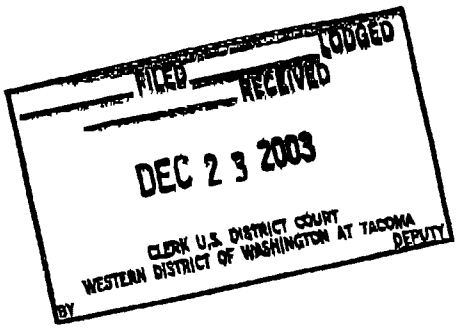

IN THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF WASHINGTON AT TACOMA

UNITED STATES OF AMERICA Plaintiffs, v. DAVID CARROLL STEPHENSON individually and d/b/a AMERICAN BUSINESS ESTATE & TAX PLANNING SERVICE and ADVOCATE AND ASSOCIATES, INC.; A-1 CREDIT & CO.; AMERICAN BUSINESS LAW, INC.; and AMERICAN BUSINESS AND ESTATE PLANNING Defendants.	Civil No. C03-5712 RBL **UNITED STATES' MOTION FOR PRELIMINARY INJUNCTION** Note on Motion Calendar: January 9, 2004

Pursuant to F.R.C.P. 65(a), the United States moves for preliminary injunction against David Carroll Stephenson, individually and d/b/a the American Business Estate & Tax Planning Service and Advocate and Associates, Inc.; Advocate NW & Co., Inc.; A-1 Credit & Co.; American Business Law, Inc.; and American Business & Estate Planning. A proposed order granting the preliminary injunction is submitted herewith.

INTRODUCTION

David Carroll Stephenson, individually and d/b/a the American Business Estate & Tax Planning Service and Advocate and Associates, Inc.; Advocate NW & Co., Inc.; A-1 Credit &

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Co.; American Business Law, Inc.; and American Business & Estate Planning organize and promote an abusive tax scheme whereby they assist customers in evading federal tax liabilities and IRS collection efforts through the fraudulent use of trusts and business entities. As a result of their illegal activities, they have defrauded the United States of at least $43 million in lost tax revenue.

The United States is entitled to injunctive relief to halt defendants' further marketing of their illegal scheme and to stop their false statements about the internal revenue laws in connection with giving bogus tax advice. We explain below that the statutory requirements for injunctions under 26 U.S.C. ("I.R.C.") §§ 7402 and 7408 are satisfied. We also show that the traditional equitable factors applicable to non-statutory injunctions are also established here. Defendants' activities have caused and are causing substantial harm—to their clients, to the Government, and to law-abiding taxpayers who pay their proper tax liabilities. Based on the argument and evidence submitted in support of this motion, the United States is entitled to the relief it seeks—a preliminary inunction barring defendants from promoting their abusive trust scheme.

STATEMENT OF FACTS

The Scheme: Bogus Trusts to Illegally Evade Tax and Hide Assets

The defendants organize, promote, and market an abusive tax scheme targeted at self-employed persons. Defendants advocate funneling income to a series of sham trust and business entities in a fraudulent attempt to avoid income and employment tax, and to thwart the IRS's ability to collect customers' federal taxes.[1] Defendants instruct customers to divert their income to a series of trusts, and report only a small fraction of that income on their tax returns.[2]

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[1] Declaration of Revenue Agent Terry L. Martin, ¶¶ 10, 13. *See also* Declaration of Roy McCourt, ¶ 6.

[2] Martin Decl. ¶¶ 17, 19, 20; McCourt Decl. ¶ 6.

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Defendants also instruct customers to transfer their assets to these trusts in a fraudulent attempt to avoid IRS collection efforts.[3] Defendants' scheme illegally plays on an obscure point in the Internal Revenue Code—while virtually all payments to *individuals* must be reported to the IRS on Forms 1099, information-reporting requirements typically do not apply to payments made to *entities*.[4] Consequently, payments to trusts in most instances need not be reported to the IRS. The defendants' falsely advise customers that disbursements from their trusts, for their personal use, need not be reported as income on the customers' tax returns.[5] Because the customers fail to report this income on their returns, it is virtually impossible for the IRS to detect without a thorough audit. And because Stephenson advises customers that trusts are not required to file federal income tax returns, not only are no taxes being paid on this income, but the IRS has no indication that no taxes are being paid on this income.[6]

Defendants advise the use of "Pure Contract Trusts" and instruct customers to transfer their personal assets into four different trusts, each intended to perform a unique function within the scheme, with the ultimate goal of evading taxes on income and wages and hiding assets from IRS collection efforts.[7] Stephenson serves as the "Executive Trustee" of these trusts, while the customer acts as the "Managing Director."[8] This arrangement is intended to present the appearance of an independent trustee. In fact, the customer maintains exclusive control over all trust property; the customers' relationships to their income and assets is not altered by

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[3] Martin Decl. ¶¶ 14, 15, 25.

[4] *See* I.R.C. §§ 6031 through 6059.

[5] Martin Decl. ¶ 17; McCourt Decl. ¶¶ 6, 10.

[6] McCourt Decl. ¶ 10.

[7] Martin Decl. ¶ 13, and Martin Decl. Ex. 3, p. 73 and generally. *See also* McCourt Decl. ¶ 6.

[8] Martin Decl. ¶ 15; McCourt Decl. ¶¶ 13, 16.

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participation in Stephenson's scheme.[9] In using Stephenson's program, customers typically transfer their business assets to a trust, and purportedly operate their business as a trust.[10] The customer's relationship to either his personal or business income and assets, however, is not altered by participation in Stephenson's scheme.[11] Customers continue to operate their businesses in virtually the same manner under Stephenson's program as they did before using Stephenson's program; the major difference is that payments for services are no longer made to Stephenson's customer directly, but are instead made to the customer's trust.[12]

In instructing customers to deposit their business income directly to their trust checking accounts, and bypassing any accounts linked to the customer, defendants advise customers that their trusts are not obligated to pay tax on this income under the false notion that trust income is not taxable income until it is disbursed to an individual.[13] Stephenson advises customers to draw minimal salaries from their trusts, and to use this income to pay for food and certain other personal items. Stephenson calculates this salary to be equal to his customers' combined personal exemption and standard deduction amounts, so that nominal amounts of income, if any, are subject to tax.[14] Also, no employment tax is withheld from this salary, in violation of internal revenue laws.[15]

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[9] Martin Decl. ¶ 15; McCourt Decl. ¶16.

[10] Martin Decl. ¶ 16.

[11] Martin Decl. ¶ 15.

[12] Martin Decl. ¶ 16.

[13] McCourt Decl. ¶¶ 10, 15; Martin Decl. ¶¶ 16, 17; Martin Decl. Ex. 3, at p. 72.

[14] Martin Decl. ¶ 19; McCourt Decl. ¶ 15.

[15] Martin Decl. ¶ 19; McCourt Decl. ¶¶ 15, 16.

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Stephenson advises customers to pay for certain personal assets and expenses directly from their trust accounts.[16] He advises customers that they can purchase vehicles, household furniture, jewelry, watches, and pay for insurance and upkeep for personal vehicles using non-taxed trust income.[17]

Promoting the Scheme: False Statements about the Internal Revenue Laws

Defendants market this scheme though word of mouth, through seminars held within the State of Washington, and through written materials entitled *Real Solutions to Real Every Day Problems* and *Business Engineering, Estate Planning, and Asset Protection*.[18] In promoting the scheme, defendants falsely claim that the following benefits are available to participants:

a. "RETAIN *$$Thousands of Dollars$$* of Annual Earnings WHILE MINIMIZING THE LIABILITY OF ...*Estate Taxes, Excessive Taxes, Property Seizures and Tax Liens*... Through BUSINESS ENGINEERING, ESTATE & TAX PLANNING;"[19]

b. Avoid probate, estate tax, and IRS seizures;[20]

c. Reduce or eliminate income taxes;[21]

d. Eliminate capital gains taxes;[22] and

e. Become artificially poor without giving up your assets in order to qualify for Medicaid.[23]

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[16] Martin Decl. ¶ 20; McCourt Decl. ¶¶ 6, 16.

[17] Martin Decl. ¶ 20; Martin Decl. Ex. 3, at p. 72; McCourt Decl. ¶¶ 6, 16.

[18] Martin Decl. ¶ 21; McCourt Decl. ¶¶ 3-7.

[19] Martin Decl. Ex. 3, at A.

[20] Martin Decl. Ex. 3, at A and 29.

[21] Martin Decl. Ex. 3, at A and 29.

[22] Martin Decl. Ex. 3, at 83.

[23] Martin Decl. Ex. 3, at 29 and 83.

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Defendants warn customers that "...Arranging one's personal and business affairs according to the directions of the IRS and the government... could leave a citizen in a deadly trap, a sitting duck if you will, for the IRS and other looting marauders."[24]

In marketing the scheme, Stephenson has made numerous false statements about the internal revenue laws:

a. Trust income is not subject to tax;[25]

b. Filing tax returns is voluntary;[26]

c. Only those individuals or businesses that voluntarily disclose personal information on a tax return are subject to tax;[27]

d. Participants' trusts cannot be compelled to turn over books or records to the IRS;[28]

e. Property held by contract trust is exempt from IRS seizure;[29]

f. Only licensed business organizations have employees for employment tax purposes; all other business organizations have independent contractors;[30]

g. Income to a trust can be used to purchase personal assets such as vehicles, household furniture, jewelry, watches, and also to pay for car insurance and upkeep of personal vehicles without first being subject to tax;[31]

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[24] Martin Decl. Ex. 3, at 10.

[25] Martin Decl. Ex. 3, at 72; McCourt Decl. ¶¶ 6, 10.

[26] Martin Decl. Ex. 3, at 73.

[27] Martin Decl. Ex. 3, at 73; McCourt Decl. ¶ 11.

[28] Martin Decl. Ex. 3, at 73; McCourt Decl. ¶ 10.

[29] Martin Decl. Ex. 3, at 77.

[30] Martin Decl. Ex. 2, at 9-1; McCourt Decl. ¶ 12.

[31] Martin Decl. ¶ 20; Martin Decl. Ex.2, at 2-1 and Ex. 3, at 72; McCourt Decl. ¶¶ 6, 16.

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h. Participating businesses should use the following statement instead of disclosing an EIN: "Exempt as per U.S.C. 26 section 501(a); 645(b); 6109 and 7701(a)(31)"[32]

i. Estate tax can be avoided by naming your heir as your successor managing director, and upon your death, your heir takes control of your assets tax free.[33]

Stephenson charges between $2,500 and $8,000 for his trust and corporation packages. In exchange, customers generally receive a set of four trusts or other entities, pre-registered with different states, complete with pre-selected names, and valid IRS employer identification numbers.[34] Customers also receive the *Executive Trustee Operations Manual*, an instructional guide to transferring assets into the trusts and setting up trust bank accounts.[35]

The Defendants' Promotion in Action: Grossly Understated Federal Tax Liabilities.

As previously explained, defendants instruct customers to divert their income to a series of trusts, and report only a small fraction of that income to the IRS. Defendants also advise customers that their trusts are neither required to file federal income tax returns nor pay taxes. In March of 2000, IRS agents executed a search warrant on defendants' business office, and seized hundreds of customer files and other documents.[36] The IRS audited many of those customers' returns for the years in which they participated in defendants' scheme.[37] In the course of these audits, internal revenue agents discovered that defendants' customers were failing to report substantial amounts of income. The following table summarizes some of these examination results, listing the amounts Stephenson's customers claimed on their returns (if returns were even

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[32] Martin Decl. Ex. 2, at 9-2.

[33] McCourt Decl. ¶ 13.

[34] Martin Decl. ¶ 25.

[35] Martin Decl. ¶ 25.

[36] Martin Decl. ¶ 12.

[37] Martin Decl. ¶¶ 29-37.

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filed), the additional income determined as a result of the audit, and the additional tax, penalties and interest assessed as a result of the audit:

Customer	Year	Taxable income claimed on return	Audit income adjustment	Tax, penalties and interest owing
McCourt[38]	1998	$ 800	$ 221,346	$ 146,503
McCourt	1999	($ 3,444)	$ 170,650	$ 96,270
McCourt	2000	No return filed	$ 229,489	$ 125,158
McCourt	2001	No return filed	$ 151,794	$ 70,883
Ryans[39]	1998	$17,599	$ 282,499	$ 165,894
Ryans	1999	$22,674	$ 120,053	$ 68,291
Roths[40]	1999	($ 1,617)	$ 403,538	$ 172,113
Roths	2000	No return filed	$ 355,455	$ 121,062
Oldham[41]	1997	No return filed	$ 49,770	$ 23,016
Oldham	1999	No return filed	$ 68,379	$ 41,123
Rock[42]	1999	($ 1,294)	$ 343,135	$ 177,489
Rock	2000	$ 19,059	$ 141,737	$ 31,894 (tax only)
Rock	2001	($ 13,598)	$ 41,575	$ 11,140 (tax only)
Rock	2002	$124,695	$ 230,891	$ 45,545 (tax only)
Reese[43]	1995	$19,844	$ 260,064	$ 194,626
Reese	1996	($ 3,956)	$ 340,452	$ 242,433
Reese	1997	($ 51,729)	$ 560,457	$ 338,974

[38] Martin Decl. ¶ 29.

[39] Martin Decl. ¶ 31.

[40] Martin Decl. ¶ 33.

[41] Martin Decl. ¶ 34.

[42] Martin Decl. ¶ 35.

[43] Martin Decl. ¶ 37.

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As shown by the above table, defendants customers have failed to report and pay tax on substantial incomes—one customer, Robert Reese of Carmel, California, understated his income by more than $1.1 million over three years while reporting on his returns a total income of negative $35,821 for those three years. (Martin Dec. ¶ 37.)

Additional Interference with Enforcement of the Internal Revenue Laws.

Besides advising customers to not report substantial amounts of income to the IRS, defendants also instruct customers to not file trust income tax returns, to fraudulently hinder and obstruct legitimate IRS collection efforts, and to not withhold employment tax on their employees' wages.[44] Defendants advise customers to transfer their assets into four different trusts to "avoid IRS seizure."[45] In advising customers, defendants pose the question, "Can an *Executive Trustee* or *managing director* of pure contract trust avoid an IRS seizure of your property for claims of tax liability? The answer is YES."[46] Defendants' *Operations Manual* provides detailed instructions for how to accomplish this goal.[47]

Defendants also advise customers that trusts cannot have employees, and must instead hire independent contractors.[48] Defendants' customers stopped withholding employment taxes on their employees wages, and stopped providing Forms W-2 or 1099s unless the employees

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[44] McCourt Decl. ¶ 12.

[45] Martin Decl. Ex. 3 at 77.

[46] Martin Decl. Ex. 3 at 77.

[47] Martin Decl. ¶ 14; Martin Decl. Ex. 2 *generally*.

[48] McCourt Decl. ¶ 12.

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requested these forms.[49] Stephenson also advises customers that they need not withhold employment tax on the salary they draw from their trusts.[50]

Defendants' Knowledge of the Illegality of Their Scheme and the Likelihood of Recurrence

The law clearly shows that Stephenson's theories are wrong. His customers transfer assets and income to the trusts but continue to control and enjoy them as if there had been no transfer. Such trusts have been routinely rejected by courts as shams, and thus not entitled to trust treatment.[51] Moreover, there is simply no authority or basis for Stephenson's claim that these trusts render income and assets exempt from taxation.

Stephenson, a convicted felon,[52] claims to be a lawyer, and to have a variety of certifications in the field of law.[53] He claims to have spent over 20 years researching asset protection and has educated himself "in the relationship of the citizen to various levels of state

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[49] McCourt Decl. ¶ 12.

[50] Martin Decl. ¶ 19.

[51] *See, e.g., O'Donnell v. Commissioner*, 726 F.2d 679, 681 (11th Cir. 1984) (rejecting a trust where the taxpayer transferred his income to the trust and claimed business deductions for living expenses); *Zmuda v. Commissioner*, 731 F.2d 1417, 1421 (9th Cir. 1984) (rejecting a trust where the taxpayer retained control over the trust assets); *Schulz v. Commissioner*, 686 F.2d 490, 493 (7th Cir. 1982) (rejecting a trust because "income is taxed to the person who earns it, regardless of what arrangements he makes to divert the payment of it elsewhere"); *Muhich v. Commissioner of Internal Revenue*, 238 F.3d 860 (7th Cir. 2001) (holding that a trust arrangement where the defendants placed personal assets into five trusts but retained total control over the assets lacked economic substance and therefore should not be recognized by the IRS); *United States v. Welti*, No. C-1-02-243 Doc. No. 55 (S. D. Ohio Sept. 24, 2003) (permanently enjoining a promoter of abusive trusts); *United States v. Mosher*, No. 1:03-CV-208, Doc. No. 45 (W. D. Mich. Oct. 27, 2003) (preliminarily enjoining an abusive trust promoter) *See generally United States v. Buttorff*, 761 F.2d 1056 (5th Cir. 1985) (discussing abusive trusts); *United States v. Sweet*, No. 8:01-CV-331-R-23TGW, 2002 WL 963398 (M.D. Fla. Feb. 20, 2002) (enjoining an abusive trust promoter).

[52] Stephenson was found guilty in 1999 of intimidating a state court judge. Case No. 1991-1-013-16-4, Kitsap County Superior Court, Washington.

[53] McCourt Decl. ¶ 17; Martin Decl. ¶ 26; McCourt Decl. Ex. 1 at "About the Author" (4th page of document).

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and federal government provided for in the constitution and statutes."[54] Stephenson claims to have a "Doctorate of Common Law," and describes himself as a "lawyer," a "counsel," and "an advocate of the law," despite admitting that he is not a member of nor affiliated with any state bar association.[55] Stephenson falsely claims to be a member of the Federal Bar Association. His office window bears the inscription "American Business Law, Inc.," "David Carroll Stephenson, FBA #8830," "Member of the Federal Bar Association."[56] He is not a member of the Federal Bar Association.[57] Given that Stephenson holds himself out as a lawyer he should be charged with knowledge of the actual state of the law, which entirely undercuts his theories.

Since the initiation of the civil investigation preceding this suit, and despite knowledge of numerous IRS audits of his customers, Stephenson has continued to actively market his abusive scheme.[58] He also continues to operate this promotion out of his business office.[59]

Harm to the Government

As of March 2000, Stephenson had 472 customers in 22 states, as well as in Canada.[60] Civil examinations of 21 of Stephenson's customers resulted in a tax loss per participant of over $96,000.[61] Assuming that 450 of the 472 participants as of March 2000 utilized Stephenson's fraudulent tax package, the tax loss as a result of this promotion could exceed $43 million for

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[54] McCourt Decl. Ex. 1 at "About the Author" (4th page of document).

[55] McCourt Decl. ¶ 17; Martin Decl. ¶ 26; McCourt Decl. Ex. 1 at "About the Author" (4th page of document).

[56] Martin Decl. ¶ 4.

[57] Martin Decl. ¶ 5.

[58] Martin Decl. ¶ 27.

[59] Martin Decl. ¶ 21.

[60] Martin Decl. ¶ 12.

[61] Martin Decl. ¶ 28.

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these customers alone.[62] Because Stephenson has continued to promote his program after March 2000, this $43 million estimate, which is based on known clients as of March 2000, almost certainly understates the total amount of taxes evaded thus far. In all likelihood the total tax losses from Stephenson's promotion will exceed $100 million and could be substantially more than that. Many of these tax dollars may never be recovered.

ARGUMENT

A. Standards for Granting a Preliminary Injunction.

Due to the urgent need to halt irreparable harm, "a preliminary injunction is customarily granted on . . . procedures that are less formal and on evidence that is less complete than a trial on the merits. A party thus is not required to prove his case in full" at the preliminary-injunction stage.[63]

In a statutory-injunction action such as this, the moving party must demonstrate that the statute has been violated and that "there is a reasonable likelihood of future violations."[64] Because I.R.C. §§ 7407 and 7408 set forth the criteria for injunctive relief, the United States need only meet those criteria, without reference to the traditional equitable factors, for a court to issue a preliminary injunction under these sections.[65] Although § 7402 is a statutory-injunction

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[62] Martin Decl. ¶ 28.

[63] *University of Tex. v. Camenisch*, 451 U.S. 390, 395 (1981). *See Asseo v. Pan Am. Grain Co.*, 805 F.2d 23, 26 (1st Cir. 1986) ("Affidavits and other hearsay materials are often received in preliminary injunction proceedings."). "[I]nasmuch as the grant of preliminary injunction is discretionary, the trial court should be allowed to give even inadmissible evidence some weight when it is thought advisable to do so in order to serve the primary purpose of preventing irreparable harm before a trial can be held." 11 C. Wright & A. Miller, *Federal Practice & Procedure* § 2949 at 471.

[64] *S.E.C. v. Holschuh*, 694 F.2d 130, 144 (7th Cir. 1982).

[65] *See United States v. Estate Pres. Servs.*, 202 F.3d 1093, 1098 (9th Cir. 2000) ("The traditional requirements for equitable relief need not be satisfied since Section 7408 expressly authorizes the issuance of an injunction."); *Rosile*, No. 8-02-CV-466-T-24-MSS, 2002 WL 1760861, *1 (issuing a preliminary injunction based on a showing of the statutory requirements under §§ 7407 and 7408).

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section, one court has required a showing of the traditional equitable factors.[66] We nevertheless contend that these factors need not be considered because I.R.C. § 7402 specifically authorizes injunctions that are "necessary or appropriate" to enforce the internal revenue laws. In any event, the Government can easily satisfy the equitable-factors test here. The Ninth Circuit's equitable-factors test blends the four factors considered by other circuits into two: "the likelihood of the movant's success on the merits and the relative balance of potential hardships to the plaintiff, defendant, and public."[67]

The evidence submitted with this motion establishes that the Court should enjoin the defendants, and anyone working with them from: (1) promoting their abusive tax scheme or other similar schemes; (2) aiding or abetting customers in understating their federal tax liabilities; and (3) interfering with the administration or enforcement of internal revenue laws.

B. The government will likely prevail on the merits.

1. The evidence shows that an injunction should issue under I.R.C. § 7408.

An injunction under I.R.C. § 7408 is warranted to enjoin a person from further engaging in conduct subject to penalty under I.R.C. §§ 6700 or 6701. The record submitted with this motion establishes that Stephenson has engaged in conduct subject to penalty under I.R.C. §§ 6700 and 6701 in connection with the organization and promotion of his abusive tax scheme described above, and that he will continue to do so absent injunctive relief.

2. Stephenson engaged in conduct subject to penalty under § 6700.

Section 6700 imposes a penalty on a person who organizes or participates in the sale of any plan or arrangement and, in connection therewith, makes or furnishes a statement with respect to the excludability of any income that the person knows or has reason to know is false or

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[66] *United States v. Ernst & Whinney*, 735 F.2d 1296, 1301 (11th Cir. 1984) ("the decision to issue an injunction under § 7402(a) is governed by the traditional factors shaping the . . . use of the equitable remedy.")

[67] *State of Alaska v. Native Village of Venetie*, 856 F.2d 1384, 1388-89 (9th Cir. 1988).

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fraudulent as to any material matter. The evidence submitted with the Government's motion establishes that defendants organize, promote, and market an abusive tax scheme, advocating a series of sham trust and business entities in a fraudulent attempt to avoid income and employment tax, and to thwart the IRS's ability to collect customers' unpaid federal tax liabilities. In marketing the scheme, Stephenson has made numerous false statements about the internal revenue laws. He has claimed that

a. Trust income is not subject to tax;

b. Filing tax returns is voluntary;

c. Only those individuals or businesses that voluntarily disclose personal information on a tax return are subject to tax;

d. Participants' trusts cannot be compelled to turn over books or records to the IRS;

e. Property held by contract trust is exempt from IRS seizure;

f. Only licensed business organizations have employees for employment tax purposes; all other business organizations have independent contractors;

g. Income to a trust can be used to purchase personal assets without first being subject to tax;

h. Participating businesses should use the following statement instead of disclosing an EIN: "Exempt as per U.S.C. 26 section 501(a); 645(b); 6109 and 7701(a)(31);" and

i. Estate tax can be avoided by naming your heir as your successor managing director, and upon your death, your heir takes control of your assets tax free.

These false statements have induced hundreds of customers to participate in this illegal scheme.

Stephenson knew or had reason to know that his promotional statements concerning the tax benefits obtainable using his scheme were frivolous. Courts consider three factors in determining whether the Government has established the "knew or had reason to know" standard of § 6700: (1) the extent of the defendant's reliance on knowledgeable professionals; (2) the defendant's level of sophistication and education; and (3) the defendant's familiarity with tax

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matters.[68] All three factors point to Stephenson's knowledge of the falsehoods contained in his promotional material. Stephenson claims to have a variety of legal certifications and to be self-educated in the law. He also claims to have conducted over 20 years of personal research in asset protection. As such, he is undoubtedly aware that his positions are frivolous and have been repeatedly rejected by the federal courts. At a minimum he had reason to know that statements he made in promoting his scheme were false.

Furthermore, Stephenson's false statements made in the course of his promotion were material. A matter is material if it would have a substantial impact on the decision-making process of a reasonably prudent investor.[69] Stephenson has been very successful in marketing his abusive scheme. As of March 2000, he had over 450 clients in 22 states and Canada. Clearly his false claims about the tax benefits obtainable through participation in his scheme have a substantial impact on whether customers participate. Accordingly, because Stephenson made false statements during the course of promoting his abusive tax scheme, he and his enterprise have engaged in conduct subject to penalty under I.R.C. § 6700.

3. Stephenson engaged in conduct subject to penalty under § 6701.

I.R.C. § 6701 penalizes a promoter who aids, assists, or advises with respect to the preparation or presentation of any portion of a return or other document, knowing or having reason to believe that such advice will be used in connection with any material matter, and who knows that such portion, if used, would result in an understatement of tax. Stephenson advised customers to funnel their income to their trusts, use the trust bank accounts to pay for personal living expenses, and to draw a small salary from the trust which would be reported on the customers' Forms 1040. Stephenson also advised customers that their trusts need not file tax returns, and that they need not report any income received by their trusts, despite using this

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[68] *United States v. Estate Preservation Services,* 202 F.3d 1093, 1103 (9th Cir. 2000).

[69] S.Rep. No. 97-494, Vol. 1 at 267 (1982).

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income to pay for personal living expenses. Based upon Stephenson's claimed expertise in the law, and his many years of research in the area, he must know that the positions he advocates result in understatements on his customers' returns. Additionally, that the IRS audited many of his customers' returns, and that he was personally the subject of a criminal tax investigation, he cannot credibly claim that he lacked knowledge. Stephenson's conduct is therefore subject to I.R.C. § 6701 penalties.

C. Equitable considerations weigh in favor of enjoining the defendants under I.R.C. § 7402.

Manifesting "a Congressional intention to provide the district courts with a full arsenal of powers to compel compliance with the internal revenue laws,"[70] 26 U.S.C. § 7402 "has been used to enjoin interference with tax enforcement even when such interference does not violate any particular tax statute."[71] Here, injunctive relief under § 7402 is appropriate to prevent Stephenson's interference with tax enforcement. Should the Court find they apply in a Section 7402 injunction case, the equitable criteria for an injunction are present: the likelihood of the movant's success on the merits and the relative balance of potential hardships to the plaintiff, defendant, and public.[72]

The declarations and exhibits submitted in support of this motion present irrefutable evidence that Stephenson and the other defendants repeatedly have impeded the administration of the internal revenue laws. Defendants instruct customers not to file trust returns, not to report income to the IRS, and to interfere with and obstruct legitimate IRS collection efforts. They also

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[70] *Brody v. United States*, 243 F.2d 378, 384 (1st Cir. 1957). *See United States v. First Nat'l City Bank*, 568 F.2d 853 (2d Cir. 1977).

[71] *Ernst & Whinney*, 735 F.2d at 1300. *See United States v. Kaun*, 633 F. Supp. 406, 409 (E.D. Wis. 1986) ("federal courts have routinely relied on [§ 7402(a)] . . . to preclude individuals . . . from disseminating their rather perverse notions about compliance with the Internal Revenue laws or from promoting certain tax avoidance schemes"), *aff'd*, 827 F.2d 1144 (7th Cir. 1987).

[72] *Venetie*, 856 F.2d at 1388-89.

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instruct customers to stop withholding employment tax on their employees' wages, and not withhold employment tax on the salary they draw from their own trusts. Therefore, the United States has a strong likelihood of prevailing on the merits. The United States has suffered and will continue to suffer irreparable injury if Stephenson and his businesses are not enjoined. The IRS estimates that Stephenson's customers have tried to evade at a minimum $43 million in taxes. Because the defendants will not end their scheme unless forced to do so, the United States Treasury, funded by United States taxpayers, will continue to lose money as long as Stephenson and his businesses are operating. Given the audacity and breadth of their scam, at last count, in March 2000, involving over 450 clients in 22 states and Canada, and given the IRS's limited resources, identifying and recovering all lost revenue may be impossible.

In addition to the harm caused by their advice and services, Stephenson's scheme undermines public confidence in the federal tax system and incites non-compliance with the internal revenue laws. If defendants are not enjoined now, they will cause even greater damage to the United States.

The need to remedy the injury suffered by the United States outweighs any harm the defendants may suffer if an injunction is issued. The requested injunction is tailored to prevent the defendants from causing further irreparable injury. Specifically, the United States simply requests that this Court enjoin Stephenson and his businesses from continuing to violate the law. Preliminary injunctions such as this are typically granted.[73]

Finally, the public interest is clearly served by shutting down Stephenson's illegal tax-evasion scheme.[74] If a preliminary injunction is granted, it will help to stem the spread of defendants' abusive scheme. A preliminary injunction will help protect people from paying

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[73] *Dunlop v. Davis*, 524 F.2d 1278, 1281 (5th Cir. 1975) (Injunctions requiring people to follow the law do not cause hardship).

[74] *United States v. Lee*, 455 U.S. 252, 253 (1982) (noting that "the broad public interest in maintaining a sound tax system is of . . . a high order.").

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significant sums for worthless tax advice and from incurring tax penalties resulting from filing fraudulent returns—by halting their promotion at its source. And, the "collection of taxes certainly serves the public interest."[75]

Indeed, it is difficult to imagine a more compelling case for an injunction that is—in the words of § 7402—"necessary or appropriate for the enforcement of the internal revenue laws."

CONCLUSION

Defendants' activities have caused and are causing substantial harm—to their customers, to the Government, and to law-abiding taxpayers who pay their proper tax liabilities. Based upon the evidence before the Court, the United States is entitled to the relief it seeks—a preliminary inunction banning defendants from promoting their abusive trust scheme. Because of the serious nature of the harm caused, the requested relief should be granted to prevent further harm while this case is litigated.

Dated this 19th day of December, 2003

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[75] *United States v. Mathewson*, 71 A.F.T.R.2d 93-1453, 1993 WL 113434 (S.D. Fla. 1993).