overview of the Benecorp Tax-Fraud Scheme**

9 31. Drake and Sorenson began promoting the Benecorp tax-fraud scheme  
10 to Santa Ynez Band members in July of 2003.

11 32. As part of the scheme, Drake and Sorenson advise and assist Band  
12 members to form LLCs so that Band members can claim they are engaged in a  
13 legitimate business activity as "advisor[s] to Indian tribes" considering adopting  
14 the CapNet7 plan.  
15

16 33. Drake and Sorenson assert that the Band members' LLCs are engaged  
17 in a legitimate business activity because they undertake "marketing activities,"  
18 including lobbying the Santa Ynez Band to adopt the CapNet7 plan.

19 34. Drake and Sorenson assert that Band members' LLCs are engaged in  
20 a legitimate business activity because Band members' LLCs enter into a contract  
21 with Benecorp entitling the LLC to an "Incentive Fee" if Benecorp contracts with  
22 the Santa Ynez Band or other Native American tribes to implement the CapNet7  
23 plan.  
24

25 35. Under the "Incentive Fee" plan entered into between Band members'  
26  
27

1 LLCs and Benecorp, Benecorp purports to pay the Band members' LLCs 10% of  
2 the amount Benecorp earns from any Native American tribe that enters into the  
3 CapNet7 plan, "multiplied by the percentage of such amount that is derived from  
4 the Tribal Agreement [adopting the CapNet7 plan] attributable to the tribal  
5 member's LLC."

6           36. Drake and Sorenson assert that any payments under the Incentive Fee  
7 arrangement will be offset by "advances" made by Benecorp to the LLCs  
8 discussed below.  
9

10           37. The "advances" Benecorp makes to the LLCs are shams. They are  
11 simply the final step of the circular flow of casino distributions designed to create  
12 bogus tax deductions.

13           38. On information and belief, no tribes have adopted the CapNet 7 plan  
14 and thus the tribe members' LLCs are not entitled to any "incentive fee" from  
15 Benecorp.  
16

17           39. On information and belief, because no tribes have adopted the  
18 CapNet 7 plan, Benecorp has not paid an "incentive fee" to any of the customers'  
19 LLCs. Moreover, the amounts of the purported advances bear no relationship to  
20 any work or services provided by Band members or their LLCs to Benecorp.  
21 Rather, the advances, like the earlier sham transactions in the circular flow of  
22 casino distributions, are a thinly veiled disguise intended to conceal the  
23 defendants' efforts to help customers evade federal income taxes.

#### 24           **The Mechanics of the Benecorp Tax-Fraud Scheme**

25           40. Under the Benecorp tax-fraud scheme, Drake and Sorenson furnish  
26 documents to Band members and assist them in forming single-member LLCs.  
27

1           41. After Sorenson assists the Band members in setting up the LLCs, the  
2 Band members purportedly assign their per capita distribution of casino proceeds  
3 to the LLC.

4           42. In addition to helping Band members form LLCs, which use  
5 Sorenson's address as their place of business, Sorenson sets up bank accounts for  
6 the LLCs, with Sorenson having signature authority on the accounts.  
7

8           43. After Sorenson assists each Band member in setting up an LLC, the  
9 LLC  
10 enters into a purported business consultation agreement with Benecorp, which  
11 Drake signs on behalf of Benecorp.

12           44. The purported business consultation agreement provides that Benecorp  
13 will supply business management and consultation services to the Band member's  
14 LLC, in return for a monthly payment, referred to as a "consulting fee."  
15

16           45. Under the scheme, the Band member's per capita distribution is first  
17 transferred to the LLC, and then paid to Benecorp. Part of the payment is  
18 disguised as a sham "consulting fee." The defendants and the participating  
19 customers have no explanation as to why the remainder of the per capita  
20 distribution is also paid to Benecorp.

21           46. Under the purported business-consultation agreement, Band members  
22 are required to pay Benecorp a minimum "consulting fee" of \$20,000 a month  
23 (\$240,000 a year), but in fact they pay the full amount of their per capita  
24 distribution to Benecorp.  
25  
26  
27

1           47. Drake has falsely asserted that the Band members' LLCs have a  
2 legitimate business purpose, and that the LLCs can therefore deduct payments  
3 made to Benecorp for "consulting fees"

4           48. Under the Benecorp tax-fraud scheme, Sorenson prepared federal  
5 income tax returns for some Band-member customers on which Sorenson deducted  
6 the "consulting fee" purportedly paid to Benecorp as a business expense.  
7

8           49. Band-member customers' LLCs also enter into an agreement with a  
9 sham entity known as Native American Member Services LLC ("NAMS"), which  
10 purports to lend money to the Band members' LLCs on purported revolving line of  
11 credit.

12           50. To the extent, if any, that NAMS exists, it is managed and controlled by  
13 Drake and has the same business address as Benecorp. On information and belief  
14 NAMS is wholly controlled by Drake and is used by the defendants to effectuate  
15 the sham transactions of the Benecorp tax-fraud scheme.

16           51. The purported revolving line of credit agreement between each Band  
17 member's LLC and NAMS provides that the line of credit is secured by a life  
18 insurance policy for the Band member.  
19

20           52. The purported line of credit agreement further provides that the Band  
21 member will name NAMS or Benecorp as the beneficiary of the insurance policy  
22 as security for the line of credit.

23           53. Drake and Sorenson falsely assert that the purported loans from NAMS  
24 to the Band members' LLCs (which in reality are simply transfers of the Band  
25 members' casino-gaming distributions back to themselves) are bona fide debt  
26 obligations of the Band members' LLCs.  
27

1           54. Under the Benecorp tax-fraud scheme, Band members do not in fact  
2 turn over their per capita distribution to Benecorp, but retain full benefit of the per  
3 capita distribution (minus the amounts the defendants keep for themselves as a fee  
4 for implementing the scheme), which is merely channeled back to the Band  
5 members through the sham revolving line of credit.  
6

7           55. Under the scheme Band members' per capita distributions flow in  
8 circular fashion (1) from the Santa Ynez Band's general account to the Santa Ynez  
9 Band's per capita distribution account in Mid-State Bank; (2) then to the Band  
10 members' LLC accounts at Mid-State Bank (set up and controlled by Sorenson);  
11 (3) then to Benecorp's account at Mid-State Bank (controlled by Drake); and (4)  
12 finally from the Benecorp account to the Band member's personal account as a  
13 purported "advance" from NAMS (controlled by Drake), even though NAMS  
14 never has possession of the funds.

15           56. On information and belief, the transactions that transfer the Band  
16 member's per capita distribution through the Drake and Sorenson-controlled  
17 entities, and then back to the Band member (minus the defendants' fees), occur on  
18 the same day through the multiple transactions at Mid-State Bank.  
19

20           57. As part of the Benecorp tax-fraud scheme, participating Band members'  
21 LLCs transferred a total of \$9,418,938 in per capita casino gaming distributions to  
22 Benecorp's bank account in 2004.

23           58. On information and belief, before Drake and Sorenson began  
24 promoting the scheme the Santa Ynez Band properly withheld income tax for all  
25 per capita distributions and issued 1099 forms to Band members correctly listing  
26 their distribution and withheld tax. For Band members who are not participating  
27

1 in the scheme, Sorenson, on behalf of the Santa Ynez Band, continues to properly  
2 withhold federal income tax for all per capita distributions, and issues correct  
3 1099 Forms reflecting those distributions.

4  
5 59. But after defendants established the Benecorp tax-fraud scheme,  
6 defendant Sorenson, who does the Band's accounting, caused the Band to stop  
7 withholding most of the federal taxes required to be withheld for Band members  
8 participating in the scheme. Additionally, Sorenson has prepared these  
9 participating Band members' federal income tax returns and has falsely claimed  
10 tax deductions on those returns for the purported business consulting fees. This  
11 deduction effectively purports to eliminate most tax on the Band members' per  
12 capita distributions of gaming proceeds.

13 60. The Benecorp tax-fraud scheme is, if not detected and the false tax  
14 deductions reversed, somewhat beneficial to Band members and very lucrative for  
15 Drake and Sorenson. But the amounts the defendants skim for themselves from  
16 the circular flow of funds are substantial. Thus the defendants, rather than their  
17 customers, keep the lion's share of the gains from the fraudulent scheme.

18 61. Drake and Sorenson retained \$2,268,427 of the total per capita  
19 distributions transferred to Benecorp by the Band members' LLCs as Benecorp's  
20 fees in 2004 for the Benecorp tax-fraud scheme.

#### 21 **An Example of One Participating Band Member in 2004**

22 62. A review of one participating Band member's transactions with  
23 Benecorp in 2004 illustrates the mechanics of the Benecorp tax-fraud scheme.  
24 The Band member was entitled to receive annual per capita casino gaming  
25 distributions from the Band in 2004 totaling \$340,704—payable in monthly  
26

1 installments of \$27,040 from January through June and thereafter \$29,744 from  
2 July through December.

3  
4 63. The Band member entered into a sham "business consultation  
5 agreement" with Benecorp under which she purportedly was to pay Benecorp  
6 \$240,000 a year or \$20,000 per month through her LLC for Benecorp's purported  
7 management services. In return, NAMS purportedly lent her money under a  
8 purported line of credit.

9 64. In fact, however, the Band paid the Band member's monthly per capita  
10 distributions directly from the Band's Mid-State Bank account to the Band  
11 member's LLC account at Mid-State Bank, after which defendants transferred the  
12 distributions from the LLC's account to the Benecorp account at Mid-State Bank,  
13 after which the defendants transferred the distributions (less the defendants' fees)  
14 to the Band member.

15 65. The defendants' fees charged to this Band member were deducted from  
16 Benecorp's payments to her each month as purported "loan repay & costs" and  
17 "loan repayment indemnification." Over the course of the year the defendants  
18 retained fees in this manner totaling \$46,705.38. The defendants also retained  
19 \$5,946 for federal tax withholding and \$800 for "LLC State Minimum Tax." Thus,  
20 the Band member ended up with \$287,252.62 of her total \$340,704 per capita  
21 distribution for 2004. Benecorp kept \$46,705.38. Thus on \$340,704 of taxable  
22 income from which substantial federal tax withholding was required, the  
23 defendants caused the Santa Ynez Band to withhold only \$5,946.

24 66. Sorenson prepared this Band member's 2004 federal income tax return.  
25 On Line 21 of the Band member's 2004 income tax return, Sorenson reported  
26 "other income" of only \$100,704. This amount equals the \$340,704 in per capita  
27

1 distributions paid to her that year, less the \$240,000 the Band member purportedly  
2 paid to Benecorp for management fees.

3  
4 67. After the IRS detected the Benecorp tax fraud scheme it audited this  
5 Band member's 2004 income tax return and added to her income the \$240,000 that  
6 Sorenson improperly deducted. That resulted in more than \$70,000 in additional  
7 federal income tax being owed. Thus this customer paid the defendants  
8 \$46,705.38 to obtain some \$70,000 in purported 2004 income-tax benefits. But  
9 because the IRS detected the scheme the customer will now have to pay the IRS  
10 delinquent taxes, interest, and penalties.

11 **The IRS's Investigation of the Benecorp Tax-Fraud Scheme.**

12 68. Contrary to Drake and Sorenson's assertion that the Band members'  
13 LLCs are engaged in legitimate business activities, Band members have stated that  
14 Drake and Sorenson did not mention any business purpose to them. They say that  
15 the Benecorp tax-fraud scheme was pitched to them exclusively as a purported  
16 deferred-income plan.

17 69. Contrary to Drake and Sorenson's assertion that Band-member  
18 customers evidenced a business purpose by setting up LLCs and bank accounts,  
19 customers have stated that they were not given information regarding the LLCs  
20 when they met with Sorenson, and that they did not authorize Sorenson to set up  
21 bank accounts for their LLCs. Indeed, the Band-member customers did not know  
22 that Sorenson had created bank accounts for their LLCs because the LLCs' bank  
23 statements were sent to Sorenson's place of business rather than to the customers  
24 who purportedly managed the LLCs.

25  
26 70. Contrary to Drake and Sorenson's assertion that Band members were  
27

1 engaged in legitimate business activities by marketing the CapNet7 plan to the  
2 Santa Ynez Band and other Band members, Band members have acknowledged  
3 that they did not perform work or services on behalf of Benecorp or their LLCs,  
4 including marketing or promoting the CapNet7 plan.

5  
6 71. Contrary to defendants' claim that Benecorp "earned" its \$2.2 million  
7 gross profit in 2004 for providing "consulting services" to Band members' LLCs,  
8 Band members have acknowledged that Benecorp did not perform any work or  
9 services for the LLCs and thus Benecorp had no legitimate reason to receive an  
10 average of \$240,000 a year from individual Band members' LLCs as a "consulting  
11 fee."

12 72. Contrary to Drake and Sorenson's assertion that NAMS makes bona  
13 fide "loans" to Band members that are supposedly secured by life insurance  
14 policies naming NAMS or Benecorp as the beneficiary, Drake has admitted that  
15 life insurance policies were not obtained.

16 **Sorenson's Promotion as the Santa Ynez's Band Accountant**

17 73. Sorenson has served as the Santa Ynez Band's accountant since 1997.

18 74. Sorenson used his position of trust as the Santa Ynez's Band's  
19 accountant to further the Benecorp Tax-Fraud Scheme.

20  
21 75. As the Santa Ynez Band's accountant, Sorenson performs accounting  
22 functions for the Santa Ynez Band's per capita distributions, including  
23 maintaining records for the Santa Ynez Band that account for the per capita  
24 distributions, preparing monthly bank reconciliations for the per capita income  
25 bank account, preparing checks or electronic transfers to distribute the per capita  
26  
27

1 income to each member, and making deposits of the federal income taxes that are  
2 withheld from the per capita payments to the members.

3 76. As the Santa Ynez's Band's accountant, Sorenson prepares IRS  
4 Forms 945 (similar to IRS Forms 941 federal employment tax returns) for the  
5 Band that report the amounts of federal income tax withheld by the Band on per  
6 capita distributions and paid to the Internal Revenue Service on the Band  
7 member's behalf.  
8

9 77. As the Santa Ynez Band's accountant, Sorenson prepares IRS  
10 Forms 1099 for the Band reflecting per capita distributions from the Band to Band  
11 members for the per capita casino distributions at the end of each year.  
12

13 78. As the Santa Ynez Band's accountant, Sorenson prepared the Band's  
14 2003 IRS Forms 1099 for the per capita distributions.  
15

16 79. For each Band member who participated in the Benecorp tax-fraud  
17 scheme in 2003, Sorenson prepared an IRS Form 1099 which reported the per  
18 capita distribution to the Band member showing income tax withholdings for the  
19 months in 2003 before the Band member participated in the Benecorp tax-fraud  
20 scheme. This amount was properly reported on the Band member's federal  
21 income tax return as taxable "other income."

22 80. Sorenson then prepared a second IRS Form 1099 that reported the Band  
23 member's distribution for 2003 after the Band member participated in the  
24 Benecorp Tax-Fraud Scheme. This IRS Form 1099 improperly did not include  
25 any federal income tax withholding because under the scheme the Band member  
26 had purportedly assigned the distribution to the LLC.  
27

28 81. As the Santa Ynez Band's accountant, Sorenson also prepared the

1 Band's IRS Forms 1099 in 2004 that reported the Band's per capita distributions  
2 to Band members.

3 82. For Band members participating in the Benecorp tax-fraud scheme in  
4 2004 Sorenson prepared IRS Forms 1099 reporting the full amount of the per  
5 capita distribution to the Band member, with no federal tax withholding by the  
6 Santa Ynez Band.

7  
8 83. For Band members participating in the Benecorp tax-fraud scheme in  
9 2004, Sorenson also prepared IRS Forms 1099 that reported the Band members'  
10 alleged payments to Benecorp under the purported business consulting agreement,  
11 so that Band members could then falsely claim a deduction for these payments to  
12 Benecorp.

13 **Sorenson's Preparation of Band Members' Federal Income Tax Returns**

14 84. For Band members who participated in the Benecorp tax-fraud  
15 scheme in 2003, Sorenson prepared Band members' federal income tax returns,  
16 improperly reporting the per capita distribution on Schedule E of the Band  
17 members' IRS Form 1040 as "royalties received" so as to disguise or conceal their  
18 true nature as casino gaming distributions.

19  
20 85. Sorenson also improperly reported a corresponding deduction for the  
21 same amount on Band members' Form 1040 Schedule E as "commissions paid,"  
22 thereby reducing to zero the Band members' reported tax attributable to per capita  
23 distribution of casino proceeds.

24 86. As a result of Sorenson's fraudulent return preparation, Band  
25 members failed to report and pay the correct 2003 federal income tax due on the  
26 per capita casino-gaming distribution.

1 87. For Band members who participated in the Benecorp tax-fraud  
2 scheme in 2004, Sorenson prepared federal tax returns that subtracted the amounts  
3 paid to Benecorp for purported business consulting from the per capita  
4 distribution reported on the return, thereby reducing taxable income on the return  
5 by the amount paid to Benecorp for purported consulting.  
6

7 88. Sorenson knew that he was required to report the full amount of the  
8 Band members' \$340,074 per capita distribution as taxable income, but failed to  
9 do so.

10 89. As a direct result of Sorenson's fraudulent return preparation,  
11 Band members participating in the scheme failed to report and pay most of the  
12 federal income tax owed on their per capita distributions for 2004.

13 90. In addition to fraudulently preparing individual Band members'  
14 federal income tax returns, Sorenson provided to Band members who had retained  
15 other return preparers to prepare their returns, a document that falsely instructed  
16 these return prepares to deduct income from per capita casino proceeds based on  
17 the Benecorp tax-fraud scheme. As a certified public accountant, Sorenson knew  
18 or had reason to know that the document he provided to other return preparers  
19 falsely instructed these return prepares to deduct income from per capita casino  
20 proceeds on the Benecorp tax-fraud scheme, which is not allowed under the  
21 Internal Revenue Code.  
22

23 **Sorenson's Improper Accounting of the**  
24 **Santa Ynez's Band's Per Capita Distributions.**

25 91. As the accountant for the Santa Ynez Band, Sorenson knew or should  
26  
27

1 have known that per capita casino-gaming distributions can be made only to  
2 individual Band members, not LLCs, and that the per capita distributions are  
3 taxable to individual Band members.

4  
5 92. As the accountant for the Santa Ynez Band, Sorenson knew that the  
6 Santa Ynez Band was required to withhold federal income tax on per capita  
7 distributions to individual Band members, whether or not these distributions were  
8 later purportedly transferred to individual Band members' LLCs.

9 93. As an accountant for the Santa Ynez Band, Sorenson knew or had  
10 reason to know that the Santa Ynez Band was required to distribute casino  
11 proceeds to individual Band members and not the Band members' LLCs.

12 **Drake and Sorenson Continued to Promote**

13 **the Tax-Fraud Scheme After Receiving Notice of Its Illegality**

14 94. On March 24, 2005, Drake met with the IRS and was extensively  
15 questioned regarding the Benecorp tax-fraud scheme.

16  
17 95. During this interview, Drake falsely asserted that Band members  
18 entered into consultation agreements with Benecorp to promote the CapNet7 plan  
19 and thus that he is not promoting a tax-fraud scheme.

20 96. Despite the IRS's investigation of his illegal activities, Drake  
21 continued to assert the validity of the Benecorp tax-fraud scheme, has not posted a  
22 retraction at the Capnet7.com website explaining that the Benecorp tax-fraud  
23 scheme is not permissible under the Internal Revenue Code, has not otherwise  
24 informed Band members that they are participating in a tax-fraud scheme, or  
25 assisted Band members in filing corrected amended returns to report their accurate  
26 tax liabilities.

1 97. After Drake met with the IRS, Sorenson continued to prepare federal  
2 income tax returns for Band members based on the Benecorp tax-fraud scheme,  
3 and to prepare 1099s and other forms for the Band based on the scheme.  
4

5 98. On February 8, 2006, Sorenson prepared and filed for a Band member  
6 who participated in the scheme a 2005 federal income tax return that claimed a  
7 \$200,000 bogus deduction on the IRS Form 1040 Schedule C for expenses related  
8 to purported "outside services," amounts paid to Benecorp for purported "business  
9 consulting."

10 99. Sorenson then used this purported business expense to reduce the Band  
11 member's reported taxable income on IRS Form 1040, thus underreporting the  
12 Band member's taxable income.

13 100. On information and belief, Drake and Sorenson continue to promote  
14 the CapNet7 plan, on which the Benecorp tax-fraud scheme is based, at the  
15 capnet7.com website and at gaming conferences.  
16

17 101. Sorenson continues to serve as the Santa Ynez Band's accountant and  
18 remains responsible for accounting for the Band's per capita distributions.

19 102. On information and belief, Drake and Sorenson continue assisting  
20 current Santa Ynez Band customers to effectuate the Benecorp tax-fraud scheme  
21 and continue to solicit business from other Native American tribes and tribe  
22 members who receive per capita casino-gaming distributions.

23 103. Drake and Sorenson harm the United States because Band members  
24 are not correctly reporting and paying their federal income tax liabilities. The total  
25 known tax loss from the Benecorp tax-fraud scheme is approximately \$3.3 million  
26

1 so far. This tax loss does not include the substantial costs of detecting the scheme  
2 and assessing and collecting the additional taxes that Band members owe.

3  
4 104. By promoting the Benecorp tax-fraud scheme, Drake and Sorenson  
5 undermine public confidence in the administration of the federal tax system and  
6 encourage violations of the internal revenue laws.

7 105. Drake and Sorenson further harm the United States because the  
8 Internal Revenue Service must devote its limited resources to identifying their  
9 customers and recovering any refunds erroneously issued. Given the IRS's limited  
10 resources, identifying and recovering all revenues lost from Drake and Sorenson  
11 plan may be impossible.

12 106. Drake and Sorenson also harm their customers, both the individual  
13 Band members who receive per capita distributions and the Santa Ynez Band  
14 itself, which makes the distributions. By making false statements to these  
15 customers, and preparing false tax forms, returns, and other documents for them,  
16 the defendants subject their customers to paying substantial delinquent taxes,  
17 interest, penalties. The defendants also potentially subject customers to possible  
18 criminal prosecution for participating in the defendants' illegal scheme.

19  
20 **Count I**

21 **(Injunction under IRC § 7407)**

22 **(As to Kenneth Sorenson)**

23 107. The United States incorporates herein the allegations in paragraphs 1  
24 through 106.

25 108. IRC § 7407 authorizes a court to enjoin a person from engaging in  
26 specified misconduct if the person has:

- 1 a. engaged in conduct subject to penalty under IRC § 6694  
2 (which penalizes a return preparer who prepares or submits a  
3 return that contains an unrealistic or frivolous position);  
4 b. guaranteed the payment of a tax refund or allowance of a tax  
5 credit; or  
6 c. engaged in any other fraudulent or deceptive conduct that  
7 substantially interferes with the proper administration of the  
8 internal revenue laws.

9 109. Sorenson has engaged in conduct subject to the IRC § 6694 penalty  
10 by preparing federal income tax returns and forms that understate his customers'  
11 income and tax liabilities based on the Benecorp tax-fraud scheme.

12 110. Sorenson's conduct violates IRC § 6694 and is subject to  
13 injunction under IRC § 7407.

14 111. If he is not enjoined, Sorenson is likely to continue to prepare and file  
15 false and fraudulent forms and returns for Band members, for the Santa Ynez  
16 Band, and for others.

## 17 Count II

### 18 (Injunction under 26 U.S.C. § 7408 for 19 Conduct Subject to the IRC § 6700 Penalty) 20 (As to Stephen Drake and Kenneth Sorenson)

21 112. The United States incorporates by reference the allegations in  
22 paragraphs 1 through 111.

23 113. IRC § 7408 authorizes a court to enjoin persons who have engaged in  
24 any conduct subject to penalty under IRC § 6700 if the court finds that injunctive  
25 relief is appropriate to prevent the recurrence of such conduct.  
26

27 114. IRC § 6700 penalizes any person who organizes or sells a plan or  
28

1 arrangement and in connection with the organization or sale makes a statement  
2 regarding the securing of any tax benefit that the person knows or has reason to  
3 know is false or fraudulent as to any material matter.

4 115. Drake and Sorenson organize and sell a plan or arrangement and in  
5 connection therewith make or furnish, to their customers and others, statements  
6 regarding the characterization of casino distributions and the allowance of  
7 deductions for amounts purportedly paid to Benecorp, which Drake and Sorenson  
8 know or have reason to know are false and fraudulent.

9 116. Drake and Sorenson falsely state that Band members can legally  
10 reduce their federal income tax liabilities on their per capita distributions and  
11 retain a higher cash flow by participating in the Benecorp tax-fraud Scheme.

12 117. If not enjoined under IRC § 7408, Drake and Sorenson are likely to  
13 continue to organize and sell the Bencorp tax-fraud scheme and engage in conduct  
14 subject to penalty under IRC § 6700.

15  
16 **Count III**

17  
18 **(Injunction under I.R.C. § 7408 for Violation of I.R.C. § 6701)**  
19 **(As to Sorenson)**

20 118. The United States incorporates by reference the allegations in  
21 paragraphs 1 through 117.

22 119. IRC § 7408 authorizes a court to enjoin persons who have engaged in  
23 any conduct subject to penalty under IRC § 6701 if the court finds that injunctive  
24 relief is appropriate to prevent the recurrence of such conduct.

25 120. IRC § 6701 penalizes any person who (1) aids or assists in, procures,  
26 or advises with respect to, the preparation or presentation of any portion of a  
27

1 return, affidavit, claim or other document; (2) knows (or has reason to believe)  
2 that such document or portion will be used in connection with any material matter  
3 arising under the internal revenue laws; and (3) knows that such portion (if so  
4 used) will result in an understatement of another person's tax liability.

5 121. Sorenson prepared or assisted in the preparation of false and  
6 fraudulent 1099 Forms for the Santa Ynez Band and false and fraudulent federal  
7 income tax returns for Drake and Sorenson's customers.

8 122. Sorenson knew or had reason to know that these income tax forms  
9 and returns would be used in connection with computing and reporting federal  
10 income tax liabilities and knew that if they were so used they would result in  
11 understatements of other persons' tax liabilities.

12 123. If Sorenson is not enjoined, he is likely to continue to engage in  
13 conduct subject to penalty under IRC § 6701.  
14

15  
16 **Count IV**

17 **(Unlawful Interference with the Administration of the Internal Revenue**  
18 **Laws)**

19 124. The United States incorporates herein the allegations in paragraphs 1  
20 through 123.

21 125. IRC § 7402 authorizes a court to issue orders of injunction as may be  
22 necessary or appropriate for the enforcement of the internal revenue laws.  
23

24 126. Drake and Sorenson, through the conduct described above, have  
25 engaged in conduct that substantially interferes with the administration and  
26 enforcement of the internal revenue laws. Unless enjoined, Drake and Sorenson  
27 are likely to continue to engage in such improper conduct. If the Court does not  
28

1 enjoin Drake and Sorenson from engaging in fraudulent and deceptive conduct the  
2 United States will suffer irreparable injury.

3 127. Enjoining Drake and Sorenson is in the public interest because an  
4 injunction, backed by the Court's contempt powers if needed, will stop their illegal  
5 conduct and the harm it causes the United States Treasury.

6 128. The United States is entitled to injunctive relief under 26 U.S.C.  
7 § 7402(a).

8 WHEREFORE, the plaintiff, United States of America, prays for the  
9 following:  
10

11 A. That the Court find that Sorenson has engaged in conduct subject to  
12 penalty under IRC §§ 6694, and that an injunction under IRC §§ 7402 and 7407 is  
13 appropriate to prevent him and anyone acting in concert with him from preparing  
14 or filing federal tax forms based on the Benecorp tax-fraud scheme or otherwise  
15 asserting unrealistic positions;

16 B. That the Court find that Sorenson engaged in conduct subject to penalty  
17 under IRC §§ 6700 and 6701, and that injunctive relief is appropriate under IRC  
18 § 7408 to prevent him and anyone acting in concert with him from engaging in any  
19 further such conduct;

20 C. That the Court find that Sorenson engaged in conduct that interferes  
21 with the administration and enforcement of the internal revenue laws, and that  
22 injunctive relief against him and anyone acting in concert with him is appropriate  
23 to prevent the recurrence of that conduct under the Court's inherent equity powers  
24 and IRC § 7402(a);  
25  
26  
27

1 D. That the Court, under IRC §§ 7402 and 7408, enter a permanent  
2 injunction prohibiting Sorenson and his representatives, agents, servants,  
3 employees, or anyone in active concert or participation with him, from:

- 4 1) Engaging in activity subject to penalty under I.R.C. § 6700, including  
5 organizing or selling a plan or arrangement and in connection  
6 therewith making a statement regarding tax deductions, the  
7 excludability of income, or the securing of any tax benefit that he  
8 knows or has reason to know is false or fraudulent as to any material  
9 matter, including but not limited to promoting the Benecorp tax-fraud  
10 scheme;
- 11 2) Engaging in activity subject to penalty under I.R.C. § 6701, including  
12 preparing or assisting in the preparation or presentation of any portion  
13 of a return, affidavit, claim or other document, which he knows or has  
14 reason to know will be used in connection with any material matter  
15 arising under the internal revenue laws; and if so used will result in  
16 an understatement of another person's tax liability, including but not  
17 limited to documents implementing the Benecorp tax-fraud scheme;
- 18 3) Engaging in any other activity subject to penalty under I.R.C. §§ 6700  
19 or 6701;
- 20 4) Engaging in other similar conduct that substantially interferes with  
21 the proper administration or enforcement of the internal revenue laws;  
22
- 23

24 E. That the Court find that Drake engaged in conduct subject to penalty  
25 under IRC §§ 6700, and that injunctive relief is appropriate under IRC § 7408 to  
26  
27  
28

1 prevent him and anyone acting in concert with him from engaging in any further  
2 such conduct;

3 F. That the Court find that Drake engaged in conduct that interferes with  
4 the administration and enforcement of the internal revenue laws, and that  
5 injunctive relief against him and anyone acting in concert with him is appropriate  
6 to prevent the recurrence of that conduct under the Court's inherent equity powers  
7 and IRC § 7402(a);

8 G. That the Court, under IRC §§ 7402 and 7408, enter a permanent  
9 injunction prohibiting Drake and his representatives, agents, servants, employees,  
10 or anyone in active concert or participation with him, from:

- 11 1) Engaging in activity subject to penalty under I.R.C. § 6700, including  
12 organizing or selling a plan or arrangement and in connection  
13 therewith making a statement regarding tax deductions, the  
14 excludability of income, or the securing of any tax benefit that he  
15 knows or has reason to know is false or fraudulent as to any material  
16 matter, including but not limited to promoting the Benecorp tax-fraud  
17 scheme;
- 18 2) Engaging in any other activity subject to penalty under I.R.C. § 6700;
- 19 and
- 20 3) Engaging in other similar conduct that substantially interferes with  
21 the proper administration or enforcement of the internal revenue laws.

22 H. That this Court, under IRC §§ 7402, 7407, and 7408, enter an  
23 injunction requiring Drake and Sorenson to contact:

- 24 1) all persons to whom they gave, sold, or distributed any materials  
25 promoting or otherwise related to the Benecorp tax-fraud scheme;

1           2) all persons for whom Sorenson prepared and/or assisted in the  
2           preparation of any federal income tax returns or tax-related  
3           documents (including 1099 forms) based on the Benecorp tax-fraud  
4           scheme; and

5           3) provide these persons with a copy of the Court's permanent  
6           injunction.

7           I. That this Court, pursuant to I.R.C. §§ 7402 and 7408, enter an injunction  
8           requiring Drake and Sorenson and their representatives, agents, servants,  
9           employees, attorneys, and those persons in active concert or participation with  
10          them, to display prominently, at the top of the first page of the capnet7.com  
11          website, a complete copy of the Court's permanent injunction within 14 days of  
12          the entry of this Order, and to keep the Order posted there for one year.

13          J. That this Court, under IRC §§ 7402, 7207, and 7408, enter an injunction  
14          requiring Drake and Sorenson to turn over to the United States a list of the names,  
15          addresses, e-mail addresses, phone numbers, and Social Security numbers of (1)  
16          all persons to whom they gave or sold, directly or indirectly, any materials related  
17          to the Benecorp tax-fraud scheme, (2) all persons who assisted in the marketing or  
18          preparation of materials used by Drake and Sorenson or written materials sent to  
19          potential customers as part of the Benecorp tax-fraud scheme, (3) all persons for  
20          whom Drake and Sorenson, or their associates, prepared or assisted in the  
21          preparing any tax-related documents, including Forms 1099 or tax returns, as part  
22          of the Benecorp tax-fraud scheme (4) all persons who purchased or used any other  
23          tax shelter, plan, or arrangement that Drake and Sorenson have organized or  
24          promoted; and (5) all persons who assisted Drake and Sorenson in promoting and  
25          implementing the Benecorp tax-fraud scheme;

1 K. That the Court allow the government full post-judgment discovery to  
2 monitor Drake and Sorenson's compliance with the injunction; and

3 L. That the Court grant such other and further relief as it deems appropriate.  
4  
5  
6

7 DEBRA W. YANG  
8 United States Attorney  
9 SANDRA BROWN  
10 Assistant United States Attorney  
11 Chief, Tax Division  
12 EVAN DAVIS  
13 Assistant United States Attorney  
14 Federal Building, Room 7211  
15 300 North Los Angeles Street  
16 Los Angeles, California 90012  
17 Telephone: (213) 894-2400  
18 Facsimile: (213) 894-0115

19 *Michael R. Pahl* by EJD

20 MICHAEL R. PAHL  
21 MICHAEL J. ROESSNER  
22 Trial Attorney, Tax Division  
23 U.S. Department of Justice  
24 Post Office Box 7238  
25 Washington, D.C. 20044  
26 Telephone: (202) 514-6487  
27 Facsimile: (202) 514-6770