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UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA
WESTERN DIVISION

United States of America,

Plaintiff,

vs.

Kenneth Elliott, d/b/a KAE Insurance Services, Inc., Vista Barranca, Inc., and KAE Consulting; Sea Nine Associates, Inc., and Ramesh Sarva,

Defendants.

Case No. SACV13-1582JLS (JPRx)

COMPLAINT FOR PERMANENT INJUNCTION AND OTHER RELIEF

The United States of America, for its complaint against Defendants Kenneth Elliott d/b/a KAE Insurance Services, Inc., Vista Barranca, Inc., and KAE Consulting, and Sea Nine Associates, Inc., and Ramesh Sarva, seeking a permanent injunction pursuant to 26 U.S.C. ("I.R.C.") §§ 7402 and 7408 to prohibit them from further promoting a fraudulent tax scheme (more completely described herein), states as follows:

NATURE OF ACTION

1. Defendants organize, operate, and/or promote a scheme in which they sell to customers owning small, often closely-held companies participation in Voluntary Employee Beneficiary Association ("VEBA") plans. The Defendants claim that customers can, through the contributions their businesses make to VEBA plans administered or operated by the Defendants, fund for their employees (and more often than not themselves) a valuable insurance-oriented welfare benefit while claiming all of the VEBA contributions as a federal income tax deduction. At the same time, those plan contributions are intended to provide participating customers with a valuable deferred compensation-like benefit that allows them to recoup the full value of their initial contributions. In fact, this scheme – through which the Defendants' customers enjoy a substantial tax deduction for their plan contributions, while also permitting them to retain the full value of the contributions later - violates the Internal Revenue Code and applicable Treasury regulations, and the Defendants' promotion of it constitutes enjoinable penalty conduct.

2. Defendant Kenneth Elliott ("Elliott"), personally and through both his employment with co-defendant Sea Nine Associates, Inc. ("Sea Nine"), a number of related entities he controls (KAE Insurance Services, Inc. ("KAE"), Vista

Barranca, Inc., and KAE Consulting), and a network of affiliated third parties (*e.g.* independent certified public accountants ("CPA") and financial planners) informs potential participating companies that participating in a VEBA plan provides them with a lucrative and tax-advantaged method to accrue wealth.

3. Defendant Ramesh Sarva ("Sarva") is a CPA who has been steering his customers toward VEBA plans for over 20 years – and in particular, toward Sea Nine-administered VEBA plans. He promotes the plans' false benefits while also rebroadcasting the false statements that Elliott and Sea Nine make about the plans they operate and administer. Sarva has persuaded more than 30 taxpayers to participate in a Sea Nine plan, enriching himself (as well as Elliott and Sea Nine) in the process.

4. As a result of the Defendants' promotion, companies from across the nation have contributed millions in dollars to a variety of VEBA plans, and paid the Defendants substantial sums to manage these plans. VEBA plan participating companies also deduct millions of dollars in contributions to the plans.

5. More than a decade ago, however, the IRS ruled that employee welfare benefit plans like the VEBAs the Defendants promote and operate do not comply with federal tax law, and such determinations have been repeatedly upheld by federal courts. Yet the Defendants have continued to falsely claim that the VEBA plans in fact comply with the tax laws, and manage and promote them to this day despite their documented knowledge of the illegality of the plans. The result is significant amounts of lost tax revenue to the Treasury based on erroneously claimed tax deductions.

6. Accordingly, the United States brings this complaint pursuant to I.R.C. §§ 7402 and 7408 to enjoin the Defendants from promoting participation in VEBA plans, managing the plans, and/or assisting persons in participating in them,

thereby enabling their customers to falsely claim tax deductions to which they are not entitled.

JURISDICTION AND VENUE

7. This Court has jurisdiction under 28 U.S.C. §§ 1340 and 1345, and I.R.C. §§ 7402(a).

8. This action for injunctive relief is brought at the request of 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 of the United States, pursuant to I.R.C. §§ 7402 and 7408.

9. Venue is proper in this Court under 28 U.S.C. § 1391(b) because a substantial part of the events giving rise to this suit took place in this district. The Court has personal jurisdiction over all named defendants, including those not domiciled in this jurisdiction, because the claims asserted against them arise out of events that took place in this district, and because it was foreseeable they would be sued in this district.

THE PARTIES

10. Defendant Elliott is a resident of Rancho Santa Margarita, California. Besides his employment with Sea Nine, Elliott conducts business relevant to the claims in this lawsuit through a variety of entities that he set up for administrative purposes (*e.g.* to enable him to separate income streams he derives for the different kinds of work and services he generally provides through Sea Nine).

11. Defendant Sea Nine is a Nevada corporation founded by Stephen Ross. After Ross's death in 2000, ownership and formal control of Sea Nine passed to his widow, Sylvia Ross Calhoun. Elliott (via a management contract between

Sea Nine and one of his personal business entities) operates and manages Sea Nine as a business concern as if he were its chief executive officer, even though he does not possess a formal title at the company.

12. KAE is the business name Elliott utilizes for performance of any licensed insurance agent-related work he performs for Sea Nine.

13. Vista Barranca is a business entity Elliott created for the purpose of employing and paying him for the work he performs for Sea Nine. At the end of each year, Sea Nine issues a Form 1099 to Vista Barranca for whatever income Elliott has drawn from his work for Sea Nine.

14. KAE Consulting is the business name Elliott utilizes when he performs certain fee-for-service consulting work for Sea Nine or independently.

15. Defendant Sarva is a CPA and resident of Little Neck, New York. He does business as "Ramesh Sarva, CPA, PC" and has offices in New York and Tennessee. He also does business as "Soft Tech Source," which is a division of his CPA practice.

BACKGROUND ON WELFARE BENEFIT PLANS

16. As described in more detail below, the Defendants typically market participation in the VEBA plans that Sea Nine operates to high net worth customers who operate small or closely-held businesses, such as medical practices. They inform such customers that participation in a Sea Nine-administered VEBA plan allows the customers to lawfully avoid paying taxes on the funds contributed to the plans - because such contributions constitute tax-deductible payments to a "welfare benefit plan" that purportedly complies with the Internal Revenue Code.

17. A welfare benefit plan provides certain benefits – such as medical or death benefits – to a company's employees or its other designated beneficiaries,

like the company's principals. Where such a plan provides benefits for only one company's employees, it is sometimes referred to as a "single employer plan" or "Section 419(e) Plan." By contrast, if ten or more employers participate in the plan, and other conditions are met, the plan is commonly called a "10 or more employer plan," "multiple employer plan" or "Section 419A(f)(6) plan." The Defendants purport to operate lawful and compliant Section 419A(f)(6) plans.

18. Welfare benefit plans under Section 419 have common characteristics. To finance the employee benefits that such a plan is supposed to make available, the plan creates a single joint trust or other fund to which an employer (or, in the case of a 419A(f)(6) plan, all participating company/employers) makes contributions. In turn, the trust uses those contributions to purchase insurance contracts and other assets which provide welfare benefits (mainly life insurance protection) to certain of the company's employees. A trustee (often a bank or other financial institution) typically takes formal ownership of the insurance policies purchased by the plan and helps operate the VEBA plan.

19. A company could opt simply to finance the purchase of individual insurance policies for those employees to whom it wished to provide such a benefit. However, in such cases the premium paid for the individual insurance policies would generally be included as part of the employee's gross income. (*See* Treasury Reg. §1.61-2(d)(2)(ii)(A)).

20. By contrast, under appropriate circumstances, contributions to a legally compliant welfare benefit plan that are used to purchase life insurance for a company's eligible employees are deductible in the year they are paid without the entirety of the premiums for such policies being counted as part of the employee's income. This makes a welfare benefit plan attractive – because of the benefit it provides to employees as well as its tax advantages. Federal tax law, however,

strictly limits the deductibility of contributions to welfare benefit plans in a number of ways in order to limit the abuse of such plans (which in the past have been used as tax shelters).

21. First, a company generally cannot deduct its contribution to a welfare benefit plan if the payment does not constitute an "ordinary and necessary" business expense within the meaning of I.R.C. § 162. For example, a corporation may not claim a deduction for a purported plan contribution that is actually used to distribute corporate earnings (a dividend) to the company's shareholders rather than to purchase a health or insurance benefit.

22. Second, a company cannot deduct a contribution to a welfare benefit plan in the year made if the benefits provided constitute deferred compensation as defined by I.R.C. § 404. *See* I.R.C. § 419(e)(2). Contributions to a deferred compensation plan are deductible only in the future year in which the recipient employee includes the compensation in his or her gross income. I.R.C. § 404(a)(5).

23. In addition, even if a particular contribution to a purported welfare benefit plan passes these two tests, a company still generally may not deduct the full amount of its contribution unless the requirements of I.R.C. §§ 419 and 419A are also met.

24. To prevent taxpayers from using welfare benefit plans to obtain improperly inflated tax deductions, Congress has limited a company's deductible contributions to the fund's "Qualified Cost" for the taxable year (less the fund's after-tax income). *See* I.R.C. § 419(c). A fund's Qualified Cost is the sum of (1) the "Qualified Direct Cost" for the taxable year, and (2) any addition to a "Qualified Asset Account" for the taxable year (subject to certain limitations). *Id.* The Qualified Direct Cost excludes – and therefore an employer may not deduct –

contributions paid for premiums on life insurance policies that have cash value. *See* Rev. Rul. 2007-65.

25. This "Qualified Cost" deduction limit does not, however, apply to contributions made to a legitimate "10 or more employer plan" (also known as a "multiple employer plan") under I.R.C. § 419A(f)(6). In a legitimate "10 or more employer plan," generally a group of smaller employers pool together to provide benefits for their employees – making the relationship between each participant and the plan like that of an insurer and insured. The tax code excludes contributions to a qualified "10 or more employer plan" from the Qualified Cost limits of Section 419 – and thus permits such contributions to be deducted - since it presumes that an employer would not rationally pay more for the welfare benefits they are purchasing than the benefits' actual cost. Excess contributions paid to a plan fund that complies with Section 419A(f)(6) are available to pay the benefits of the employees of all other participating employers, and thus are generally not recoupable at a later date by the employers making the excess contributions. However, a plan in which all, or nearly all, employers are making excess contributions may (often through clever bookkeeping) operate in a manner such that all excess contributions are in fact recoupable to the employers making the excess contributions.

26. Thus, to ward against the possibility of participating companies abusing welfare benefit plans through the Section 419A(f)(6) exception in order to obtain both large tax deductions and the preservation of the value of their excess contributions, Section 419A(f)(6) narrowly defines "10 or more employer plan" as existing only where (a) there is a single plan, (b) more than one company contributes, (c) to which no company regularly makes more than 10% of the total contributions to the plan, and (d) there are no experience-rating arrangements with

respect to individual employers. *See* I.R.C. § 419A(f)(6); Treas. Reg. § 1.419A(f)(6)-1(a)(1).

27. Applicable Treasury regulations describe an "experience-rating arrangement" to be when a particular plan participant's costs for being in the plan vary from those of other participants - whether because the participant's past contributions are applied to reduce his specific later contributions, or because the generation of a policy's cash value over time reduces the need for future payments (in effect, excessive earlier premium payments result in the policy being fully funded at a later date). (*See* Treas. Reg. § 1.419A(f)(6)-1(b)(1)).

28. Purported Section 419A(f)(6) welfare benefit plans have been vehicles for rampant tax abuse. In one common tax avoidance scheme, employers pay excessive contributions to Section 419A(f)(6) welfare benefit funds that obtain cash value insurance policies or otherwise set funds aside for a particular company owners' future benefit. In doing so, the companies are not really providing a welfare benefit for their employees, but are instead either distributing excess corporate profits to employees or providing deferred compensation to their owners and, in the process, avoiding current federal taxes. *See, e.g., Neonatology Assoc., P.A. v. Comm'r*, 299 F.3d 221 (3d Cir. 2002); *V.R. De Angelis v. Comm'r*, T.C. Memo. 2007-360, *aff'd* 574 F.3d 789 (2d Cir. 2009); IRS Notice 95-34; IRS Notice 2007-83; IRS Notice 2007-84.

29. Significantly, the *Neonatology* case involved the participants in a Sea Nine-sponsored and promoted VEBA plan – thus evidencing the Defendants' persistent promotion of the tax scheme at issue in this case despite knowledge of its potential illegality for over 10 years.

30. Since 1995, the IRS has warned taxpayers and their representatives that many arrangements claiming to provide substantial tax deductions through

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contributions to purported multiple employer welfare benefit plans are, in fact, abusive transactions that violate I.R.C. §§ 419 and 419A. *See* Notice 95-34. These transactions require large employer contributions relative to the cost of the term insurance that would be required to provide the death benefits under the arrangement, often maintain separate accounting of assets of the employers within the plan, and may insulate an individual employer from the experiences of the plan's other participating employers.

31. The IRS has designated such transactions, and those substantially similar, as "listed transactions." *See* IRS Notice 2000-15. A listed transaction is a transaction that is the same as or substantially similar to one of the types of transactions that the IRS has determined to be a tax avoidance transaction, and must therefore be reported by participants to the IRS in accordance with specified regulations. *See* I.R.C. § 6111(a) and (b); Treas. Reg. § 301.6111-3.

32. Further, since at least 2007, the IRS has warned taxpayers and their representatives that certain purported "single employer plans" involving cash value life insurance policies are properly deemed "listed transactions" because of their abusive characteristics. *See* IRS Notice 2007-83; Notice 2007-84; *see also* Rev. Rul. 2007-65. In these transactions, employers take large deductions for contributions to purported welfare benefit plans and the plans accumulate value for the benefit of select owners either inside the life insurance policies or through agreements outside of the policies.

DEFENDANTS' VEBA PLAN SCHEME

Overview

33. Since 2001, Elliott has organized, promoted, and (through Sea Nine and the various other business entities he uses) administered a number of VEBA

plans that falsely purport to meet the definition of a "10 or more employer plan" under I.R.C. § 419A(f)(6), thereby permitting a participating company to fully deduct its contributions. Elliott was instrumental in creation of the present iteration of Sea Nine's VEBA plan, and the ultimate resource for questions about its operation by participating companies (although such companies were usually first solicited to participate in the VEBA plans by third party insurance brokers or CPAs, some of whom consistently identified customers for Elliott).

34. Sea Nine typically tries to group facially-similar entities into the same plans, giving them names reflective of their participants' respective businesses.

35. In the mid-1990s, Elliott began working for Stephen Ross at Sea Nine, where he learned about the VEBA plans. After Ross's death Elliott continued to operate Sea Nine's business and to market and manage the VEBA plans it promotes. Through his administration of the VEBA plans, Elliott receives a share of the total commission paid from the sale of the underlying life insurance policy.

36. A typical Sea Nine-originated VEBA plan has several common components. First, there is a "master plan" document that establishes the responsibilities of the parties to the plan. The participant's company adopts the master plan through an adoption agreement. Sea Nine created the first version of such a master plan in 1985 when Sea Nine's former principal, Stephen Ross, was still alive. There is a separate master plan document for each VEBA plan Sea Nine administers, with VEBAs distinguished typically by the nature of the businesses that participate in them. Nevertheless, the master plans used by Sea Nine and Elliott for each VEBA they administered have historically been largely identical.

37. The master plans for each Sea Nine VEBA specify their elements and provisions, such as the nature and circumstances in which contributions are made to it, the eligibility requirements for participation or beneficiaries, the nature of the

benefit provided by the plan and the establishment of the Master Committee tasked with choosing the proper insurance policy to purchase. The plans specify that the participating company will make contributions to the plan sufficient to provide the intended insurance benefits to eligible employees. The plans also specified the conditions under which participating companies may terminate participation, providing the policies' beneficiaries the opportunity to take personal ownership of the life insurance policy.

38. Next, a participating company enters into an "adoption agreement" with Sea Nine. Through such an agreement, the participating taxpayer adopts the Master Plan, specifies the initial amount of contributions paid into the plan, and specifies the benefits to be provided by the plan. The adoption agreement also specifies the eligibility requirements for that participating company's employees to be covered by the plan, and establishes and appoints irrevocably the members of the Master Committee.

39. The Trustee appointed under the plan document is technically responsible for protecting and preserving the assets of the plan like an independent fiduciary. In fact, under the terms of the plan document the Trustee acts only at the direction of the Master Committee. The Master Committee ultimately determines the kind of insurance policies to be purchased with the contribution, the insurance company from which they will be purchased, and is responsible for all other issues concerning the payment of benefits under the plan.

40. Participating companies in a Sea Nine VEBA plan typically contribute a set amount per year as set forth in the adoption agreement until the date by which the policies are mostly funded (usually for five years). Although the annual contribution amount can vary, it is typically in increments of $250,000.

41. Participating companies are told that they can legally reduce their federal income taxes by deducting the amount of their VEBA plan contributions on their companies' tax returns. Those contributions, however, invariably exceeded the actual cost of the primary "welfare benefit" claimed to be the aim of the VEBA plans – the death benefit derived from a life insurance policy – for a given year. The excess sums were in fact used to fund cash value whole life policies that plan participant beneficiaries (typically including, since most participating companies were small businesses, the company's principal or founder) could later purchase and then use as a source of tax-free income – either to borrow against or cash out entirely. Doing so merely reduced the value of the death benefit to be paid (assuming loans on the policy were not repaid).

42. The price of purchasing a whole life policy that has this sort of cash value is usually substantially higher than if the plan merely purchased term life insurance (which would only provide a death benefit without any cash value). For example, one participant, Dr. Sydney Smith, joined a Sea Nine VEBA plan through his Hawaii-based medical practice. Dr. Smith's company contributed more than $300,000 to the Sea Nine VEBA plan between January 1, 2004 and December 31, 2006, even though he was the only beneficiary. The cost of term insurance for this same period for Dr. Smith would have been approximately $7,410.[1]

43. The higher premiums for whole life policies purchased through the Sea Nine VEBA plans serve a dual purpose. The larger the contribution, the larger the tax deduction a participating employer could claim (and because most VEBA participating companies were owned by a single individual, such as a doctor or

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[1] Dr. Smith was covered by a $1.9 Million policy during this period. He was 42 years old at the time the policy was issued. IRS Table 2001 was used to determine that the applicable annual cost for term insurance based on Dr. Smith's age is $1.20 per thousand dollars of insurance. The total cost for all three year is calculated as follows: $1,900 X $1.2 X 3 Yrs = $7,410.

entrepreneur, the benefit of the deduction flowed directly to that individual). In addition, large contributions were beneficial to participating companies because the contributions were used to pay premiums that mostly flowed through into the accumulating cash value of the life insurance that the VEBA bought to benefit the company's employees (including the company principal).

44. Thus, the core purpose and effect of the participation in a Sea Nine VEBA plan is to provide participants with a mechanism to accumulate wealth for their personal benefit, unlawfully protecting that income from federal taxation by treating it as a welfare benefit when it was that in name only. Sea Nine VEBA participating employers were able to deduct the entirety of their substantial contributions – and then realize the complete benefit of those contributions later, when they left the VEBA. Even though the Defendants purport that their VEBA plans conform to the Tax Code, in substance they do not at all – a fact of which the Defendants are well aware.

Marketing of the VEBA plans

45. As noted, Elliott and Sea Nine promote the VEBA plans mostly to high-income professionals across the country who own small, closely-held companies. They do so through a variety of insurance brokers, CPAs, and independent financial advisors. Although the principals of participating companies did not always speak directly to Elliott in the course of adopting a plan and making contributions to it, Elliott provided all the information about the VEBA plans and their functioning to the individuals initially responsible for marketing the VEBA plans to potential customers. Elliott was always involved in operating the VEBA plans and always the ultimate expert on how they worked.

46. Defendant Sarva has for many years been particularly avid and successful in promoting participation in Sea Nine VEBA plans to taxpayers. Sarva

encouraged small business owners with high net worth (often doctors with small but lucrative medical practices) to consider VEBA plans. Sarva's familiarity with Sea Nine VEBA plans extended back to when Stephen Ross was alive. After Mr. Ross' death, Sarva dealt with Elliott on matters pertaining to the functioning of the plans. Sarva continues to this day to refer customers to Sea Nine plans where he deems it appropriate.

47. Sarva has successfully marketed at least 33 separate VEBAs plans to a variety of small business owners. All of these participants have been or are currently being audited by the IRS. 13 of these participant audits have been completed and have resulted in total tax adjustments of $3,500,519. The remaining 20 audits are still in progress, but at present the IRS expects that these pending audits will result in additional total tax adjustments of $5,385,414.

Examples of VEBA plans marketed by Defendants

48. In the past 10 years, Elliott and Sea Nine have (directly or through intermediaries like Sarva) successfully promoted VEBA plans to a large number of taxpayers. In the process, however, they have frequently been confronted with the fact that their conduct is illegal and that they make false statements about the tax benefits of their VEBA plans. They have learned of the illegality of their acts both from the examination by the IRS of their customers' tax returns, and also when those same customers (alarmed to learn that they owe substantial unpaid taxes after relying on the Defendants' representations) have sued the Defendants themselves. But nothing has stopped the Defendants from continuing to promote the VEBA plans or to falsely claim that they comply with federal law.

J & M Associates

49. J & M Associates ("J & M") is a subchapter S corporation located in Mobile, Alabama that provided contract labor for marinas and shipyards in the

Gulf Coast and San Diego, California regions. Its two principal shareholders were brothers John and Mike Wilks.

50. J & M was interested in a financially prudent benefit plan that would have tax advantages. It specifically learned of the Sea Nine VEBA plans in 2004 through a financial consultant – who in turn had a personal connection with another financial advisor who repeatedly promoted VEBA plans.

51. Through such intermediaries, J & M learned that Sea Nine administered a welfare benefit plan that had room for a new participating employer if J & M acted quickly. In particular, Elliott (directly or through the individuals promoting Sea Nine's VEBA plan directly) told J & M that the Sea Nine VEBA plan had been approved by the IRS. To establish this assertion, Elliott frequently showed potential customers like J & M copies of old letters from the IRS acknowledging that the Sea Nine VEBAs were proper tax-exempt entities under I.R.C. § 501(c)(9) – ***not*** that they complied with § 419A(f)(6). Indeed, the letters Elliott provided to potential customers and which he claimed showed the IRS's approval predated the 2004 changes to the relevant Treasury regulations.

52. J & M consequently agreed to enter into the Sea Nine VEBA plan in the spring of 2004. The terms of the plan obligated the Wilkses to contribute one million dollars annually for five years toward the purchase of cash value whole life insurance policies that the plan's Trustee would control. Elliott (directly or through the individuals who first contacted J & M) informed the Wilkses that after the five-year funding period, they could terminate the plan and directly obtain ownership of the policies they had been funding, allowing them after an additional period of time to make annual tax free withdrawals on the policies as a retirement benefit. He also (directly or indirectly) informed the Wilkses that they could easily terminate the plan even earlier in case of hardship (*e.g.*, if it became difficult for

them to make the required yearly contributions), permitting them to withdraw entirely from the plan but still realize the benefits for those portions of the policies that had been paid for.

53. In order to clear up questions they had about the overall legality of the Sea Nine VEBA plan, the Wilkses obtained a legal opinion from attorney Frederick Romero "as to the legal viability of deductions claimed for contributions made for the initial 2004 plan year as well as substantial authority concerning the implementation of the program including consideration of the final regulations issued by the Internal Revenue Service relative to the 'ten or more' employer programs." On August 12, 2004, Romero provided an opinion that the IRS would "more likely than not" lose on the issues of 1) whether the VEBA program is one described under IRS 501(c)(9) and 419A(f)(6), and 2) whether J & M was entitled to a current deduction for the entire contribution into the VEBA program. Elliott and Sea Nine referred Romero to the Wilkses; Sea Nine had maintained a long standing relationship with Romero dating back to the time when Ross was alive. Romero had previously written several favorable legal opinions with regard to the VEBAs.

54. In 2005, after Hurricane Katrina devastated the Gulf Coast, J & M's business was severely impacted, making it impossible for it to make the second million dollar contribution due for its participation in the VEBA plan. The Wilkses subsequently requested (in keeping with the manner in which they had been told the plan was to be operated) that their participation be restructured to reduce their yearly payment because of their financial hardship. J & M received reassurances from Elliott and his representatives that all of their understandings were correct, and were able to make a lesser contribution of $250,000.

55. In 2006, however, J & M subsequently received a contradictory message: because they were not making the proper level of contributions to their VEBA plan, the cash value of their total contribution was dwindling rapidly and would soon have no value at all (because the plan was using the cash value of the policies to make up the balance of unpaid contributions). One of the individuals responsible for directly marketing the Sea Nine VEBA plan to J & M even admitted this was the case.

56. J & M's Form 1120S corporate tax return was audited by the IRS for the 2004 and 2005 tax years. As a result of the audits, the IRS determined that the VEBA plan promoted by Sea Nine and in which J & M had participated did not qualify for the deduction limit exceptions set forth in § 419A(f)(6), and therefore the Wilkses' personal income taxes would be adjusted by nearly $1.3 million for the two tax years – causing them to jointly owe over $460,000 in unpaid taxes. The IRS also issued penalties against J & M for failure to report their participation in the VEBA plan as a listed transaction.

57. J & M subsequently brought a lawsuit in federal court against the individuals who directly marketed Sea Nine's VEBA and AIG (issuer of the insurance policies that were purchased for it through the VEBA plan). Elliott was deposed in the case but not named as a party. J & M obtained a favorable settlement after the Court ruled, on summary judgment, that questions of fact existed as to whether the defendants had properly disclosed to J & M all the facts of which they were aware as to the legal validity of the Sea Nine VEBA plan.

<u>Drs. Singer and Smith</u>

58. Drs. Daniel Singer and Sydney Smith are Hawaii-based orthopedic surgeons who learned of Elliott's Sea Nine VEBA plans through a financial

planner in Honolulu. That individual in turn relied on Elliott as his source for information about the VEBA plans and how they functioned.

59. Although Elliott did not directly initiate contact with Drs. Singer and Smith, he participated in explaining the VEBA plans to them and the purported tax benefits, and personally prepared materials sent to them while they weighed whether to participate. The two doctors decided to participate in a Sea Nine VEBA plan after hearing (from Elliott and his representatives or interested third parties) the same kinds of representations that convinced other owners to do so, *e.g.* that contributions were tax-deductible; that they could pre-fund the insurance through such contributions; that they could buy out the insurance while its cash value remained low; and that the resulting whole life policy would have high value later against which they could borrow or otherwise obtain tax free income.

60. Elliott thus packaged the materials necessary for Drs. Singer and Smith to become VEBA plan participating employers. Ultimately, however, the IRS learned of their participation in the VEBA plans and disallowed their contributions after audit. As a result, Dr. Singer had in excess of $500,000 in additional tax liabilities, while Dr. Smith owed approximately $209,000.

61. Drs. Singer and Smith also filed suit in Circuit Court for the State of Hawaii against (among others) Elliott, Sea Nine, AIG, and the financial planner who had first steered them toward the Sea Nine plan. The complaint alleged against Elliott and the other defendants claims of fraud, intentional misrepresentation, negligent misrepresentation, civil conspiracy, negligent failure to disclose, and violation of Hawaii's consumer protection statute. The lawsuit settled in 2012.

Other VEBA plan participants

62. Numerous other small or closely-held businesses have become Sea Nine VEBA plan participating employers – and many of them have been audited and had their contributions disallowed, resulting in their owing additional unpaid taxes to the Government.

63. For example, Dr. Atul Patel, an anesthesiologist and sole employee of her medical practice business, was looking for a life insurance product and was put in touch with Ramesh Sarva, who assisted Dr. Patel in participating in a Sea Nine VEBA plan beginning in 2005. Elliott acted as Dr. Patel's trustee and provided Dr. Patel, directly or through Sarva, all of the information and paperwork needed for participation in the Sea Nine VEBA plan. Dr. Patel's VEBA plan required her to make contributions for five to seven years to fund a death benefit of $7 million.

64. The IRS, however, audited Dr. Patel's tax returns claiming deductions for the contributions to the VEBA plan and disallowed them, resulting in adjustments of $791,335 to her taxes.

65. Another company, LSL Associates, LLC ("LSL") of Naples, Florida, wanted to offer an individual, Sean Lawley, an ownership interest in the partnership, and was trying to identify incentives to get him to agree to join.

66. To this end, LSL explored with one of its financial advisors possible ways it could structure alternative forms of compensation for Lawley, and determined that it would use an insurance product to do so. Through this inquiry, LSL learned of the Sea Nine VEBA plans.

67. LSL specifically decided to make Lawley the beneficiary of such a VEBA plan because the insurance benefit he would receive included a guaranteed cash benefit. Thus, offering Lawley this benefit was a way to provide him with a

valuable incentive to join LSL without also having to directly pay him more in compensation.

68. In the course of adopting the Sea Nine VEBA plan, LSL's principals learned (from the individuals promoting the plan – who in turn relied directly on Elliott to answer any questions about the Sea Nine plans) that the plan had been previously approved by the IRS, as well as that contributions were tax-deductible. Lawley was the sole LSL employee or member designated as a beneficiary of the VEBA plan.

69. The IRS subsequently audited LSL and disallowed the tax deductions it had taken for its contributions to the Sea Nine VEBA plan, resulting in LSL owing additional taxes of $143,550.

70. Omer Katzir was another Sea Nine/Elliott customer who ultimately paid a high price for participating in the VEBA plan they promoted. Katzir owns "Katzir's Floor & Home Design," a Southern California company specializing in hardwood floor design and installation. Katzir wished to invest extra money he was earning, and through his CPA was introduced to a California financial planner, who informed him about the Sea Nine VEBA plans and their tax benefits.

71. Katzir had reservations about participating in the plan, deeming it "too good to be true," and therefore he resisted joining for six months. However, after several meetings (some of which Elliott himself participated in) he decided to participate in a Sea Nine VEBA plan (specifically, the "Southern California Retail Merchant's League" plan) and began making contributions in 2004 to fund the purchase of an $8 million life insurance policy. The sole beneficiaries of the insurance to be purchased through the plan were Katzir and his wife.

72. In the course of Katzir's evaluating whether to participate in the Sea Nine VEBA plans, Elliott informed Katzir both that his contributions were fully

tax-deductible and that he could borrow against the cash value of the policy at age 64. Elliott and the third parties working with him, in response to Katzir's questions about the legal validity of the plan showed Katzir irrelevant IRS "approvals" predating the relevant regulations but which, they told him, established the IRS's approval of the plans.

73. As with other Sea Nine plan participating companies, however, the IRS audited Katzir's company and disallowed his contributions, resulting in Katzir owing an additional $1,284,270 in taxes.

Defendants' Knowledge of the Illegality of the VEBA Plans

74. For over 10 years, the Defendants have been on notice that statements they were making about the tax effects or benefits of participation in a VEBA plan, and the legality of the Sea Nine plans themselves, were false. Yet the Defendants persist to this day in promoting as well as operating and/or administering such plans.

75. In July 2003, the U.S. Treasury Department issued final regulations applicable to programs that purport to be "multiple employer plans" under I.R.C. § 419A(f)(6). *See* Treas. Reg. § 1.419A(f)(6)-1.

76. As of that date, Elliott had been running Sea Nine for almost two years since the death of Stephen Ross. Sea Nine was also still using the same plan documents it had employed for its VEBA plans since 1985. Those documents were thus unquestionably not drafted in light of the new regulations, and contained provisions that would likely not satisfy those regulations.

77. In particular, those versions of Sea Nine's VEBA plans allowed participants to distribute the value of the assets contributed to the plan back to themselves in accordance with a defined formula – in effect, to recover some value of their contribution in excess of the basic death benefit provided by the insurance

policy that the plan contributions were funding. This is very much the kind of "experience-rating arrangement" that the revised regulations prohibited. (*See* Treas. Reg. 1.419A(f)(6)-1(b)).

78. Similarly, Elliott has stated that the various VEBA plans Sea Nine administers contain sufficient funds within them to avoid the need for individual participants to adjust their contributions later. These excess sums are the result of differences between the amounts contributed by plan participants and the costs of the insurance policies purchased by the VEBA plans. But the 1.419A(f)(6) regulations define an "experience-rating arrangement" to include situations arising in a welfare benefit plan where the *cost of coverage* is, or can be expected to be, based on the employer's *benefit experience* or *overall experience* as those terms are defined in the regulations. (Trea. Reg. § 1.419A(f)(6)-1(d)). Thus, each Sea Nine plan maintains an experience-rating arrangement because` the cost of coverage for any employer is based on that employer's insurance funding from a prior year (i.e., his or her overall "experience" with the plan).

79. In addition, the 2003 version of the Sea Nine plan documents encouraged participants to obtain the financial benefit of terminating participation in the plan after making only five years of contributions – shortly before the policy to be purchased began realizing its springing cash value. To do so would violate the 2003 revisions to the regulations relating to Section 419A(f)(6), because participants would be paying a variable amount for their policies not common to all plan participants, while also obtaining a benefit in excess of the cost of the basis death benefit (which, as noted above, could be obtained for far less had the plan participants simply purchased term life insurance for their beneficiaries instead of whole life policies with cash value).

80. AIG (which at one point sold many of the insurance policies obtained by the Sea Nine VEBA plans for its participants) corresponded with Elliott directly in September 2003, asking him to provide it with a legal opinion that the Sea Nine VEBA plans complied with the new Section 419A(f)(6) regulations. In response, counsel retained by Elliott provided him with several different opinion letters in 2004 admitting that the existing Sea Nine VEBA plans did ***not*** comply with the new regulations, but that a proposed redrafted set of plan documents was "more likely than not" to be in compliance once such documents were formally accepted. Elliott was also informed through such opinion letters that the changes to the law were in effect as of January 2003 – and that therefore the VEBA plan documents being relied upon by Elliott needed immediate modification.

81. Nevertheless, and despite his awareness of the need to amend the plan documentation, Elliott continued to inform third parties interested in participation in a VEBA plan that the Sea Nine VEBA plans complied with the law and were not listed transactions (without ever disclosing the contrary opinions about the need to amend or update the existing version of the plans).

82. Thus, in 2007 and 2008 correspondence with a representative of Drs. Singer and Smith asking for confirmation that the Sea Nine VEBA plans conformed to existing law and regulations, Elliott specifically represented that new plan documents had been "restated" but not yet formally sent out to plan participants for execution, but that regardless "we have been operating and administering the Plan in compliance with the Final Regs." In fact, this was false.

83. Numerous taxpayers detrimentally relied on Elliott's representations about the legality of the Sea Nine plans, with the result that such taxpayers have been audited and found to owe significant additional taxes.

84. Financial institutions that served as plan trustees, such as Union Bank, also began raising questions about how the Sea Nine VEBA plans were administered, and demanding audits to determine if certain of their plans were operating in compliance with the plan document. In the course of attempting to resolve such concerns, Elliott acknowledged in correspondence that the VEBAs were not in compliance with the 2003 Treasury regulations, but claimed (as he continues to do so today) that they were being "operated" in accordance with the changes in the law even if the formal plan documents had not been modified.

85. Yet despite his knowledge of problems with the regulatory compliance of the Sea Nine VEBA plans – as evidenced not only by the above but by the number of IRS audits of his customers or lawsuits directed by customers at Elliott and those working with him - Elliott has continued to insist that he is making or has made any necessary changes to the plans he markets. In fact, he has not done so.

86. For example, in recent interviews with the IRS, Elliott has claimed that he has addressed the appearance of experience rating between the different participants of each VEBA plan by having an independent actuary design appropriate ratings groups in 2008 that would be applied consistently to all participants. There is no evidence, however, that these proposed ratings groups were ever actually put into practice with respect to existing VEBA plans. Indeed – it appears Elliott simply asked the actuary he retained to help design "ultimate ratings groups" so that a plan participant's contributions could be adjusted after the fact – that is, earlier contributions to the plan, where in excess of what was actually needed to fund the insurance purchased, could be applied to later contribution requirements. This is the essence of experience rating prohibited by law.

87. In addition, Elliott has admitted (in sworn testimony in the lawsuit brought by Drs. Singer and Smith) that VEBA plan participants not only were never told about the need to change the plans' terms after adoption of the new Treasury regulations in 2003, but also that they were never asked to sign any new plan documents.

88. The Sea Nine VEBA plan documents have not been substantively altered despite Elliott's knowledge of the changes to the law in 2003. Although Elliott purports to have prepared a revised plan document in 2009, it has not yet replaced older versions currently in use by the various Sea Nine VEBAs in existence.

89. Substantively, the 2009 version of the Sea Nine plan differs facially from prior versions in that (1) certain plan provisions, such as the provisions relating to voluntary terminations, that would cause the plan to fail to satisfy the requirements of the 1.419A(f)(6) regulations on form alone have been removed; (2) other plan provisions, such as the <u>fixed benefits</u> provision which uses language straight out of the 1.419A(f)(6) regulations, were added (apparently to give the plan the appearance that it satisfies the requirements of the 1.419A(f)(6) regulations); and (3) the plan adopted a "Rating Group" structure in the most general sense (*i.e.*, "the group of Participants with the same rating factors as defined in the Regulations and described in the Adoption Agreement").

90. Such changes, however – even if adopted by all existing Sea Nine VEBA plans – are insufficient to satisfy Section 419A and its applicable regulations. In particular, the 2009 revised plan document still exhibits experience rating because it appears to continue to allow participants to make contributions in excess of their actual cost for insurance, with the notion that such contributions can later be "trued up" through an "ultimate ratings group."

91. Sarva also knows or has reason to know that the Sea Nine VEBA plans he urges his customers to adopt are not compliant with the tax laws. As an accountant, Sarva is professionally obligated to keep abreast of developments in the law relevant to the services and investments he advises his customers to participate in. Yet Sarva has repeatedly provided his customers with evidence of IRS "approvals" of the Sea Nine plan that facially say nothing about whether its plan complies with Section 419A(f)(6). He also was in possession of the legal opinions that Elliott and Sea Nine obtained around the time the VEBA regulations were revised that noted that the existing plan documents did not comply with the law, and yet he repeatedly promoted Sea Nine plans to his customers as legally valid. Indeed, Sarva has informed customers as well as the IRS that for a long time after 2004, Sea Nine's VEBA plan remained unchanged – thus underscoring his knowledge of the fact that it was not compliant with the Tax Code.

Defendants' False Statements Promoting the VEBA Plans

92. Elliott has made or furnished, or caused other persons to make or furnish, many false and/or fraudulent statements with respect to the tax benefits of participation in the VEBA plans and their legality. He has done so both directly, to potential plan participants or their representatives, as well as indirectly, through the individuals who market Sea Nine VEBA plans to others and who rely on his expertise and information in explaining the operations of the plans to interested taxpayers.

93. Thus, Elliott has repeatedly but falsely informed participants that the entirety of their contributions were tax deductible in the year made, despite the fact that their plan contributions greatly exceeded their deductible "qualified cost" under Section 419(c), because they exceeded the actual premium amount for the insurance purchased by the plan for its beneficiaries.

94. He has also repeatedly but falsely informed participants that the plans to which the contributions were made qualified as I.R.C. § 419A(f)(6) "10 or more employer plans," (meaning the plans did not show experience rating and therefore were not subject to the deduction exceptions).

95. Elliott has also falsely informed participants that plan contributions help create a "tax free income stream" later in the lives of plan beneficiaries. This would be accomplished by funding the plan for five years and then terminating it, allowing the plan participant to buy the almost fully-funded whole life insurance policy provided under the VEBA plan at the lower amount of its cash surrender value, rather than at its fair market value. A few years later, however, the springing value of the policy would mean the participant-Owner could now realize the policy's cash value in the form of loans or distributions taken against the policy's death benefit.

96. In making such representations, Elliott did not inform participants that the only benefit properly provided by a VEBA plan is the death benefit, aware that plan participants expected more than just the protections provided by term life insurance.

97. Elliott also made numerous false statements about the Sea Nine VEBA plans' compliance with applicable provisions of the Internal Revenue Code or Treasury regulations. Thus, he (a) falsely indicated that existing plans had been properly revised or amended in light of the 2003 regulations pertaining to Section 419A(f)(6), (b) falsely represented to certain participant/Owners that the plans had been approved by the IRS based on prior IRS determinations having nothing to do with Section 419A(f)(6), and (c) falsely claimed that the VEBA plans were not listed transactions.

98. Elliott had ample notice that his assertions about the legality of the Sea Nine VEBA plans were false, but he persisted in his representations despite such knowledge.

99. Sarva has similarly made numerous false statements to his customers about the Sea Nine VEBA plans despite his notice that they are not compliant with Section 419A(f)(6). He touts his many years of work with Sea Nine VEBA plans to potential customers, reassuring them that the plans are completely legal. He provides potential plan participants with materials that he says establish the legality of the plans, despite his possession of contradictory materials (such as the legal opinions obtained by Elliott and Sea Nine) indicating that after 2004 the Sea Nine plans were not in conformity with the relevant provisions of the Tax Code. And he has promoted the concept that participation in the Sea Nine VEBA plans permits participants to withdraw contributions early through termination – essentially underscoring the cash value nature of the universal or whole life policies that the plans purchase for their participants, even though (as noted above) a VEBA plan that operates in this fashion evidences experience rating.

HARM TO THE GOVERNMENT AND THE PUBLIC

100. Elliott has admitted in prior sworn testimony that there are at least 200 employer/companies that have participated in a Sea Nine VEBA plan, and the IRS is aware of 205 such entities. Elliott and Sarva continue today to promote Sea Nine VEBA plans, and Sea Nine appears to have obtained additional plan participants in 2012. And third parties with whom he has previously worked continue to recommend Sea Nine VEBA plans to certain of their customers.

101. As of August 23, 2013, the IRS has completed audits of the tax returns of 41 individuals and/or their businesses who participated in a Sea Nine-managed VEBA plan, including entities discussed above such as J & M Associates

or Drs. Smith and Singer. In 36 of the 41 audits, the IRS determined that the taxpayer was liable for additional taxes, because the plan participants had some or all of their plan contributions disallowed for not being in compliance with Section 419A(f)(6). The total amount of tax deficiencies assessed in the audits of these 41 Sea Nine/Elliott taxpayer customers for 108 separate tax years is $13,874,555. There are at least 89 other pending audits involving 21 additional Elliott VEBA Plan participants, so the total figure may become higher.

102. If all companies participating in an illegal Sea Nine VEBA that the IRS is presently aware of were similarly liable for additional taxes, the total amount lost by the Treasury to date from improperly-claimed contributions deducted on participant tax returns could exceed $70 million dollars.

103. As of August 23, 2013, the IRS has closed audits of 12 Sea Nine VEBA plan-participating taxpayers who were referred to Sea Nine by Sarva. For those taxpayers alone, the IRS assessed a total of $4,852,106 in additional taxes, or an average additional tax of $404,342 per audit. Because Sarva has acknowledged directing at least 40 of his customers to Sea Nine, the total amount of harm to the Treasury he has caused through promotion of improper VEBA plans is likely almost four times higher.

104. If Defendants are not enjoined, the United States will suffer irreparable harm from the underpayment of tax liability and the exhaustion of resources to enforce the internal revenue laws, and the substantial losses caused by Defendants' actions will continue to increase.

105. The Internal Revenue Service is harmed because it must dedicate scarce resources to detecting and examining inaccurate returns filed by participants, and to attempting to assess and collect unpaid taxes.

106. Companies participating in Sea Nine VEBA plans are also harmed because they are liable for any unpaid tax, plus interest and penalties resulting from their disallowed plan contribution deductions. Such entities and their principals may detrimentally rely on the false representations Elliott and Sarva make about the tax benefits to be derived from participation.

Count I - Injunction under I.R.C. § 7408

107. The United States incorporates by reference the allegations in Paragraphs 1 through 106.

108. Section 7408 authorizes a district court to enjoin any person from further engaging in conduct subject to penalty under either I.R.C. § 6700 or § 6701, if injunctive relief is appropriate to prevent recurrence of that conduct.

109. Section 6700 provides that a penalty will be imposed against any person who organizes or assists in the organization of a partnership or other investment plan or arrangement, or participates in the sale of an interest in an entity or plan, and (a) knowingly makes, or causes to be made, a false or fraudulent statement as to the allowability of a deduction or credit, the excludability of any income, the securing of another tax benefit, because of an interest held in the entity or because of his participation in the plan, or (b) makes a gross valuation overstatement as to any material matter.

110. Section 6701 imposes a penalty on 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 a reason to believe that it will be used in connection with any material matter arising under the internal revenue laws, and knowing that if so used it would result in an understatement of another person's tax liability.

111. The Sea Nine VEBA plans that Defendants promote, administer, and/or operate are "plans or arrangements" within the meaning of I.R.C. § 6700.

112. Elliott and Sea Nine have been intimately involved in the organization and operation of the Sea Nine VEBA plans for 15 years. They have overseen the plans' evolution and are aware of both the manner in which the plans operate as well as the legal guidelines governing their operation.

113. Defendants have also directly and indirectly promoted the VEBA plan scheme to prospective participants. Sarva for his part has been marketing Sea Nine's VEBA plans to customers across the United States for nearly 30 years – even before Elliott became involved – and continues to do so to this day.

114. In connection with the organization and/or sale of participation in the VEBA plan scheme, Defendants have made or furnished, or caused others to make or furnish, material and false and/or fraudulent statements with respect to the Sea Nine VEBA plans' purported tax benefits.

115. Defendants knew or had reason to know that their statements were false and/or fraudulent.

116. By promoting participation in the VEBA plans and/or administering such plans, the Defendants have also aided and abetted their customers' preparation of income tax returns in which the customers claim large deductions reflecting the entirety of their contributions to the plans based on the belief that the plans comply with I.R.C. § 419A(f)(6). All of the Defendants are fully aware that their customers will claim such deductions, as a principal and widely-promoted feature of participating in a VEBA plan is the deductibility of the contributions.

117. In fact, however, Sea Nine VEBA plan participants consistently understate their true tax liability because the plans are not compliant with the Internal Revenue Code.

118. The Defendants know that full deduction of their customers' Sea Nine VEBA plan contributions results in an understatement of their customers' tax liability. They have been on notice for nearly ten years of the fact that the existing version of the Sea Nine plan documents (used for all Sea Nine plans) were not revised even after Section 419A(f)(6) and its applicable regulations were changed. And a more recent version of the plan and its documents revised after 2009 is still not compliant with the law.

119. Accordingly, Defendants have engaged in conduct subject to penalty under I.R.C. §§ 6700 and 6701, and are subject to an injunction under I.R.C. § 7408.

120. Here, an injunction under Section 7408 is appropriate to prevent the recurrence of the penalty conduct specified above. Defendants have consistently defended the legality of the Sea Nine VEBA plans and do not acknowledge that any aspect of their structure or operation violates the Internal Revenue Code. And they continue to promote participation in Sea Nine VEBA plans. Thus, unless enjoined, the Defendants are highly likely to continue to do so in the future, given the lucrative nature of promotion and operation of the plans by Defendants.

Count II - Injunction under I.R.C. § 7402

121. The United States incorporates by reference the allegations contained in Paragraphs 1 through 120.

122. I.R.C. § 7402 authorizes the Court to issue an injunction or other judgment that is necessary or appropriate for the enforcement of the internal revenue laws.

123. I.R.C. § 7402(a) authorizes a district court to issue injunctions as may be necessary or appropriate for the enforcement of the internal revenue laws, even if the United States has other remedies available for enforcing those laws.

124. The Defendants have substantially interfered with the enforcement of the internal revenue laws by continuing to promote and operate the Sea Nine VEBA plans despite their knowledge of their noncompliance with the law, while falsely promoting the tax benefits of participation in the plans. They have resisted all efforts by the IRS to investigate their conduct. They have also refused to amend or modify their plan documents in light of changes to the law, or pretended to make cosmetic, nonsubstantive changes that simply obfuscate further the elements of the VEBA plans that fail to comply with the relevant Treasury regulations.

125. As a result of Defendants' misconduct, the taxpayers that have agreed to participate in the Sea Nine VEBA plans have consistently understated their actual tax liability. Plan participants also frequently find that, contrary to the representations of the Defendants, they are not entitled to the large deductions they claimed, and face audit and additional unpaid tax liabilities as a result of having accepted the representations of the Defendants.

126. Unless enjoined by this Court, the Defendants will continue to promote and administer participation in the Sea Nine VEBA plans.

127. Under I.R.C. § 7402(a), the United States is entitled to injunctive relief to prevent the recurrence of this misconduct.

RELIEF SOUGHT

WHEREFORE, Plaintiff United States of America respectfully prays the following:

A. That this Court find that Defendants Kenneth Elliott (d/b/a KAE Insurance Services, Inc., Vista Barranca, Inc., and KAE Consulting), Sea Nine Associates, Inc., and Ramesh Sarva have engaged in conduct subject to penalty under I.R.C. § 6700 and that injunctive relief under I.R.C. § 7408 is appropriate to prevent recurrence of that conduct;

B. That this Court find that Defendants Kenneth Elliott (d/b/a KAE Insurance Services, Inc., Vista Barranca, Inc., and KAE Consulting), Sea Nine Associates, Inc., and Ramesh Sarva have engaged in conduct subject to penalty under I.R.C. §§ 6700 and 6701 and that injunctive relief under I.R.C. § 7408 is appropriate to prevent recurrence of that conduct;

C. That this Court find that Defendants Kenneth Elliott (d/b/a KAE Insurance Services, Inc., Vista Barranca, Inc., and KAE Consulting), Sea Nine Associates, Inc., and Ramesh Sarva have engaged in conduct interfering with the administration and enforcement of the internal revenue laws and that injunctive relief is appropriate to prevent recurrence of that conduct under I.R.C. § 7402(a);

D. That this Court, pursuant to I.R.C. §§ 7402 and 7408, enter a permanent injunction prohibiting Defendants Kenneth Elliott (d/b/a KAE Insurance Services, Inc., Vista Barranca, Inc., and KAE Consulting), Sea Nine Associates, Inc., and Ramesh Sarva, and any other person in active concert or participation with them, from directly or indirectly:

i. Promoting, administering, managing, or selling any version of the Sea Nine VEBA plan described in this complaint;

ii. Promoting or selling any plan or arrangement that is similar to the Sea Nine VEBA plan, including any plan or arrangement that claims to be a welfare benefit plan or to allow an employer to make deductible contributions to a welfare benefit fund under I.R.C. § 419 and/or I.R.C. § 419A;

iii. Promoting or selling any plan or arrangement that advises or assists others in violating or attempting to violate the internal revenue laws or unlawfully evading the assessment or collection of one's federal tax liabilities;

iv. Engaging in conduct subject to penalty under I.R.C. § 6700, *i.e.*, organizing or selling any plan or arrangement and in connection therewith (a) making a gross valuation overstatement, or (b) making or furnishing (or causing another person to make or furnish) false or fraudulent statements with respect to the tax benefits derived from participation in such a plan or arrangement, when he knows and/or has reason to know the statements are false or fraudulent as to a material matter;

v. Engaging in conduct subject to penalty under I.R.C. § 6701, *i.e.*, aiding or assisting in, procuring, or advising with respect to the preparation or presentation of any portion of a tax return, affidavit, claim, or other document, where he knows (or has reason to believe) that such portion will be used in connection with any material matter arising under the internal revenue laws, and he knows that such portion (if so used) would result in an understatement of the liability for tax of another person; and

vi. Engaging in any other conduct subject to penalty under any provision of the Internal Revenue Code.

E. That this Court, pursuant to I.R.C. §§ 7402 and 7408, enter a permanent injunction prohibiting Defendants Kenneth Elliott (d/b/a KAE Insurance Services, Inc., Vista Barranca, Inc., and KAE Consulting), Sea Nine Associates, Inc., and Ramesh Sarva, and any other person in active concert or participation with them, from directly or indirectly:

i. Acting as trustee, representative, salesman, manager, or administrator for, or otherwise organizing, administering, or implementing any version of the Sea Nine VEBA plan described in this complaint;

ii. Acting as trustee or administrator for, or otherwise organizing, administering, or implementing any plan or arrangement that is similar to the Sea Nine VEBA plan, including any plan or arrangement that claims to be a welfare benefit plan or to allow an employer to make deductible contributions to a welfare benefit fund under I.R.C. § 419 and/or I.R.C. § 419A;

iii. Organizing, administering, or implementing any plan or arrangement that advises or assists others in violating or attempting to violate the internal revenue laws or unlawfully evading the assessment or collection of one's federal tax liabilities;

iv. Selling or organizing, or causing the sale or organization of, any type of corporation, trust, limited liability company, arrangement of business entities, or plan which he knows or has reason to know is designed to or will be used to facilitate non-compliance with the federal tax laws; and

v. Engaging in any other conduct that substantially interferes with the administration or enforcement of the internal revenue laws.

F. That the Court, pursuant to I.R.C. § 7402, order Defendants Kenneth Elliott (d/b/a KAE Insurance Services, Inc., Vista Barranca, Inc., and KAE Consulting), Sea Nine Associates, Inc., and Ramesh Sarva to produce to counsel for the United States within 30 days of entry of judgment in this case a list identifying (by name, address, e-mail address, phone number, and Social Security or other tax identification number) all of the companies and Owners of such companies who have participated in any Sea Nine VEBA plan promoted, operated, or organized by any of the Defendants in the past 13 years;

G. That the Court, pursuant to I.R.C. § 7402, order Defendants Kenneth Elliott (d/b/a KAE Insurance Services, Inc., Vista Barranca, Inc., and KAE Consulting), Sea Nine Associates, Inc., and Ramesh Sarva, at their own expense, to send by mail to each individual identified in Paragraph F above a copy of the permanent injunction and a copy the Court's findings in support of the permanent injunction;

H. That the Court, pursuant to I.R.C. § 7402, order Defendants Kenneth Elliott (d/b/a KAE Insurance Services, Inc., Vista Barranca, Inc., and KAE Consulting), Sea Nine Associates, Inc., and Ramesh Sarva each to file with the Court, within 45 days of the date on which the permanent injunction is entered, a certification signed under penalty of perjury that he or she has complied with paragraphs E and F above;

I. That the Court allow the United States full post-judgment discovery to monitor compliance with the injunction;

J. That the Court retain jurisdiction over this action for the purpose of implementing and enforcing the final judgment and any additional orders necessary and appropriate to the public interest;

K. That Defendants Kenneth Elliott (d/b/a KAE Insurance Services, Inc., Vista Barranca, Inc., and KAE Consulting), and Sea Nine Associates, Inc., and Ramesh Sarva shall not make any statements, written or verbal, or cause or encourage others to make any statements, written or verbal, that misrepresent any of the terms of this injunction; and

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

October 8, 2013

Respectfully submitted,

ANDRÉ BIROTTE, JR.
United States Attorney
SANDRA R. BROWN
Assistant United States Attorney
Chief, Tax Division

/s/
DARWIN THOMAS (SBN 80745)
Assistant United States Attorney

BRIAN H. CORCORAN
DC Bar, No. 456976
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U.S. Department of Justice

UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA

NOTICE OF ASSIGNMENT TO UNITED STATES JUDGES

This case has been assigned to District Judge Josephine L. Staton and the assigned Magistrate Judge is Jean P. Rosenbluth .

The case number on all documents filed with the Court should read as follows:

8:13CV1582 JLS JPRx

Pursuant to General Order 05-07 of the United States District Court for the Central District of California, the Magistrate Judge has been designated to hear discovery related motions.

All discovery related motions should be noticed on the calendar of the Magistrate Judge.

Clerk, U. S. District Court

October 9, 2013
Date

By J.Prado
Deputy Clerk

NOTICE TO COUNSEL

A copy of this notice must be served with the summons and complaint on all defendants (if a removal action is filed, a copy of this notice must be served on all plaintiffs).

Subsequent documents must be filed at the following location:

☐ Western Division
312 N. Spring Street, G-8
Los Angeles, CA 90012

☒ Southern Division
411 West Fourth St., Ste 1053
Santa Ana, CA 92701

☐ Eastern Division
3470 Twelfth Street, Room 134
Riverside, CA 92501

Failure to file at the proper location will result in your documents being returned to you.

COPY

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Attorneys for the United States of America

UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA
WESTERN DIVISION

United States of America, Plaintiff, vs. Kenneth Elliott, d/b/a KAE Insurance Services, Inc., Vista Barranca, Inc., and KAE Consulting; Sea Nine Associates, Inc., and Ramesh Sarva, Defendants.	Case No. ____________ **COMPLAINT FOR PERMANENT INJUNCTION AND OTHER RELIEF**

10296991.1

COPY

UNITED STATES DISTRICT COURT, CENTRAL DISTRICT OF CALIFORNIA
CIVIL COVER SHEET

I (a) PLAINTIFFS (Check box if you are representing yourself ☐)
UNITED STATES OF AMERICA

DEFENDANTS
Kenneth Elliott, d/b/a KAE Insurance Services, Inc., Vista Barranca, Inc., KAE Consulting, Sea Nine Associates, Inc.; Ramesh Sarva

(b) County of Residence of First Listed Plaintiff (Except in U.S. Plaintiff Cases):
Los Angeles County

County of Residence of First Listed Defendant (In U.S. Plaintiff Cases Only):
Orange County

(c) Attorneys (Firm Name, Address and Telephone Number. If you are representing yourself, provide same.)
DARWIN THOMAS, AUSA
US Attorney's Office, Tax Division
300 N. Los Angeles St. #7211, Los Angeles, CA 90012
Tel: (213) 894-2740 Fax: (213) 894-0115

Attorneys (If Known)

II. BASIS OF JURISDICTION (Place an X in one box only.)

☑ 1 U.S. Government Plaintiff
☐ 3 Federal Question (U.S. Government Not a Party)
☐ 2 U.S. Government Defendant
☐ 4 Diversity (Indicate Citizenship of Parties in Item III)

III. CITIZENSHIP OF PRINCIPAL PARTIES - For Diversity Cases Only
(Place an X in one box for plaintiff and one for defendant.)

	PTF	DEF		PTF	DEF
Citizen of This State	☐ 1	☐ 1	Incorporated or Principal Place of Business in this State	☐ 4	☐ 4
Citizen of Another State	☐ 2	☐ 2	Incorporated and Principal Place of Business in Another State	☐ 5	☐ 5
Citizen or Subject of a Foreign Country	☐ 3	☐ 3	Foreign Nation	☐ 6	☐ 6

IV. ORIGIN (Place an X in one box only.)

☑ 1 Original Proceeding ☐ 2 Removed from State Court ☐ 3 Remanded from Appellate Court ☐ 4 Reinstated or Reopened ☐ 5 Transferred from another district (specify): ☐ 6 Multi-District Litigation ☐ 7 Appeal to District Judge from Magistrate Judge

V. REQUESTED IN COMPLAINT: JURY DEMAND: ☐ Yes ☑ No (Check 'Yes' only if demanded in complaint.)

CLASS ACTION under F.R.C.P. 23: ☐ Yes ☑ No ☐ **MONEY DEMANDED IN COMPLAINT: $**__________

VI. CAUSE OF ACTION (Cite the U.S. Civil Statute under which you are filing and write a brief statement of cause. Do not cite jurisdictional statutes unless diversity.)
Pursuant to 26 USC 7402 and 7408

VII. NATURE OF SUIT (Place an X in one box only.)

OTHER STATUTES
- ☐ 400 State Reapportionment
- ☐ 410 Antitrust
- ☐ 430 Banks and Banking
- ☐ 450 Commerce/ICC Rates/etc.
- ☐ 460 Deportation
- ☐ 470 Racketeer Influenced and Corrupt Organizations
- ☐ 480 Consumer Credit
- ☐ 490 Cable/Sat TV
- ☐ 810 Selective Service
- ☐ 850 Securities/Commodities /Exchange
- ☐ 875 Customer Challenge 12 USC 3410
- ☐ 890 Other Statutory Actions
- ☐ 891 Agricultural Act
- ☐ 892 Economic Stabilization Act
- ☐ 893 Environmental Matters
- ☐ 894 Energy Allocation Act
- ☐ 895 Freedom of Info. Act
- ☐ 900 Appeal of Fee Determination Under Equal Access to Justice
- ☐ 950 Constitutionality of State Statutes

CONTRACT
- ☐ 110 Insurance
- ☐ 120 Marine
- ☐ 130 Miller Act
- ☐ 140 Negotiable Instrument
- ☐ 150 Recovery of Overpayment & Enforcement of Judgment
- ☐ 151 Medicare Act
- ☐ 152 Recovery of Defaulted Student Loan (Excl. Veterans)
- ☐ 153 Recovery of Overpayment of Veteran's Benefits
- ☐ 160 Stockholders' Suits
- ☐ 190 Other Contract
- ☐ 195 Contract Product Liability
- ☐ 196 Franchise

REAL PROPERTY
- ☐ 210 Land Condemnation
- ☐ 220 Foreclosure
- ☐ 230 Rent Lease & Ejectment
- ☐ 240 Torts to Land
- ☐ 245 Tort Product Liability
- ☐ 290 All Other Real Property

TORTS
PERSONAL INJURY
- ☐ 310 Airplane
- ☐ 315 Airplane Product Liability
- ☐ 320 Assault, Libel & Slander
- ☐ 330 Fed. Employers' Liability
- ☐ 340 Marine
- ☐ 345 Marine Product Liability
- ☐ 350 Motor Vehicle
- ☐ 355 Motor Vehicle Product Liability
- ☐ 360 Other Personal Injury
- ☐ 362 Personal Injury-Med Malpractice
- ☐ 365 Personal Injury-Product Liability
- ☐ 368 Asbestos Personal Injury Product Liability

TORTS
PERSONAL PROPERTY
- ☐ 370 Other Fraud
- ☐ 371 Truth in Lending
- ☐ 380 Other Personal Property Damage
- ☐ 385 Property Damage Product Liability

BANKRUPTCY
- ☐ 422 Appeal 28 USC 158
- ☐ 423 Withdrawal 28 USC 157

CIVIL RIGHTS
- ☐ 441 Voting
- ☐ 442 Employment
- ☐ 443 Housing/Accommodations
- ☐ 444 Welfare
- ☐ 445 American with Disabilities - Employment
- ☐ 446 American with Disabilities - Other
- ☐ 440 Other Civil Rights

PRISONER PETITIONS
- ☐ 510 Motions to Vacate Sentence Habeas Corpus
- ☐ 530 General
- ☐ 535 Death Penalty
- ☐ 540 Mandamus/ Other
- ☐ 550 Civil Rights
- ☐ 555 Prison Condition

FORFEITURE / PENALTY
- ☐ 610 Agriculture
- ☐ 620 Other Food & Drug
- ☐ 625 Drug Related Seizure of Property 21 USC 881
- ☐ 630 Liquor Laws
- ☐ 640 R.R. & Truck
- ☐ 650 Airline Regs
- ☐ 660 Occupational Safety /Health
- ☐ 690 Other

LABOR
- ☐ 710 Fair Labor Standards Act
- ☐ 720 Labor/Mgmt. Relations
- ☐ 730 Labor/Mgmt. Reporting & Disclosure Act
- ☐ 740 Railway Labor Act
- ☐ 790 Other Labor Litigation
- ☐ 791 Empl. Ret. Inc. Security Act

PROPERTY RIGHTS
- ☐ 820 Copyrights
- ☐ 830 Patent
- ☐ 840 Trademark

SOCIAL SECURITY
- ☐ 861 HIA (1395ff)
- ☐ 862 Black Lung (923)
- ☐ 863 DIWC/DIWW (405(g))
- ☐ 864 SSID Title XVI
- ☐ 865 RSI (405(g))

FEDERAL TAX SUITS
- ☑ 870 Taxes (U.S. Plaintiff or Defendant)
- ☐ 871 IRS-Third Party 26 USC 7609

VIII(a). IDENTICAL CASES: Has this action been previously filed and dismissed, remanded or closed? ☑ No ☐ Yes

If yes, list case number(s):

SACV13-1582

FOR OFFICE USE ONLY: Case Number: __________

UNITED STATES DISTRICT COURT, CENTRAL DISTRICT OF CALIFORNIA
CIVIL COVER SHEET

AFTER COMPLETING THE FRONT SIDE OF FORM CV-71, COMPLETE THE INFORMATION REQUESTED BELOW.

VIII(b). RELATED CASES: Have any cases been previously filed that are related to the present case? ☐ No ☑ Yes

If yes, list case number(s): SA CV 08-00619 - AHS

Civil cases are deemed related if a previously filed case and the present case:

(Check all boxes that apply)
☑ A. Arise from the same or closely related transactions, happenings, or events; or
☐ B. Call for determination of the same or substantially related or similar questions of law and fact; or
☐ C. For other reasons would entail substantial duplication of labor if heard by different judges; or
☐ D. Involve the same patent, trademark or copyright, and one of the factors identified above in a, b or c also is present.

IX. VENUE: List the California County, or State if other than California, in which **EACH** named plaintiff resides (Use an additional sheet if necessary)
☑ Check here if the U.S. government, its agencies or employees is a named plaintiff.

Los Angeles County

List the California County, or State if other than California, in which **EACH** named defendant resides. (Use an additional sheet if necessary).
☐ Check here if the U.S. government, its agencies or employees is a named defendant.

Orange County; New York State

List the California County, or State if other than California, in which **EACH** claim arose. (Use an additional sheet if necessary)
Note: In land condemnation cases, use the location of the tract of land involved.

Orange County

X. SIGNATURE OF ATTORNEY (OR PRO PER): Damon Thomas **Date** Oct. 9, 2013

Notice to Counsel/Parties: The CV-71 (JS-44) Civil Cover Sheet and the information contained herein neither replace nor supplement the filing and service of pleadings or other papers as required by law. This form, approved by the Judicial Conference of the United States in September 1974, is required pursuant to Local Rule 3-1 is not filed but is used by the Clerk of the Court for the purpose of statistics, venue and initiating the civil docket sheet. (For more detailed instructions, see separate instructions sheet.)

Key to Statistical codes relating to Social Security Cases:

Nature of Suit Code	Abbreviation	Substantive Statement of Cause of Action
861	HIA	All claims for health insurance benefits (Medicare) under Title 18, Part A, of the Social Security Act, as amended. Also, include claims by hospitals, skilled nursing facilities, etc., for certification as providers of services under the program. (42 U.S.C. 1935FF(b))
862	BL	All claims for "Black Lung" benefits under Title 4, Part B, of the Federal Coal Mine Health and Safety Act of 1969. (30 U.S.C. 923)
863	DIWC	All claims filed by insured workers for disability insurance benefits under Title 2 of the Social Security Act, as amended; plus all claims filed for child's insurance benefits based on disability. (42 U.S.C. 405(g))
863	DIWW	All claims filed for widows or widowers insurance benefits based on disability under Title 2 of the Social Security Act, as amended. (42 U.S.C. 405(g))
864	SSID	All claims for supplemental security income payments based upon disability filed under Title 16 of the Social Security Act, as amended.
865	RSI	All claims for retirement (old age) and survivors benefits under Title 2 of the Social Security Act, as amended. (42 U.S.C. (g))