

*Monroe # 8634*

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**DEC 28 2006**

IN THE UNITED STATES DISTRICT COURT  
FOR THE NORTHERN DISTRICT OF ILLINOIS

MICHAEL V. F. STUBBS  
CLERK, U.S. DISTRICT COURT

UNITED STATES OF AMERICA, )

Plaintiff, )

v. )

NEAL A. REDDY; and )  
ROYANNE REDDY; each individually )  
and d/b/a ROYANNE'S TAX SERVICES; )  
and ROYANNE & COMPANY, INC., )

Defendants. )

**06C 7157**

Case No. \_\_\_\_\_

**JUDGE KENDALL**

**MAGISTRATE JUDGE  
GERALDINE SOAT BROWN**

**COMPLAINT FOR PERMANENT INJUNCTION AND OTHER RELIEF**

The United States of America alleges against defendants Neal A. Reddy and Royanne Reddy, each individually and doing business as Royanne's Tax Services, and Royanne & Company, Inc., as follows:

**Nature of Complaint**

1. This is a civil action brought by the United States pursuant to 28 U.S.C. §§ 1340 and 1345, and Internal Revenue Code (26 U.S.C.; the "Code") §§ 7402(a), 7407 and 7408 to enjoin Neal A. Reddy and Royanne Reddy, each individually and doing business as Royanne's Tax Services, and Royanne & Company, Inc., and any other persons or entities in active concert or participation with them, from:

- (a) Preparing or assisting in the preparation or filing of any federal income tax return for any other person or entity;
- (b) Understating taxpayers' liabilities as prohibited by Code § 6694;

- (c) Engaging in conduct subject to penalty under Code § 6701, *i.e.*, preparing or assisting others in the preparation of any tax form or other document to be used in connection with a material matter arising under the internal revenue laws and which the defendant knows will (if so used) result in the understatement of tax liability;
- (d) Engaging in similar conduct that substantially interferes with the proper administration and enforcement of the internal revenue laws;
- (e) Engaging in any other activity subject to penalty under the Code; and
- (f) Representing persons before the Internal Revenue Service.

### **Jurisdiction and Venue**

2. This action has been requested by a delegate of the Secretary of the Treasury, and commenced at the direction of the Attorney General of the United States, pursuant to Code §§ 7402, 7407, and 7408.

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

4. Venue is proper in this court under 28 U.S.C. § 1391.

### **Defendants**

5. Defendants Royanne and Neal Reddy are married to each other and reside in Seneca, Illinois, within this district, and conduct business in Marseilles, Illinois and Princeton, Illinois.

6. Royanne Reddy has been a federal income tax return preparer since 1978.

7. Neal Reddy began preparing tax returns in 2002 and obtained his own Preparer Tax Identification Number (PTIN) in 2006.

8. Royanne Reddy is the sole shareholder of Royanne & Company, Inc., in Marseilles, Illinois, within this judicial district. Royanne Reddy registered Royanne & Company, Inc., with

the Illinois Secretary of State in 2005 and serves as its registered agent.

9. Royanne and Neal Reddy, individually and/or doing business as Royanne's Tax Services, prepare federal income tax returns for others for compensation.

#### **Defendants' Activities**

10. The Reddys are income tax return preparers as defined by Code § 7701(a)(36) because they prepare other people's federal income tax returns for compensation and employ others to prepare returns for compensation.

11. Royanne Reddy first prepared other people's tax returns on a small scale. However, Royanne and Neal Reddy have significantly increased their business over the past five years by preparing fraudulent returns that produce larger income tax refunds for customers and, at times, by amending customers' prior returns to claim improper refunds.

12. The Reddys' reputation for generating larger income tax refunds led to increased business through word of mouth from customers. The number of returns the Reddys and their business have prepared has increased from 1,054 returns prepared during 2002 to 7,607 returns during 2005.

13. The Reddys and their business have prepared at least 15,000 federal income tax returns between January 2002 and December 2005. Their customers live in numerous states, including: Illinois, Iowa, Wisconsin, Alaska, Massachusetts, Tennessee, Virginia, California, Florida, New Jersey, Pennsylvania, Arizona, and Wyoming.

14. Currently, the defendants employ six to eight return preparers in addition to other support staff. Because of the increase in their business they have opened another office in Princeton, Illinois, and have expanded their Marseilles office.

15. Neal and Royanne Reddy are both involved in the day-to-day operations of the business and closely manage and oversee their employees' duties and tasks, including income tax return preparation.

16. The IRS examined 70 federal income tax returns that the Reddys or employees under their direct supervision prepared between 2002 and 2005.

17. All of these 70 returns required adjustments. Sixty-five of the returns claimed a deduction for employee business expenses. Of the 65 returns that claimed a deduction for employee business expenses, 64 returns contained inflated or unsubstantiated deductions for vehicle expenses, meal and travel expenses, work clothes, and other miscellaneous deductions, and often improperly claimed deductions for commuting expenses between a customer's tax home and regular place of business. The amount of the improper deductions for inflated or unsubstantiated employee business expenses ranged from a few hundred dollars to approximately \$30,000.

18. The IRS's examination of the 70 returns also revealed 35 returns that included Schedules C "Profit or Loss from Business." All of the 35 returns had adjustments to gross receipts, expenses, or both. The examined returns improperly reported Schedule C expenses from activities not engaged in for profit, unsubstantiated and inflated vehicle expenses, home office deductions for rooms or equipment not exclusively used for business purposes, and other unsubstantiated or personal expenses including deductions for the use of cell phones.

19. The Reddys ignored information given to them by their customers or simply fabricated tax deductions and other items on tax returns.

20. The average tax deficiency per return of the 70 returns the IRS examined was \$2,775.

A conservative estimate of the total tax loss as a result of the Reddys' improper tax return preparation is \$13.31 million, which is based on an assumption that approximately one-half of the returns that the Reddys personally prepared for others between 2002 and 2005 were improper and that the average tax deficiency per return was \$2,711 (derived from the average tax deficiency of the 70 customer returns audited and two undercover agent's returns).

21. Neal and Royanne Reddy also improperly claim eligibility for the Earned Income Tax Credit (EITC) on their customers' returns by improperly preparing and filing separate returns for both a husband and wife as single or head of household to improperly qualify them for an Earned Income Tax Credit.

22. Royanne and Neal Reddy assured their customers that the Reddys' employees would prepare returns that generated refunds that would be as satisfactory as those claimed on returns that Royanne and Neal personally prepared. Royanne and Neal Reddy intervened if customers were not satisfied with the refund amount or reduction in tax liability generated from a return prepared by one of the Reddys' employees.

23. According to a former employee who worked for the Reddys between 2003 and 2004, Royanne Reddy ordered her return preparers to avoid claiming deductions with round numbers, so as to escape IRS detection methods.

24. Royanne Reddy represented several of her customers during the IRS's examination of the customers' returns. Royanne Reddy fabricated documents to support claimed deductions and submitted the fabricated documents to the IRS during these examinations.

25. Royanne Reddy improperly prepared two federal income tax returns for an IRS undercover agent posing as a customer. Royanne Reddy inflated unreimbursed business mileage

and business supplies expenses on the undercover agent's 2002 return and an amended 2001 return.

26. In preparing an Oglesby, Illinois customer's 2002 and 2003 tax returns, Neal Reddy and an employee under the Reddys' supervision improperly claimed deductions for inflated and unsubstantiated employee business expenses. Despite statements from the customer that his employer reimbursed him for employee business expenses he incurred, Neal Reddy and the supervised employee improperly claimed unsubstantiated and inflated employee business expenses. An IRS examination of the return allowed only \$248 of the \$20,945 employee business expenses claimed on the customer's 2002 return. The customer's 2002 return claimed deductions for unsubstantiated travel and vehicle expenses and improperly claimed deductions for work-related education expenses for courses that may lead to qualifying the customer's wife for a new trade or business and were therefore not deductible. The customer told the IRS that he relied on the preparer's expertise and did not know how the Reddys arrived at the specific amount of the deduction.

27. Royanne Reddy improperly directed one of her employees, in connection with preparing a Granville, Illinois customer's 2002 federal income tax return, to deduct personal mileage expenses for miles logged in a company vehicle.

28. Since the IRS examinations of their customers, the defendants have continued to prepare a large number of federal income tax returns. IRS records indicate that as of September 27, 2006, for the 2006 processing year (2005 federal income tax returns) the Reddys and their employees have prepared 4,356 returns and, individually, Royanne Reddy has prepared 1,746 returns and Neal Reddy has prepared 465 returns.

29. The defendants' tax return preparation business has caused substantial harm to the United States. To the extent that the IRS does not detect the understatements of tax and issues erroneous refunds, defendants' customers receive substantial tax refunds to which they are not entitled. The United States is also harmed because the IRS must devote significant resources to locating and examining their customers' returns. In addition, the defendants' false and fraudulent return preparation harms the defendants' customers because they are liable for tax deficiencies, interest, and penalties.

#### **Count I - Injunction under § 7407**

30. The United States incorporates by reference the allegations in paragraphs 1 to 29.

31. Code Section 7407 authorizes the United States to seek an injunction against any tax preparer who has engaged in any "fraudulent or deceptive conduct which substantially interferes with the proper administration of the Internal Revenue laws," or who has "engaged in any conduct subject to penalty under section 6694 or 6695."

32. Section 6694(a) penalizes tax preparers who negligently understate a customer's liability because of an unrealistic position.

33. Section 6694(b) penalizes tax preparers who willfully attempt to understate the tax liability of another person or who recklessly or intentionally disregard internal revenue rules or regulations to understate another person's tax liability.

34. Section 6695(g) penalizes tax preparers who fail to exercise due diligence in determining the eligibility of their customers for the Earned Income Tax Credit (EITC). The regulations penalize tax preparers who know or have reason to know that information they use in determining the eligibility for the EITC is incorrect. 26 C.F.R. § 1.6695-2(b)(3).

35. Neal and Royanne Reddy engage in fraudulent and/or deceptive conduct, which substantially interferes with the proper administration of the internal revenue laws. They prepare returns that fraudulently inflate business expenses and fabricate income to qualify customers for the EITC.

36. The defendants willfully attempted to understate the tax liability of their customers by claiming false business expenses without corroborating evidence. They also have fabricated documents and given them to IRS auditors as purported substantiation for the bogus positions the defendants asserted on customers' tax returns. The defendants intentionally and/or recklessly disregarded internal revenue rules by claiming employee business deductions without reasonable support or documentation to generate tax refunds for their customers. The defendants fraudulently generated income for customers to qualify them for the EITC.

37. The defendants fail to exercise due diligence in determining whether their customers are eligible for the EITC, conduct that is subject to penalty under Code § 6695(g).

38. Injunctive relief is appropriate to prevent this misconduct because, absent an injunction, Neal and Royanne Reddy are likely to continue to prepare false federal income tax returns and engage in other misconduct of the type described in this complaint. The defendants continue to prepare returns and have shown no remorse.

39. The defendants' misconduct was continual and/or repeated over the course of at least three years.

40. Neal and Royanne Reddy should be permanently enjoined under Code § 7407 from acting as income tax return preparers because a more limited injunction would be insufficient to stop their interference with the proper administration of the tax laws.

### **Count II - Injunction under § 7408**

41. The United States incorporates the allegations of paragraphs 1 through 40.

42. Code § 7408 authorizes courts to issue injunctions against persons who engage in conduct subject to penalty under Code § 6701.

43. Section 6701 imposes a penalty on persons who procure, assist, or advise others with respect to the preparation or presentation of any document that will be used in connection with any material matter arising under the internal revenue laws, and “who knows that such portion (if so used) would result in an understatement of the liability for tax of another person.”

44. The defendants ordered their employees to prepare returns with fraudulent deductions that were not substantiated or documented.

45. The defendants have engaged in conduct that is subject to penalty under Code § 6701, and an injunction under Code § 7408 is appropriate.

46. Unless defendants are enjoined, they are likely to continue to understate the tax liability of their customers by overstating and creating fraudulent business expenses.

47. Accordingly, Neal and Royanne Reddy should be enjoined under § 7408 from engaging in conduct subject to penalty under § 6701 or engaging in conduct subject to penalty under any other section of the Code.

### **Count III - Injunction under Code § 7402**

48. The United States incorporates the allegations of paragraphs 1 through 47.

49. Code § 7402(a) authorizes courts to issue injunctions “as may be necessary or appropriate for the enforcement of the internal revenue laws.” The remedies available to the United States under this statute “are in addition to and not exclusive of any and all other

remedies.” Code § 7402(a).

50. The defendants, through the actions described above, have engaged in conduct that substantially interferes with the administration and enforcement of the internal revenue laws, and are likely to continue to engage in such conduct unless enjoined. The defendants’ conduct is causing irreparable injury to the United States and an injunction under Code § 7402(a) is necessary and appropriate.

51. Unless the defendants are enjoined, the IRS will have to devote substantial time and resources to identify and locate their customers, and then examine their customers’ tax returns and liabilities. Pursuing all individual customers may be impossible given the IRS’s limited resources.

52. The Court should order injunctive relief under Code § 7402(a).

WHEREFORE, the United States of America requests the following relief:

A. That the Court find that the defendants have continually and repeatedly engaged in conduct subject to penalty under Code §§ 6694 and 6695, and that injunctive relief limited to prohibiting such conduct would not be sufficient to prevent their interference with the proper administration of the Internal Revenue Code;

B. That the Court, pursuant to Code §§ 7407 and 7402(a), enter a permanent injunction prohibiting the defendants from preparing or filing or assisting in the preparation or filing of federal income tax returns or other related documents and forms for others;

C. The Court find that the defendants have engaged in conduct that is subject to penalty under § 6701, and an injunction under Code § 7408 is appropriate to prevent recurrence of that conduct;

D. That the Court, pursuant to Code § 7408, enter a permanent injunction prohibiting the defendants from knowingly aiding, assisting, or procuring the preparation or presentation of any portion of a return that would understate the tax liability of another;

E. That the Court find that the defendants have engaged in conduct that interferes with the enforcement of the internal revenue laws, and that injunctive relief against them and anyone acting in concert with them is appropriate to prevent the recurrence of that conduct pursuant to the Court's inherent equity powers and Code § 7402(a);

F. That the Court, pursuant to Code § 7402(a), prohibit the defendants from representing customers or appearing on behalf of customers before the Internal Revenue Service;

G. That the Court, pursuant to Code § 7402(a), order the defendants to contact all persons for whom they prepared or assisted in preparing a federal income tax return after January 1, 2002, and inform those persons of the entry of the Court's findings, 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 assess and collect any federal income taxes, interest, and penalties, which they may owe, and the entry of the permanent injunction against the defendants;

H. That the Court, pursuant to Code § 7402(a), order the defendants to turn over to the United States a list of the names, addresses, e-mail addresses, social security numbers (and any other federal tax identification numbers), and telephone numbers of all persons for whom they have prepared or assisted in preparing federal income tax returns since January 1, 2002;

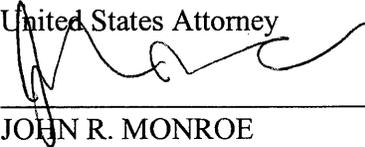
I. That the Court authorize the United States to engage in post-judgment discovery pursuant to the Federal Rules of Civil Procedure in order to monitor compliance with the Court's

injunction; and

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

Respectfully submitted,

PATRICK J. FITZGERALD  
United States Attorney



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JOHN R. MONROE  
IA Bar No. 0008881  
Trial Attorney, Tax Division  
U.S. Department of Justice  
Post Office Box 7238  
Washington, D.C. 20044  
Telephone: (202) 307-0638  
Fax: (202) 514-6770  
E-mail: john.r.monroe@usdoj.gov