

FILED

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

MAR 20 2012

DAVID BREWS CLERK
BY MT [Signature] Deputy

UNITED STATES OF AMERICA,)
)
Plaintiff,)
)
v.)
)
CYNTHIA H. CARTER, individually)
and d/b/a CYNTHIA'S TAX SERVICE,)
)
Defendant.)

Civil No.

1:12CV69-A-S

COMPLAINT FOR PERMANENT INJUNCTION AND OTHER RELIEF

Plaintiff, United States of America, alleges against Defendant, Cynthia H. Carter, individually and doing business as Cynthia's Tax Service, as follows:

1. This is a civil action brought by the United States under sections 7402(a), 7407, and 7408 of the Internal Revenue Code (26 U.S.C.) ("I.R.C.") to enjoin Cynthia Carter, and anyone in active concert or participation with her, from:

- (a) acting as a federal tax return preparer or requesting, assisting in, or directing the preparation or filing of federal tax returns, amended returns, or other related documents or forms for any person or entity other than herself;
- (b) preparing or assisting in preparing federal tax returns that she knows or reasonably should have known would result in an understatement of tax liability or the overstatement of federal tax refund(s) as penalized by I.R.C. § 6694;
- (c) engaging in any other activity subject to penalty under I.R.C. §§ 6694, 6701, or any other penalty provision in the I.R.C.; and
- (d) engaging in any conduct that substantially interferes with the proper administration and enforcement of the internal revenue laws.

Jurisdiction and Venue

2. Jurisdiction is conferred on this court pursuant to 28 U.S.C. §§ 1340, 1345 and I.R.C. § 7402(a).

3. 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 a delegate of the Attorney General, pursuant to the provisions of I.R.C. §§ 7402, 7407 and 7408.

4. Venue is proper in the Northern District of Mississippi pursuant to 28 U.S.C. § 1391 because Cynthia Carter resides in the district, and a substantial part of the activities giving rise to this suit took place in the district.

Defendant's Activities

5. Carter is a commercial tax return preparer doing business under the name "Cynthia's Tax Service." Cynthia's Tax Service does business at 1801 5th Avenue North, Columbus, Mississippi, 39701.

6. Carter is the sole owner of Cynthia's Tax Service, a sole proprietorship. Prior to operating Cynthia's Tax Service, Carter was employed by H&R Block as a return preparer until 2009.

7. Carter and Cynthia's Tax Service prepared 702 income tax returns for customers in processing years 2009 and 2010. Carter is identified on these returns as the paid preparer through her social security number. Of these 702 returns, more than 80% claimed a refund, an unusually high percentage. These returns frequently claim bogus deductions for business expenses and charitable contributions, and make false claims for the Earned Income Tax Credit ("EITC") and the First Time Home Buyer Credit ("FTHBC").

8. The IRS estimates the harm to the United States from Carter's tax-return preparation in 2009 and 2010 to be \$4,250,000, based on an average tax deficiency of \$6,063.90 from a

sample of 39 tax returns examined containing bogus business deductions (15 returns) and FTHBC claims (24 returns).

Charitable Contribution and Employee Business Expense Fraud

9. Carter often prepares tax returns for customers on which she fraudulently inflates the amount of a customer's charitable contributions and the amount of unreimbursed employee business expenses incurred by the taxpayer.

10. Section 170 of the Internal Revenue Code (the "Code") governs charitable contributions. Section 170(a) provides that qualifying charitable contributions, as defined by I.R.C. § 170(c), are allowable only if verified. Carter prepares returns for clients that report a fraudulently inflated amount of contributions.

11. Section 162 of the Code governs trade or business expenses. Carter frequently prepares returns for customers that claim deductions for fraudulently inflated or non-qualifying business expenses. IRS Publication 529 provides examples of qualifying business expenses, including "Union dues and expenses" and "Work clothes and uniforms if required and not suitable for everyday use." *See* IRS Publication 529 (2009) (available online at: <http://www.irs.gov/publications/p529/ar02.html>). Publication 529 also provides examples of expenses that do not qualify as business expenses, including "Commuting expenses," "Lunches with co-workers," "Meals while working late," and "Personal, living, or family expenses."

12. Of the returns that Carter prepared in 2009 and 2010 that the IRS has examined, 15 claimed improper Schedule A deductions for employee business expenses. The total additional tax due from the bogus Schedule A deductions on these fifteen returns was \$80,918, reflecting an average deficiency per return of \$5,395.

13. For example, Carter prepared a 2009 tax return for a customer, Debra Wynn, on which Carter claimed a bogus itemized deduction for "union and professional dues" in the amount of \$27,690. Carter also claimed bogus charitable contributions in the amount of \$3,708. Wynn is a nurse whose wages for 2009 totaled \$62,444. Thus, according to Carter's false claims, Wynn spent more than half of her entire year's salary on professional dues and charitable contributions. Additionally, Carter claimed a non-deductible "cell phone" expense in the amount of \$2,335. Carter's improper deductions thus underreported Wynn's taxable income by \$38,471 and understated her tax liability by \$7,772.

14. Similarly, Carter claimed fraudulently inflated amounts for employee business expenses and charitable contributions on the 2008 and 2009 tax returns of customer Kevin Bowen. Bowen is an insurance agent with reported wages of \$40,946 in 2008 and \$27,405 in 2009. On Bowen's 2008 tax return, Carter claimed a \$28,125 deduction for employee expenses and a \$4,000 contribution to charity. On the 2009 tax return, Carter claimed a false deduction for union and professional dues in the amount of \$10,800, and a bogus charitable contribution of \$2,125. Carter also included over \$30,000 in improper business expenses, including over \$23,000 for vehicle expenses, on two Schedules C attached to Bowens' 2009 return. Carter thus underreported Bowens' taxable income by \$31,798 and \$49,430 and understated his tax liability by \$4,822 and \$8,156 for tax years 2008 and 2009, respectively.

15. On the 2008 tax return of customer Sammie Beard, Carter falsely claimed deductions on the Schedule A attached to the return in the amount of \$16,680, including \$2,500 in gifts to charity and \$12,726 for employee business expenses. Sammie Beard's total income for 2008 was only \$20,124, making it very unlikely that Beard could afford such expenses.

16. On the 2009 tax return of customer Elbert Ruff, Jr., Carter falsely claimed deductions on the Schedule A attached to the return in the amount of \$37,766, including deductions for union and professional dues in the amount of \$25,358, charitable contributions in the amount of \$3,250, and medical expenses in the amount of \$8,688. Ruff's total income for 2009 was \$55,408, of which \$18,218 was received as unemployment compensation. Carter underreported Ruff's 2009 taxable income by \$32,455, and understated his tax liability by \$6,081.

Improper Credits for First Time Home Buyers

17. Carter also knowingly prepared numerous false claims for the First Time Home Buyer Credit ("FTHBC").

18. Congress enacted the FTHBC in July of 2008. The credit allowed first-time home buyers a credit against their federal income tax of the lesser of ten percent of the home's purchase price or \$7,500 in 2008 (\$8,000 for homes purchased in 2009). The credit, which is refundable, is codified at 26 U.S.C. § 36 and is claimed by completing an IRS Form 5405 and attaching it to the income tax return. Form 5405 sets forth the requirements for credit eligibility, and requires the preparer to list the purchased home's address and acquisition date.

19. To be eligible for the credit, a person must not have owned a home in the previous three years and must have actually purchased a home after April 8, 2008 and during the tax year for which the credit is claimed. The taxpayer must also have reportable income (taxable or non-taxable) listed on the return filed with the FTHBC claim.

20. Carter fraudulently claimed the FTHBC for customers who did not purchase homes within the tax year for which the credit was claimed. Additionally, on the overwhelming majority of the returns that Carter claims the FTHBC, the returns do not list any taxable income,

but report only non-taxable social security income, even where Carter's customer had other taxable income, such as benefits or IRA distributions. By not reporting taxable income, Carter improperly minimizes or eliminates her customer's reported federal income tax liability, while increasing the customer's refund through the false FTHBC claim.

21. For tax years 2008 and 2009, Carter claimed the FTHBC on at least 514 tax returns, claiming a total of \$3,313,524.91 in FTHBC. The IRS issued \$905,006.19 in erroneous refunds based on the FTHBC claims reported on 252 of these returns. Fortunately, the IRS identified the fraudulent nature of the FTHBC claims on the remaining 262 returns before issuing refunds.

22. Of the 514 returns claiming the FTHBC, the IRS examined a sample of 24 returns. The total additional tax due from these 24 returns was \$155,574, reflecting an average deficiency per return of \$6,428.

23. For example, Carter prepared a 2008 tax return for customer Mary Hayes on which Carter claimed the FTHBC. Hayes, however, does not own a home and did not buy a home in 2008. Additionally, Carter listed \$8,076 in non-taxable social security income as Hayes's only income in 2008, when in fact Hayes also received a taxable IRA distribution. As a result, Hayes received an improper refund in the amount of \$7,790.

24. Carter also claimed the FTHBC for customer Larry Lewis of Dixons Mills, Alabama on his 2008 tax return. Lewis did not purchase a home in 2008. Lewis stated that Carter did not even ask him about purchasing a house when he met with her to prepare the return, and he did not provide any documents to her. Lewis received only non-taxable social security income in 2008, but received an improper refund of \$6,624 because of Carter's bogus FTHBC claim. Carter charged Lewis \$35 at the time she prepared his return, and \$500 when he received his refund.

Improper Earned Income Tax Credits

25. Carter also frequently prepares returns on which she fraudulently manipulates a taxpayer's income or claims bogus dependants in order to maximize the claim for the Earned Income Tax Credit ("EITC").

26. The EITC is a refundable credit available to certain low-income individuals. The amount of the credit depends up on an individual's earned income, filing status, and number of claimed dependents. Because the credit is refundable, it is possible for an individual to reduce their federal income tax liability below zero and obtain a refund from the U.S. Treasury. The statutory provisions regarding the EITC are set forth in 26 U.S.C. § 32.

27. Because of the way the credit is calculated, a qualifying individual can actually receive a larger EITC by making more money in a tax year. For example, in tax year 2009, the maximum EITC was \$5,657 and was available to eligible individuals with three dependent children and earned income between \$12,550 and \$16,400. The amount of the credit increases as income increases between \$1 and \$12,550, and decreases as income increases beyond \$16,400. This range of earned income corresponding to a maximum EITC is sometimes referred to as the "sweet spot."

28. Unscrupulous tax return preparers like Carter exploit the rules by fraudulently adjusting income upwards or downwards so that a customer's income falls within the "sweet spot."

29. Because of the potential for abuse in claiming the EITC, Congress has authorized the Secretary of the Treasury to impose "due diligence" requirements on federal income tax return

preparers claiming the EITC for their customers. These “due diligence” requirements obligate the tax return preparer to make “reasonable inquiries” to ensure the customer is legitimately entitled to the EITC. The tax return preparer may not “ignore the implications of information furnished to, or known by, the tax return preparer, and must make reasonable inquiries if the information furnished to the tax return preparer appears to be incorrect, inconsistent, or incomplete.” *See* 26 C.F.R. § 1.6695-2 (2010). Tax return preparers must also document their compliance with these requirements and keep that documentation for three years. *Id.*

30. To document compliance with the due diligence requirements, tax return preparers must complete either the “Paid Preparer’s Earned Income Credit Checklist” (Form 8867) or record and maintain other documentation verifying customer eligibility for the EITC.

31. For tax years 2008 and 2009, Carter prepared over 99 returns claiming the EITC. Of the Carter-prepared returns that the IRS has examined, 16 claimed the EITC, and the IRS made adjustments reducing the amount of EITC on all of these returns. These adjustments represent a total tax deficiency of \$13,797, or an average deficiency per return of \$862. The IRS estimates that Carter’s fraudulent EITC claims resulted in a total harm to the United States of over \$85,338.

32. For example, Carter prepared the 2009 federal income tax return of Bruce Temple of Hamilton, Mississippi. Temple is employed as a truck driver. Carter reported two dependents on Temple’s tax return, identified as Temple’s adult sisters, who she claimed were disabled. However, Temple’s sisters did not qualify as his dependents in 2009. Based on the purported dependents that Carter reported on the return, Carter claimed an earned income tax credit in the amount of \$2,394. Because of this and other bogus deductions, Carter claimed a refund for

Temple in the amount of \$4,025. In actuality, Temple was not entitled to the earned income credit or a refund, and owed tax for 2009.

Harm Caused by Carter

33. Carter's customers have been harmed because they paid Carter fees to prepare proper tax returns, but Carter prepared returns that substantially understated their correct tax liabilities. Many customers now face large income tax deficiencies and may be liable for sizeable penalties and interest.

34. Carter's conduct harms the United States because her customers are under-reporting and under-paying their correct tax liabilities. The IRS examined a sample of 39 Carter-prepared federal income tax returns for processing years 2009 and 2010 containing bogus business deductions (15 returns) and FTHBC claims (24 returns), and these returns had a total of \$236,492 in lost revenue (an average of over \$6,063.90 per return) based on false claims and deductions. The IRS estimates that Carter's tax return preparation could have resulted in as much as \$4,250,000 or more in lost revenue to the United States. This estimate may be low, as it does not take into consideration the sample of Carter-prepared returns claiming the EITC that the IRS examined, or the FTHBC credits that were disallowed after the IRS recognized the fraudulent nature of those Carter-prepared returns.

35. In addition to the direct harm caused by preparing tax returns that understate customers' tax liabilities, Carter's activities undermine public confidence in the administration of the federal tax system and encourage noncompliance with the internal revenue laws.

36. Carter further harms the United States because the Internal Revenue Service must devote its limited resources to identifying Carter's customers, ascertaining their correct tax

liabilities, recovering any refunds erroneously issued, and collecting any additional taxes and penalties.

Count I
Injunction under I.R.C. § 7407

37. The United States incorporates by reference the allegations in paragraphs 1 through 36.

38. Section 7407, I.R.C., authorizes a district court to enjoin a tax return preparer from engaging in conduct subject to penalty under I.R.C. § 6694 or 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 the preparer has engaged in such conduct and that injunctive relief is appropriate to prevent the recurrence of the conduct. Additionally, if the court finds that a preparer has continually or repeatedly engaged in such conduct, and the court further 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 tax preparer.

39. Carter has continually and repeatedly engaged in conduct subject to penalty under I.R.C. § 6694 by preparing federal income tax returns that understate her customers' liabilities based on unrealistic, frivolous, and reckless positions.

40. Carter's continual and repeated violations of I.R.C. § 6694 fall within I.R.C. § 7407(b)(1)(A) and (D), and thus are subject to an injunction under I.R.C. § 7407.

41. If she is not enjoined, Carter is likely to continue to prepare and file false and fraudulent tax returns.

42. Carter's continual and repeated conduct subject to an injunction under I.R.C. § 7407, including her continual and repeated bogus claims of expenses and deductions and of eligibility for the First Time Home Buyer Credit, demonstrates that a narrow injunction prohibiting only specific conduct would be insufficient to prevent Carter's interference with the proper administration of the internal revenue laws. Thus, she should be permanently barred from acting as a tax return preparer.

Count II
Injunction Under I.R.C. § 7408

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

44. Section 7408 of the I.R.C. authorizes a district court to enjoin any person from engaging in conduct subject to penalty under I.R.C. § 6701 if injunctive relief is appropriate to prevent recurrence of such conduct.

45. Section 6701(a) of the I.R.C. penalizes any person who aids or assists in, procures, or advises with respect to the preparation or presentation of a federal tax return, refund claim, or other document knowing (or having reason to believe) that it will be used in connection with any material matter arising under the internal revenue laws and knowing that if it is so used it will result in an understatement of another person's tax liability.

46. Carter prepares federal tax returns for customers that she knows will understate their correct tax liabilities, because Carter knowingly prepares returns claiming improper expenses and deductions, and claiming improper credits. Carter's conduct is thus subject to a penalty under I.R.C. § 6701.

47. If the Court does not enjoin Carter, she is likely to continue to engage in conduct subject to penalty under I.R.C. § 6701. Carter's preparation of returns claiming improper expenses, deductions and credits is widespread over many customers and tax years. Injunctive relief is therefore appropriate under I.R.C. § 7408.

Count III
Injunction under I.R.C. § 7402(a)

48. The United States hereby incorporates by reference the allegations in paragraphs 1 through 47.

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

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

51. Unless enjoined, Carter is likely to continue to engage in such improper conduct and interfere with the enforcement of the internal revenue laws. If Carter is not enjoined from engaging in fraudulent and deceptive conduct, the United States will suffer irreparable injury by wrongfully providing federal income tax refunds to individuals not entitled to receive them.

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

53. Enjoining Carter is in the public interest because an injunction, backed by the Court's contempt powers if needed, will stop Carter's illegal conduct and the harm it causes the United States.

54. The Court should impose injunctive relief under 26 U.S.C. § 7402(a).

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

A. That the Court find that Cynthia Carter has continually and repeatedly engaged in conduct subject to penalty under I.R.C. § 6694, and has continually and repeatedly engaged in other fraudulent or deceptive conduct that substantially interferes with the administration of the tax laws, and that a narrower injunction prohibiting only this specific misconduct would be insufficient;

B. That the Court, pursuant to I.R.C. § 7407, enter a permanent injunction prohibiting Cynthia Carter from acting as a federal tax return preparer;

C. That the Court find that Cynthia Carter has engaged in conduct subject to a penalty under I.R.C. § 6701, and that injunctive relief under I.R.C. § 7408 is appropriate to prevent a recurrence of that conduct;

D. That the Court find that Cynthia Carter has engaged in conduct that interferes 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 I.R.C. § 7402(a);

E. That the Court, pursuant to I.R.C. §§ 7402(a), 7407, and 7408, enter a permanent injunction prohibiting Cynthia Carter, and all those in active concert or participation with her, from:

- (1) acting as a federal tax return preparer, or assisting in or directing the preparation or filing of federal tax returns, amended returns, or other related documents or forms for any person or entity other than herself;
- (2) understating customers' liabilities as prohibited by I.R.C. § 6694;
- (3) engaging in any other activity subject to penalty under I.R.C. §§ 6694, 6701, or any other penalty provision in the I.R.C.; and

- (4) engaging in conduct that substantially interferes with the proper administration and enforcement of the internal revenue laws;

F. That the Court, pursuant to I.R.C. §§ 7402(a), 7407, and 7408, enter an order requiring Cynthia Carter to contact, within fifteen days of the Court's order, by United States mail and, if an e-mail address is known, by e-mail, all persons for whom she prepared federal tax returns or claims for a refund for tax years 2008 through 2010 to inform them of the permanent injunction entered against her;

G. That the Court, pursuant to I.R.C. §§ 7402(a), 7407, and 7408, enter an order requiring Cynthia Carter to produce to counsel for the United States, within fifteen days of the Court's order, a list that identifies by name, social security number, address, e-mail address, and telephone number and tax period(s) all persons for whom she prepared federal tax returns or claims for a refund for tax years 2008 through 2010;

H. That the Court, pursuant to I.R.C. §§ 7402(a), 7407, and 7408, enter an injunction requiring Cynthia Carter to provide a copy of the Court's order to all of Carter's principals, officers, managers, employees, and independent contractors within fifteen days of the Court's order, and provide to counsel for the United States within 30 days a signed and dated acknowledgment of receipt of the Court's order for each person whom Carter provided a copy of the Court's order;

I. That the Court retain jurisdiction over Cynthia Carter and over this action to enforce any permanent injunction entered against her;

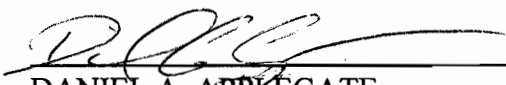
J. That the United States be entitled to conduct discovery to monitor Cynthia Carter's compliance with the terms of any permanent injunction entered against her; and

K. That the Court grant the United States such other and further relief, including costs, as is just and reasonable.

DATED: March 19, 2012

Respectfully submitted,

FELICIA C. ADAMS
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