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CLERK, U.S. DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA
SOUTHERN DIVISION AT SANTA ANA
BY _____ DEPUTY

UNITED STATES DISTRICT COURT

FOR THE CENTRAL DISTRICT OF CALIFORNIA

UNITED STATES OF AMERICA, Plaintiff, v. SAMUEL J. DeANGELO; JOE GORDON SHIELDS, a/k/a GORDON SHIELDS; ALAN M. HOVEY; JEFFREY R. WRIGHT; KELLY DAVID, a/k/a DAVID KELLY; and WESTERN TAX SERVICES, INC., Defendants.	No. SA CV 03-0251 COMPLAINT FOR PERMANENT INJUNCTION AGAINST THE PREPARATION OF TAX RETURNS AND OTHER EQUITABLE RELIEF

COMPLAINT

The United States of America, by and through its counsel of record, alleges as follows:

NATURE OF ACTION

1. This is a civil action brought pursuant to Title 26 U.S.C. Sections 7401, 7402(a), 7407, and Title 28 U.S.C. Sections 1340 and 1345.

2. This action is to obtain a permanent injunction against the above-named defendants prohibiting them from further: (1) acting as income tax return preparers, (2) engaging in conduct subject to penalty under Sections 6694 and 6695 of Title 26 of the United States Code, or any criminal conduct prohibited by Title 26 of the United States Code, (3) in the case of defendant Shields, misrepresenting his eligibility to practice before the IRS, and (4) engaging in any other fraudulent or deceptive conduct which substantially interferes with the proper administration of the Internal Revenue laws.

JURISDICTION

3. This Court has jurisdiction over this action pursuant to Title 26 U.S.C. Sections 7401, 7402(a), 7407, and Title 28 U.S.C. Sections 1340 and 1345.

4. This suit has been properly authorized pursuant to Title 26 U.S.C. Section 7401.

DEFENDANTS

5. Defendant Samuel J. DeAngelo (DeAngelo) resides in Yorba Linda, California, within the Central District of California. He currently owns and operates Western Tax Services, Inc. (WTS), located in Anaheim, California. Prior to operating his income tax return preparation business through WTS, DeAngelo operated as

a sole proprietorship known as DeAngelo Tax Service (DTS).

6. Defendant Joe Gordon Shields, a/k/a Gordon Shields (Shields), resides in Orange, California, within the Central District of California. He is currently employed as an income tax preparer in Riverside, California with Tax Matters, Inc. Though he currently holds himself out as an enrolled agent with the IRS, his enrolled agent status was terminated in 1993.

7. Defendant Alan M. Hovey (Hovey) resides in Cathedral City, California, within the Central District of California. He currently works as a paid income tax preparer for WTS.

8. Defendant Jeffrey R. Wright (Wright) resides in Anaheim, California, within the Central District of California. He currently works as a paid income tax preparer for WTS. He also serves as the president of WTS. He is DeAngelo's son-in-law.

9. Defendant Kelly David, a/k/a David Kelly (David) resides in Newport Beach, California, within the Central District of California. He currently works as a paid income tax preparer for WTS.

10. Defendant WTS is a California corporation, its principal place of business being in Anaheim, California, within the Central District of California. WTS is in the business of providing income tax return preparation services. The business is owned and operated by DeAngelo. WTS was incorporated in 2000.

DEFENDANTS' ACTIVITIES

11. For approximately the last thirty years, and continuing to the present, DeAngelo has been engaged in the preparation of

tax returns, acting as a paid income tax return preparer for individuals (sometimes referred to herein as "customers"). DeAngelo currently offers tax return preparation services through WTS, which he owns and operates. While operating his tax return preparation business, and continuing to the present, DeAngelo has trained and supervised other return preparers, including the other individual defendants in this case.

12. Defendants Shields, Hovey, Wright, and David each began their careers as paid income tax return preparers working for DeAngelo. Each of these defendants currently is preparing income tax returns as a paid preparer.

13. Each defendant has continually or repeatedly engaged in conduct subject to penalty under Section 6694, Title 26 U.S.C., in that each has, among other things, (1) taken unrealistic and unsustainable positions on customers' tax returns, resulting in understatements of tax due, and (2) willfully or recklessly understated the tax due (and, in nearly every case, overstated the refund due) on customers' tax returns.

14. Each defendant has continually or repeatedly engaged in conduct subject to penalty under Section 6695(c), Title 26 U.S.C., in that each has failed to furnish a correct identifying number for WTS on each return prepared under the auspices of WTS.

15. Further, each defendant has continually or repeatedly engaged in fraudulent and deceptive conduct which has substantially interfered with the proper administration of the Internal Revenue laws in that each defendant has, among other

things, improperly and purposefully reduced and understated customers' tax liabilities by claiming false and inflated itemized deductions for charitable contributions and employee business expenses, including improper expenses for home computers or home offices, resulting, in most cases, in an undeserved refund.

16. All of the defendants have been informed by the Internal Revenue Service that their conduct is improper and illegal; however, it is believed that each defendant has continued to prepare improper tax returns.

SPECIFIC ALLEGATIONS REGARDING DEFENDANTS' CONDUCT

How the WTS return-preparation scheme worked

17. At all times relevant hereto, the defendants' typical customers were middle-income individual wage earners. Advertising was by word of mouth. Customers typically were referred by friends or relatives who had received tax refunds through DTS/WTS. Over 90 percent of the Form 1040 tax returns the defendants prepared resulted in a refund.

18. WTS operated a high-volume business. In the 2000 return season (i.e., tax returns for 1999), WTS prepared 4,229 returns; in the 2001 season, 8,749 returns; in the 2001 season, 5,262 returns. WTS generally prepared each return during a single conference with the customer at WTS's office, which sometimes lasted only a few minutes. Returns were prepared using computer software and were filed electronically.

19. During the customer conference, the individual return

preparer/defendant would input the customer's data into the computer. The preparer used the customer's Form W-2 or Form 1099 as a source for income data and interviewed the customer regarding potential deductions.

20. Customers typically were asked whether they made charitable contributions and whether they owned home computers, used their cars for work, or had other expenses arguably related to their jobs. For example, military customers were asked if they paid for their own haircuts and drycleaning. The individual return preparer/defendant did not, however, make reasonable inquiries or otherwise attempt to determine or substantiate the actual amounts of such contributions or expenses.

21. In most cases, the customer was not legally entitled to itemize any employee business expenses or other expenses such as depreciation on office equipment on Schedule A of Form 1040 because the actual amounts of any such expenses were, in the aggregate, below the customer's 2 percent adjusted gross income "floor". The standard deduction thus should have been claimed. Nonetheless, the defendants claimed fictitious, inflated and improper itemized deductions for job expenses to reduce customers' taxable income.

22. In addition to improperly claiming job expenses, the defendants claimed fictitious or inflated charitable contribution amounts to further reduce customers' taxable income.

23. The defendants did not point out or explain these bogus deductions for expenses and contributions to the customers.

24. In nearly every case, the defendants appear to have improperly generated false deductions large enough to create a refund.

25. The defendants charged fees ranging from a minimum of $300 to $3,000 or more. This was well over the range customarily charged by professional return preparers in the Orange County area to prepare returns for similar taxpayers.

26. The refund claimed on the typical return was larger than the fee charged by the defendants. This served to foreclose most complaints about the size of the fee. Further, most customers were given the option of paying the fee by tendering a check post-dated to when the IRS was expected to deposit the refund into the customer's bank account. Thus most customers could have their returns prepared without having to pay any funds out of pocket, regardless of how high the fee.

27. After a return was completed on-screen by the individual defendant/preparer, the customer generally would sign it electronically by entering a personal identification number in the computer. In the alternative, the customer would sign a one-page form to authenticate the electronic portion of the Form 1040.

28. At the end of the defendants' return preparation process, the customers would be given a copy of their completed Form 1040. By that point, the customers had already signed the returns electronically or authenticated them by signing separate forms, so there was little incentive to review them for accuracy.

Particular customers' experiences

29. In April 2001, one customer, referred to WTS by a family member, went to WTS' offices in Anaheim to have his 2000 joint tax return prepared. He met with David for approximately 20 minutes. David asked the customer whether he made charitable contributions during the year or incurred any employee business expenses. The customer told David that he made contributions to his church but incurred no expenses with respect to his employment. David prepared a tax return for the customer that claimed bogus charitable contributions of $7,800 and bogus employee business expenses of $8,114. The customer was charged $1,500 for the tax return and initially received a refund. Since then, the IRS has examined the customer's tax return and has determined that approximately $5,000 of tax and interest is due.

30. In February 2001, another customer went to WTS to have her 2000 tax return prepared. She met with Hovey for approximately 5 minutes. Hovey asked the customer if she attended church (which she did) and asked if she had bought a computer (which she had). Hovey prepared a tax return for the customer that claimed false charitable contributions of $2,600 and false employee business expenses of $10,927. The customer was charged $500 for the tax return and initially received a refund. Since then, the IRS has examined the tax return and has determined additional tax and interest due in the amount of approximately $1,700.

31. In April 2001, another customer, referred to WTS by a

family member, went to WTS to have her 2000 joint tax return prepared. The customer met with Wright for approximately 10 minutes. The customer told Wright she made charitable contributions of $3,500 to the Salvation Army. Wright asked the customer, a social worker, whether she had a computer, a desk, chairs, and a bookshelf at home (which she did). Wright incorrectly told the customer she could deduct these items because she took work home at night. Wright prepared a tax return for the customer showing inflated charitable contributions of $6,500 and bogus employee business expenses of $15,173. The customer was charged $1,050 for the return preparation. She initially received a refund. Since then, the IRS has examined the tax return and has determined additional tax and interest due in the amount of approximately $4,568.

32. In March 2001, another customer, referred to WTS by a co-worker, went to WTS to have her 2000 joint tax return prepared. She was told by her co-worker that WTS would get her a large refund. She and her husband met with Shields. Shields asked the customer, an ultrasound technician at a hospital, and her husband if they owned a home computer and any office furniture at home (which they did). Shields did not ask the customer when the items were purchased or what they cost. Shields prepared a tax return for the customer claiming $1,000 in false charitable contributions and $13,005 of bogus employee business expenses. The customer was charged $1,500 for the return preparation. The customer and her husband initially

received a refund. Since then, the IRS has examined the tax return and has determined that additional tax and interest in the amount of $8,884 is due.

33. In February 2000, another customer, referred by a friend, went to DTS to have her 1999 tax return prepared. She met with DeAngelo, who asked her whether she made charitable contributions (which she did) and whether she owned a home computer (which she did). The customer told DeAngelo that she did not have receipts to show the amount of her contributions or the cost of the computer. DeAngelo told the customer how to create receipts if ever audited by the IRS. DeAngelo prepared a tax return for the customer showing false charitable contributions of $2,600 and false employee business expenses of $13,895. The customer was charged $550. She initially received a refund. Since then, the IRS has examined the tax return and has determined that additional tax and interest is due in the amount of $5,827.

34. With respect to the 1999 tax year, DeAngelo claimed a bogus "slave reparation credit" of $40,000 on behalf of an African-American customer.

Customers in military service

35. By its proximity to the now-closed El Toro Marine Base in Orange County, California, and through word-of-mouth, the defendants managed to target military personnel in Orange County and San Diego County, California, with their false tax return preparation scheme. During the 1999 and 2000 tax return filing

seasons, it is estimated that DTS/WTS personnel prepared returns for well over one hundred enlisted men and women. These tax returns, like the other tax returns prepared by DTS/WTS, followed the same pattern of false deductions as described herein, in that they contained bogus charitable deductions and bogus employee business expenses.

36. In 2001, it came to the attention of several officers on the Marine bases at Miramar and Camp Pendleton that WTS was preparing returns for military personnel that yielded suspiciously large refunds. After further investigation, it was determined by these officers, who were attorneys working with the Volunteer Income Tax Assistance (VITA) programs on the bases, that the refunds were based on bogus deductions. After contacting the IRS, these officers warned the military population of this scam. A military newspaper ran a story entitled "Firm allegedly cheats on Marine tax refunds." Personnel who may have filed improper returns were urged to come forward. VITA assisted those who responded to file amended returns and make arrangements to pay back, with interest, the undeserved refunds.

INJURY TO THE UNITED STATES

37. The Internal Revenue Service has thus far examined approximately 93 of the estimated 18,240 tax returns prepared by the defendants for the 2000-2002 tax seasons (i.e., returns for years 1999-2001). Over 90 percent of these audited returns contained understatements of tax liability, the average tax loss being $1,919. Over 90 percent of these audited returns claimed

false deductions for charitable contributions or job expenses, or both.

38. Over 90 percent of the returns prepared by the defendants claimed a refund. This percentage is significantly higher than the overall percentage of Form 1040 returns claiming refunds. Of all Forms 1040 filed nationwide, the percentage of returns claiming a refund was 72.1 for tax year 1999, 72 percent for 2000, and 76 percent for 2001.

39. The errors contained in the returns prepared by the defendants cannot be automatically detected by cross-checking information reported to the IRS by employers or other third parties. The defendants generally report such information (for example, income from Forms W-2) accurately. Time-intensive audits by revenue agents, including interviews with the taxpayer-customers, are usually necessary to ferret out the bogus deductions claimed by the defendants.

40. As a result of the defendants' improper actions, acting either in concert or individually, the United States has suffered a significant tax loss. The exact loss is unknown, but based on the total number of returns prepared by DTS/WTS for the periods at issue, approximately 18,240, assuming that 90 percent of these returns contain understatements of tax, and assuming further an average tax loss per return of $1,919, the IRS estimates the aggregate tax loss at $31.5 million.

INJURY TO THE DEFENDANTS' CUSTOMERS

41. As a result of the defendants' improper actions, acting

either in concert or individually, many of their customers have been required to file amended returns or undergo audits by the IRS. They have incurred severe, and in most cases unanticipated, financial burdens due to their liability for additional tax beyond the amount reported on their original returns, plus statutory interest.

42. As a result of the defendants' improper actions, acting either in concert or individually, many of their customers will be required to file amended returns or undergo audits by the IRS. They will incur severe financial, and in most cases unanticipated, financial burdens due to their liability for additional tax beyond the amount reported on their original returns, plus statutory interest (and perhaps civil penalties).

COUNT I

(Engaging in Conduct Prohibited by Sections 6694 and 6695)

43. Plaintiff realleges and incorporates by reference paragraphs 1 through 42 of the Complaint.

44. The defendants, by reason of their preparation, or assistance in the preparation, of federal income tax returns for which they were compensated, are income tax return preparers within the meaning of Section 7701(a)(36) of the Internal Revenue Code ("the Code"), Title 26, U.S.C.

45. The defendants have continually or repeatedly engaged in conduct subject to penalty under Section 6694 of the Code by either (a) recklessly or intentionally disregarding rules and regulations in preparing the return of another person, resulting

in an understatement of federal tax liability for that person; or (b) willfully or recklessly understating the federal tax liability of another person in preparing the return of that person; or both.

46. The defendants have continually or repeatedly engaged in conduct subject to penalty under Section 6695 of the Code in that they have failed to consistently furnish the correct identifying number for WTS on the returns they have prepared under the auspices of WTS.

47. Unless enjoined by the Court, the defendants will continue to engage in the above-described conduct.

48. The defendants must be enjoined from further acting as income tax return preparers because an injunction prohibiting their engaging in conduct subject to penalty under Sections 6694 and 6695 of the Code would not be sufficient to prevent their further interference with the proper administration of the tax laws.

COUNT II

(Unlawful Interference with the Internal Revenue Laws)

49. Plaintiff realleges and incorporates by reference paragraphs 1 through 48 of the Complaint.

50. The defendants' fraudulent and deceptive conduct as set forth above has the effect of substantially interfering with the proper administration of the Internal Revenue laws by causing the filing of improper and illegal tax returns or claims for refunds, as well as the filing of tax returns containing improper and

illegal deductions, all of which contributes to undermining the respect for, and deterring voluntary compliance with, the federal tax laws.

51. Unless enjoined by this Court, the defendants will continue to engage in this conduct.

APPROPRIATENESS OF INJUNCTIVE RELIEF

52. Injunctive relief is appropriate under Sections 7407 and 7402 of the Code for the following reasons:

a. Proscribed Conduct. The defendants, in the course of preparing income tax returns on behalf of their customers, have continually or repeatedly engaged in conduct subject to penalty under Sections 6694 and 6695 of the Code and which otherwise interferes with the proper administration of the Internal Revenue law. In addition, by continuing to represent himself as an enrolled agent even though that status was terminated in 1993, Shields has misrepresented his eligibility to practice before the IRS.

b. Likelihood of Recurrence. If the defendants are not enjoined from preparing federal income tax returns, it is likely that they will continue to do so, since they have engaged in a pattern and practice of abuse extending over a number of years.

c. Irreparable Injury. The defendants, by their continual or repeated violations of the internal revenue laws, have caused a substantial revenue loss to the United States Treasury as well as a severe drain of government

administrative resources in identifying and examining the returns the defendants prepared and in attempting to collect the monies owed. The IRS lacks sufficient resources to examine all of the returns the defendants have prepared to date and are continuing to prepare. The 2003 return preparation season is in full swing. In addition, the resulting and potential litigation relating to the tax returns prepared by the defendants will place a heavy burden on the judicial system.

d. Public interest. Members of the public whom the defendants aided, advised, or assisted have been harmed because such persons paid the defendants for their services in preparing tax returns, and if their returns are examined by the IRS, they will likely be assessed with deficiencies in tax, be required to pay statutory interest on the tax deficiencies resulting from the defendants' improper preparation, and may also be subject to civil penalties resulting from the deficiencies. Moreover, the defendants' behavior encourages a reckless disregard for the internal revenue laws and erodes public confidence in the fairness of the federal income tax system, thus causing irreparable injury to the government and the nation as a whole.

RELIEF REQUESTED

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

1. That the Court find that the defendants, Samuel

DeAngelo, Gordon Shields, Alan Hovey, Jeffrey Wright, Kelly David, and Western Tax Services, Inc., have continually or repeatedly engaged in conduct subject to penalty under Sections 6694 and 6695; that an injunction prohibiting such conduct would not be sufficient to prevent the defendants' interference with the proper administration of Title 26; and that the defendants therefore should be permanently enjoined from acting as income tax return preparers pursuant to Sections 7407 and 7402 of the Internal Revenue Code.

2. That the Court find that the defendants, Samuel DeAngelo, Gordon Shields, Alan Hovey, Jeffrey Wright, Kelly David, and Western Tax Services, Inc., have continually or repeatedly engaged in fraudulent or deceptive conduct that substantially interferes with the proper administration and enforcement of the internal revenue laws by the Internal Revenue Service; that an injunction prohibiting such conduct would not be sufficient to prevent the defendants' interference with the proper administration of Title 26; and that the defendants therefore should be permanently enjoined from acting as income tax return preparers pursuant to Sections 7407 and 7402 of the Internal Revenue Code.

3. That the Court enter a Final Judgment of Permanent Injunction enjoining the defendants, Samuel DeAngelo, Gordon Shields, Alan Hovey, Jeffrey Wright, Kelly David, and Western Tax Services, Inc., and all other persons in active concert or participation with them, directly or indirectly, by use of any

means or instrumentality, from:

a. Acting as income tax return preparers within the meaning of Section 7701(a)(36) of the Code;

b. Taking any action in furtherance of aiding, assisting, advising, or preparing for compensation tax returns of third-party taxpayers;

c. Further engaging in conduct subject to penalty under Sections 6694 and 6695 of the Code; or

d. Substantially interfering with and/or impeding the proper administration of the internal revenue laws.

4. That this Court further order and decree, as part of its permanent injunctive relief, that the defendants notify, in writing, all persons whose tax returns they have prepared from January 1, 1999 to the date of the Court's order, of the findings and relief ordered by the Court, including in such notice to each person a copy of the Complaint and of the Court's Final Order of Permanent Injunction; and that the defendants file with the Court a list of the names and addresses of all persons so notified within thirty (30) days of the date the Order is entered.

5. That this Court retain jurisdiction of this action for the purpose of implementing and enforcing the final judgment and all additional decrees and orders necessary and appropriate to the public interest.

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6. That this Court award plaintiff all its costs in prosecution of this action.

Respectfully submitted,

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EDWARD M. ROBBINS, JR.
Assistant United States Attorney
Chief, Tax Division

Dated: March 11, 2003

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