IN THE UNITED STATES DISTRICT COURT FOR THE
WESTERN DISTRICT OF MISSOURI
ST. JOSEPH DIVISION

THE UNITED STATES OF AMERICA	)	
	)	
Plaintiff,	)	
	)	
v.	)	Civil No. 08-0120-CV-W-GAF
	)	
ALLEN R. DAVISON	)	
	)	
Defendant.	)	

COMPLAINT FOR PERMANENT INJUNCTION AND OTHER RELIEF

Plaintiff, United States of America, for its complaint against defendant Allen R. Davison states as follows:

Nature of the Action

1. Davison promotes numerous tax-fraud schemes, including but not limited to schemes that involve his helping customers to use (i) sham management companies that do not perform management services; (ii) sham management companies whose shares are unlawfully owned entirely by Roth Individual Retirement Accounts; (iii) unlawfully structured retirement plans that are sponsored by sham management companies and funded exclusively by large insurance contracts; (iv) fraudulently claimed deductions reserved only for small farmers but claimed by ineligible customers; (v) artificially inflated basis or depreciation claims unlawfully taken for property and other assets; and (vi) bogus disabled access credits to offset their taxable income.

2. The United States is bringing this complaint under 26 U.S.C. §§ 7402(a) and 7408 of the Internal Revenue Code (I.R.C.) to enjoin Davison and anyone acting in concert with him from directly or indirectly:

a. Organizing, promoting, marketing, or selling any plan or arrangement – including but not limited to the tax schemes described in this complaint – that advises or assists others in violating or attempting to violate the internal revenue laws or unlawfully evading the assessment or collection of their federal tax liabilities;

b. 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 false or fraudulent statements regarding the allowability of certain deductions, the excludability of income, or the securing of tax benefits derived from participation in a plan or arrangement, when he knows and/or has reason to know the statements are false or fraudulent as to a material matter;

c. Engaging in conduct subject to penalty under I.R.C. § 6701, *i.e.*, preparing or assisting in the preparation of, or advising with respect to a document related to a matter material to the internal revenue laws that includes a position that he knows will, if used, result in an understatement of tax liability;

d. Engaging in conduct subject to penalty under I.R.C. §§ 6707(a), *i.e*., failing to file a return or statement with the IRS that identifies and describes any reportable or listed transaction, any potential tax benefits expected to result from that transaction, as well as other information required by statute;

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

f. Providing any individual or entity with any advice relating to federal taxes; and

g. Aiding, assisting, and/or advising with respect to the preparation of any federal tax return or representing customers before the IRS.

3. An injunction is warranted based on Davison's continuing conduct as a promoter of tax-fraud schemes. Davison has been promoting tax-fraud schemes since at least the mid-1990s. Davison's numerous tax-fraud schemes have caused substantial harm to the Government. The

Internal Revenue Service is harmed because it must continuously devote limited resources to detecting and examining inaccurate returns filed by Davison customers, and to attempting to assess and collect unpaid taxes from those customers. The amount of tax loss caused by Davison's promotions is incalculable but likely in the hundreds of millions of dollars.

Jurisdiction and Venue

4. Jurisdiction is conferred on this Court by 28 U.S.C. §§ 1340 and 1345, and by 26 U.S.C. §§ 7402(a) and 7408.

5. 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 discretion of a delegate of the Attorney General of the United States, pursuant to 26 U.S.C. §§ 7402 and 7408.

6. Venue is proper in this Court under 28 U.S.C. § 1391 because a substantial part of the events giving rise to this suit took place in this district.

7. Davison does business in this district at BI Services of America, located at 800 West 47th Street, Suite 525, Kansas City, Missouri 64112, and at VCW Holding Company, LLC, located at 11020 Ambassador Drive, Suite 300, Kansas City, Missouri 64513. On information and belief, Davison also works as an independent tax advisor and attorney, and he also does business through a number of companies that serve as aliases for him, including but not limited to Six D Enterprises, Inc., Six D LLP, and Wealth Services Advisory of America. Davison resides at 6504 West 132nd Terrace, Overland Park, Kansas 66209.

Background Facts

8. Davison is a certified public accountant, with licenses in Kansas, Missouri, and Nebraska. He is also an attorney, licensed in Nebraska. He holds a Bachelor of Science degree in Business Administration from the University of Nebraska and a Juris Doctorate from the University of Nebraska Law School. Davison became a CPA in 1981.

9. Davison worked for the accounting firm of Coopers and Lybrand as a tax advisor from 1979 until 1993. While at Coopers and Lybrand, Davison became acquainted with A. Blair Stover, Jr., who also promotes tax-fraud schemes.

10. In 1993, Davison and Stover became affiliated with the Grant Thornton accounting firm and went to work in its Kansas City office, where Davison was a tax partner. Many of the tax schemes Davison promotes and has promoted were initially devised and promoted by him when he was at Grant Thornton.

11. In October 2001, Davison and Stover left Grant Thornton. On information and belief, they left after that firm's management learned about the tax schemes that Davison and Stover promoted. On information and belief, Grant Thornton's management became uncomfortable with the tax advice that Davison and Stover offered to customers.

12. After leaving Grant Thornton, Davsion continued to promote many of the same tax schemes he had promoted while at Grant Thornton, and he continued to work with many of the same customers, along with some new customers, as well. Davison also began providing legal services to customers, many of whom he currently represents in cases in United States Tax Court.

13. In October 2001, after leaving Grant Thornton, Davison became affiliated with a former Grant Thornton colleague, Tami Hughes, and her company, BI Services of America, which is a bookkeeping concern that prepares tax returns for many of Davison's customers. He also worked as an in-house tax consultant and advisor for V. Cheryl Womack, a Kansas City-based businesswoman, who was then the owner of the National Association of Independent Truckers. On information and belief, since 2002 when Womack sold the National Association of Independent Truckers, Davison has continued to work for V. Cheryl Womack at her holding company, VCW Holding Company, LLC, where he currently works as an investment advisor.

14. Davison's customer-base is nationwide. Many of Davison's customers are wealthy people who own and operate lucrative businesses in a variety of sectors, especially real estate, automobile sales, and engineering. His customers are based throughout the nation, and largely in Missouri, Kansas, Nebraska and Iowa.

15. Over the years, Davison has promoted increasingly aggressive tax schemes as a means of attracting and retaining wealthy customers. According to one press account, over time Davison earned the nickname "Dr. Poof" among accountants in Kansas City for his purported ability to make customers' tax liabilities disappear. To avoid detection by the IRS, Davison has modified his schemes or concocted entirely new schemes, knowing that it sometimes takes the IRS considerable time to detect a tax-fraud scheme and pursue customers who use it and promoters who sell it.

16. Davison has generally promoted three basic types of tax schemes involving either (i) sham management companies; (ii) sham family farm partnerships; or (iii) bogus claims of inflated basis in stock and other assets or inflated depreciation of property.

Davison's Unlawful Activities

Tax-Fraud Scheme No. 1: The Sham Management Company

17. Davison promotes an unlawful tax scheme that uses sham management companies as a tool for creating bogus tax deductions. He began promoting this scheme in the mid-1990s.

18. Davison establishes sham management companies for his customers who are self-employed or own small businesses. At Davison's direction, these management companies "receive" fees for management services that are never actually performed for the customer's business. At Davison's direction, the customer's business falsely and fraudulently claims these fees as business-expense deductions on its tax return. The sham management company also falsely and fraudulently takes deductions for business expenses incurred in the performance of purported management services. Davison's Sham Management Company scheme enables his customers to evade the assessment and payment of income tax.

19. Davison directs and coordinates all aspects of the Sham Management Company Scheme that he promotes.

20. To start the scheme, Davison directs the creation of a sham management company that is often incorporated in Nevada. A number of companies operated by Davison associates incorporate these sham management companies for Davison's customers and serve as their Nevada-based resident agents.

21. In or around November 1999, at Davison's direction, two of his associates, Charles Hubbard and Ruth Donovan, founded NMN Corporate Services, LLC (NMN purportedly means "None Means None," a reference to the amount of tax Davison's customers will purportedly have to pay). Hubbard and Donovan are listed as resident agents for many of the sham management companies incorporated for Davison's customers. In December 2006 or January 2007, NMN's registered agent account portfolio was acquired by Incorp Services, Inc., which touts itself as the largest resident agent/incorporation service in Nevada, offering customers the same range of services, including items such as "old shelf corporations," designed to enable customers to establish a long corporate history in Nevada quickly.

22. In October of 2000, Tami Hughes, another Davison associate who works at Davison's direction and in cooperation with Davison, founded BI Services of America, LLC. In addition to providing tax-preparation services to Davison customers, this company also provides resident-agent services to sham management companies registered in Nevada. BI Services is listed as resident agent for 153 corporations (some of which are dissolved or revoked) owned by Davison customers.

23. On information and belief, at Davison's direction, in March 2002, Heather Larsen (a former Grant Thornton employee and Davison associate) founded North American Corporate Services, which also serves as a Nevada resident agent for sham management companies that belong to Davison customers.

24. NMN, BI Services, and North American Corporate Services (together "Nevada Incorporation Companies") make block filings of "shelf" corporations with the Nevada Secretary

of State at Davison's direction. Many of these "shelf" corporations are identified by an alphanumeric sequence that provides a placeholder name. For example, many shelf corporations filed by BI Services of America are designated as "BISOA" with a number attached to the end of that sequence. These companies are later "taken off the shelf" and used as sham management companies for specific Davison customers.

25. The Nevada Incorporation Companies provide Davison customers with a Nevada mailing address, the use of office space in Las Vegas, and a bulk-mail sorting and forwarding service. All of these services are designed to give the appearance that the sham management companies do actual business in Nevada.

26. After the sham management company is incorporated for a specific customer, Davison directs the customer's operating business to "hire" that management company to perform purported management services. To further give the appearance that the sham management company performs these services, the operating business and management company may enter into a fake management agreement that Davison provides to his customer.

27. In December of the year in which a customer's management company is formed and in subsequent years, as well, the customer's operating company pays a large management fee to the management company for the performance of services, which will purportedly occur during the management company's following tax year. Those management services are never actually performed. The management company's tax year begins each December and ends in November of the following calendar year.

28. The operating company claims the bogus management fee as a deduction under I.R.C. § 461(h)(3). This I.R.C. provision allows a company to take a recurring item deduction for management fees when a management company will perform services for the operating company within 8 ½ months after the close of the operating company's taxable year. This exception allows deductions only for services the cost of which is reasonably determined during the year in which the deduction is taken. The operating company uses a calendar tax year, ending in December.

29. Davison determines the amount of yearly management fees the operating company pays to the management company for any given year. In doing so he considers the amount of deductions the operating company needs to offset all or nearly all of its taxable income for that year. Thus, the fee bears no relation to any need for management services or any management services rendered.

30. The management fees Davison directs his customers to deduct are nothing more than paper designations; these allocations do not involve the actual transfer of funds from an operating company's bank account to the sham management company's bank account. On information and belief, customers' operating companies and sham management companies even frequently share the same bank account.

31. The management company treats the purported management fees as income received during the management company's tax year (running from December-November) and offsets this income by deducting bogus expenses purportedly incurred in performing management services. In this way, the management company reduces its income. In actuality, the management

company does not perform any of the management services for which it receives management fees; nor does the management company incur expenses that it claims to incur.

32. This tax-fraud scheme is widespread and has enabled numerous Davison customers to evade tax on taxable income. In one instance, Davison formed four separate C management companies for a customer who is a mortgage broker in Kansas. In 2000, Davison formed a sham management company for the customer, and in 2001 he formed another sham management company owned by the customer's wife, and two sham management companies that were owned by his two minor children—one of whom was two years old and one of whom had just been born at that time. The management companies had fiscal years that ran from December to November, and they were all incorporated and purportedly based in Las Vegas. The customer paid Davison more than $8,000 for his services in setting up these companies.

33. Davison also formed an S corporation for the customer, which served as the customer's purported operating company through which the customer received pass-through income and deductions; the S corporation operated on a tax year that ran from January-December. This S corporation also was registered and purportedly based in Las Vegas, even though the customer lives and works in Kansas. Davison drew up four identical management agreements for the four management companies, which stated that each management company would provide management services to the S corporation. In actuality, the S corporation had no connection to the customer's line of work or to the management companies. The S corporation never received or provided management services, never actually paid any management fees, never transacted any type of business, never maintained any books or records, never had any

assets, and never even had a bank account. Similarly—as one might expect from companies owned and run by a newborn infant and a two-year-old—none of the management companies ever provided any management services, transacted any business, had any assets, or had any bank accounts.

34. As part of the tax-fraud scheme and at Davison's direction, in 2001, 2002, 2003 and 2004, the customer's employer (the mortgage brokerage firm) paid his salary (from his partnership interest) by transferring funds to the customer's C corporation, which was also his management company. The customer's C corporation then purported to pay management fees to the customer's S corporation; these fees equaled nearly all of the funds the customer had received from his partnership interest in the mortgage company. At Davison's direction, the customer's S corporation then reported these funds as income, and offset this reported income by purporting to pay management fees to the four management companies in apportioned amounts (including to the customer's C corporation – his management company –which originally transferred the funds to the S corporation). Each of the four management companies then claimed the apportioned management fees as income for the next tax year. In actuality, the customer had transferred nearly all of these funds to his personal bank accounts, and they were never transferred to the customer's S corporation or to the three other management companies (owned one each by his wife and young children).

35. For example, for the tax year ending November 2002, the customer's C corporation received income from his partnership interest in the mortgage company. The customer then transferred nearly all of these funds to his personal bank accounts. Nevertheless, at Davison's

direction the customer's tax preparer (a Davison associate) falsely reported that the customer's C corporation paid $368,000 in purported management fees to the customer's S corporation, and falsely claimed this amount as a deduction on the C corporation's 2002 federal income tax return. As a result, the customer's C corporation paid only $8,935 in taxes when his C corporation actually owed $100,403 in income taxes for 2002.

36. Then the customer's S corporation, at Davison's direction, falsely reported $368,000 in purported management fees as income received in December, 2002, on its 2002 federal income tax return. The S corporation purportedly paid $200,000 in management fees in apportioned amounts to the four sham management companies (the two companies owned by each of the customer's minor children, the one company owned by his wife, and the customer's own company). Thus, on its 2002 income tax return, the S corporation included $368,000 in income and then claimed $200,000 in deductions for bogus management fees; that income and these deductions for the S corporation passed through to the customer's individual tax return. Ultimately, for the 2002 tax year, at Davison's direction, the customer reported and paid $1,122 in taxes on only $33,048 in income that he reported on his individual tax return. (The customer also claimed 2002 losses from two partnerships, including a $100,000 reported loss stemming from a partnership belonging to Davison that the customer did not acquire an interest in until October 2003). In actuality, the customer's actual individual income for 2002 was $500,668, and once the IRS detected and corrected Davison's fraud the customer was found to owe an additional $185,054 (not including penalties) for delinquent income and employment taxes he had not reported on his 2002 individual tax return.

37. After receiving the apportioned management fees in December of 2002, three of the four sham management companies (the wife's and the two young children's) reported $50,000 each in income on their federal corporate income tax returns for the period from December 2002-November 2003. (The customer's own sham management company did not report the $50,000 in bogus management fees as income). As part of the tax-fraud scheme and at Davison's direction, the customer and his tax preparer (a Davison associate) claimed that the sham management companies were not part of the same controlled group – that is, they claimed that the management companies were all unrelated to each other and not constructively owned by the same group of people. Essentially, Davison, acting as that customer's representative, argued to the IRS that the customer's two young children (both under three years old) had each contracted separately to provide management services to the customer's operating company. Because at Davison's direction these four sham management companies were not treated as part of the same controlled group, their corporate incomes were never aggregated. Thus, each sham management company computed its tax liability at an artificially low corporate tax rate of 15%. Accordingly, each management company paid approximately $7,500 in income taxes for the 2002 tax year on its $50,000 in reported income.

38. Through his promotion of this tax-fraud scheme, Davison makes, furnishes, and causes others to make or furnish material and false or fraudulent statements regarding the allowability of certain deductions, the excludability of income, and the securing of tax benefits derived from participation in a false or fraudulent arrangement. Davison knows and/or has reason to know that these statements are false or fraudulent. Through his promotion of this tax-fraud scheme, Davison also prepares, procures, or advises with respect to the preparation of

documents knowing (or having reason to believe) that they will be used in connection with material tax matters, and knowing that if they are so used they will result in understatements of customers' federal tax liabilities.

Tax-Fraud Scheme No. 2: The Roth IRA-Sham Management Company

39. Davison also promotes a tax-fraud scheme involving sham management companies as described above (*see* ¶¶18-31), but with the management company's shares being owned entirely by a self-directed Roth IRA (Individual Retirement Account) that is also owned by the Davison customer. Davison began promoting this scheme in or around 1998.

40. Under this scheme the Davison customer's operating business makes annual purported "payments" of large management fees to the sham management company, which "receives" these payments as income. The management company then distributes much of this income tax-free to the Roth IRA as purported stock dividends or distributions. The stock dividends or distributions then accumulate tax-free in the Roth IRA.

41. Davison directs and coordinates all aspects of the Roth IRA-Sham Management Company Scheme for his customers.

42. A Roth IRA allows an individual to accrue tax-free income that may be withdrawn without paying any taxes when the taxpayer is 59½ years old. The Internal Revenue Code allows a taxpayer to contribute a maximum amount of after-tax dollars to a Roth IRA. When a taxpayer makes more than this statutorily prescribed contribution, he or she is assessed a 6% excise penalty tax for each year of non-compliance with this statutory limit and for each year that the excess amount remains in the Roth IRA. Throughout much of the 1990s this amount was $2,000 per year; the maximum contribution was $4,000 in 2007 and is now $5,000 per year for

individuals under 50 years of age (and $1,000 more than these amounts for individuals over 50). In addition, the I.R.C. also prescribes income limits at which a taxpayer may no longer contribute to a Roth IRA. *See* I.R.C. § 408A(c)(3).

43. Davison coordinates the establishment of self-directed Roth IRAs for his customers. These self-directed Roth IRAs are housed at trust facilities, which provide only custodial services. Two trust facilities house most of the self-directed Roth IRAs that Davison customers establish. First Trust Company of Onaga in Kansas is a trust facility that calls itself a "custodian for self-directed" IRAs. The George K. Baum Trust Company in Missouri is another trust facility that houses a large number of these self-directed Roth IRAs; it is owned by Marshall & Illsley Trust Company.

44. Most Roth IRAs are not self-directed, as they are maintained with broker dealers, which monitor and direct a taxpayer's annual Roth IRA contribution, usually consisting of cash or certain types of securities.

45. After his customers establish their Roth IRAs, Davison creates closely held sham management companies for them, as described above. (*See* ¶¶18-31).

46. Davison then directs his customers to have their self-directed Roth IRAs purchase all shares of the sham management company's stock.

47. As described above, Davison directs his customers' businesses to pay management fees to the sham management company. Davison determines the amount of these fees based on the business's income that year, rather than on the amount of management services needed or provided. (*See* ¶¶ 29-31).

48. As part of the scheme, the management company receives these management fees as income. This income (usually in multiples of $20,000 or more) is distributed as purported stock dividends or distributions to the Roth IRA, as sole shareholder of the management company's stock.

49. Thus, at Davison's direction, the customer's Roth IRA receives contributions well above the statutory limits.

50. Davison's customers are liable for excise tax penalties for each year that their Roth IRAs receive such contributions – in other words, for each year that the management company distributes its income as stock dividends or distributions.

51. On information and belief, Davison advises his customers and their tax return preparers, who are Davison associates, not to pay these penalties, disclose the contributions accrued by the Roth IRA, or disclose the Roth IRA-sham management company arrangement on their tax returns.

52. On December 31, 2003, the IRS issued Notice 2004-8, which states that Roth IRA-sham management company arrangements like the ones Davison promotes are "listed transactions." This means that the Roth IRA-sham management company schemes are the "same or substantially similar to one of the types of transactions that the IRS has determined to be a tax avoidance transaction," and thus unlawful. *See* 26 CFR § 1.6011-4 (Treasury Regulations).

53. Treasury Regulations require that taxpayers who participate in listed transactions disclose their participation by filing certain forms with their federal income tax returns.

54. Davison has not instructed his customers to file these disclosure forms. Indeed, on information and belief, Davison has knowingly and falsely and fraudulently instructed his customers that they need not disclose their Roth IRA-management company arrangements. Instead, on their management company's corporate federal tax returns, Davison customers disclose only that the management company's sole shareholder is First Trust Company of Onaga.

55. The I.R.C. also requires that a promoter of listed transactions, such as Davison, file a report with the IRS identifying and describing the listed transaction and the potential tax benefits expected to result from the transaction. A promoter must furnish the IRS with this information as to each occurrence of each listed transaction that he promotes. If a promoter fails to provide the IRS with this information, he is subject to penalties. *See* I.R.C. § 6707(a).

56. Davison has failed to file any such reports with the IRS for any of the Roth IRA-sham management company tax-fraud schemes that he has promoted. All of the Roth IRA-sham management company arrangements that he has executed for his customers are listed transactions within the meaning of Notice 2004-8 and I.R.C. § 6707(a).

57. During 2004 and in prior years, the federal tax laws required promoters of tax shelters, such as Davison, to register their tax shelters with the IRS, and also to provide the IRS with a description of the potential tax benefits expected to result from these tax shelters. Promoters were required to provide the IRS with all of this information no later than the day on which the promoter first offered the tax shelter (or an interest in the tax shelter) for sale to customers. If a promoter failed to provide the IRS with this information by the date on which it

was due, he was subject to penalties. *See* I.R.C. § 6707 (prior version; effective for tax returns due before October 22, 2004).

58. Davison failed to register any such tax shelters with the IRS. He also failed to provide the IRS with any information describing the tax shelters' tax benefits. All of the Roth IRA-sham management company arrangements that he executed for his customers were tax shelters within the meaning of the prior version of I.R.C. § 6707.

59. In or around 2000, Davison helped one customer from Columbus, Nebraska, whose primary business is a Nebraska-based hydraulics company, establish a Roth IRA. That customer's adjusted gross income of $685,811 exceeded the income limits for ownership of a Roth IRA. (In 2000, the adjusted gross income limit for ownership of a Roth IRA was $110,000 for single individuals and $160,000 for married joint-filers of income tax returns.) Davison also established a sham management C corporation for that customer, and provided that customer with a bogus service agreement in which the management company agreed to perform purported management services for the customer's purported farming partnership, which was not a partnership at all but comprised only of the customer as its sole "partner." The management company had a fiscal year that ran from December to November, and was incorporated in Las Vegas. Davison established this sham management company for the customer, and in March 2001, he directed the customer to transfer all of his management company's stock shares to the customer's Roth IRA. The company issued 500 shares of stock with a purported fair market value of $250,000. Thus, the customer's Roth IRA actually received a $250,000 contribution from the customer.

60. In 2001, 2002, and 2003, the sham management company reported as income the management fees paid by the customer's operating company for purported management services. According to its tax returns, the sham management company was in the business of providing administrative or business services. The company, however, had no employees or other resources with which to perform these purported administrative services. The management company's corporate federal income tax returns, (prepared by Ellen Financial, LLP, which is owned by Ruth Donovan, a Davison associate), also included deductions for purported overhead expenses, listed on the "cost of goods sold" line. For example, in 2002, the sham management company reported $859,055 in gross receipts or sales. For that same year, the sham management company also claimed $756,000 worth of deductions for unspecified overhead expenses on its corporate federal income tax return. After claiming $65,629 in other unspecified (and unsubstantiated) deductions, the company reported $55,999 of income on its 2002 federal corporate income tax return. The customer's sham management company paid only a combined total of $23,953 in income taxes for the 2001, 2002 and 2003 tax years.

61. In January of 2005, during an audit of the customer's tax returns, the IRS interviewed Davison, who represented the customer in the audit. Davison admitted to the IRS that he had advised his customer not to unwind the Roth IRA-sham management company arrangement, even though it is a listed transaction; Davison contended (falsely) that this arrangement was allowable at the time it was established. In addition, Davison could offer no explanation, let alone substantiation, for the deductions the customer's sham management company took for business overhead on its corporate federal tax returns.

62. On learning that his Roth IRA-sham management company arrangement was a listed transaction, the customer expressed concern and subsequently reported the transaction as listed. The customer told the IRS that he had never written a check for any overhead expenses and that he had no idea why his tax preparer (who was a Davison associate who worked at Davison's direction) claimed these expenses on his management company's 2002 corporate federal income tax return. In late 2003 or early 2004, the customer sought outside counsel regarding the validity of this transaction; he then asked his tax preparer, Ruth Donovan, to unwind his Roth IRA-sham management company arrangement. By September 30, 2003, the customer's Roth IRA had accumulated $250,000 in funds. Toward the end of 2003, the customer withdrew all but $500 of these funds from his Roth IRA. Although, his preparer, who worked at Davison's direction, reversed some portion of the tax-fraud arrangement, as reflected on the customer's 2003 tax returns, she never completely unwound the transaction, even though the customer expressly requested that she do so.

63. In another instance in 1998, Davison helped a customer, who ran an accounting consultancy in Kansas, establish a Roth IRA with First Trust Company of Onaga. The customer's operating company was an S corporation. The customer maintained the Roth IRA until 2005. In December of 1998, Davison also established a sham management company C corporation for the customer.

64. At Davison's direction, on December 30, 1998, as recorded in the sham management company's bogus minutes, the customer, as the company's sole officer, "authorized and directed" his sham management company to "issue and sell to First Bank of Onaga [First Trust Company

of Onaga], Roth IRA Custodian [for the customer] 100 shares of common stock of the corporation for the aggregate cash contribution of $100." The customer's Roth IRA then became the sole shareholder of the customer's sham management company.

65. In 1999, 2002, and 2003, at Davison's direction, the customer's sham management company received $50,000 in management fees from the customer's operating company for purported management services. During each of these years, the sham management company reported the $50,000 in management fees as its only income and paid approximately $7,500 in income tax.

66. At Davison's direction, the sham management company then distributed the remaining $42,500 in management company funds, plus additional funds, to the customer's Roth IRA in the form of a purported stock dividend. For example, in 1999, the customer's company made a $44,000 distribution to the customer's Roth IRA in the form of a $44,000 check written from his sham management company's bank account to First Trust Company of Onaga, as custodian for the customer's self-directed Roth IRA. On December 31, 2002, the customer's sham management company distributed a $65,000 dividend to the customer's Roth IRA, as sole shareholder of the sham management company, and on January 16, 2003, the customer's Roth IRA distributed a $20,000 dividend to the customer's management company.

67. In 1999, 2002, and 2003, the years when the customer's sham management company distributed dividends to his Roth IRA, the customer's adjusted gross income was $169,975, $320,913 and $201,667 respectively. His income in each of these years exceeded the $160,000 adjusted gross income limit (for jointly-filed tax returns) above which Roth IRA contributions

are prohibited. *See* I.R.C. § 408A; ¶42. Indeed, the customer's adjusted gross income for the years 1999 through 2005 exceeded the statutory limits for each of these years. Thus, the customer was always prohibited from contributing to his Roth IRA. In addition, the I.R.C. also imposes an excise tax of 6% for each year in which a Roth IRA contribution exceeds the statutory limit and for each year in which this excessive contribution remains in the Roth IRA. *See* I.R.C. § 4973(a);¶42.

68. The customer maintained his Roth IRA until 2005. By the end of 2005, his Roth IRA had accrued $129,000 in tax-exempt income, none of which is permitted to accrue as tax-exempt income, and all of which is subject to an additional 6% excise penalty. Thus, at a minimum, the customer, at Davison's direction, understated his income by $150,000 (equal to the three bogus management fee payments made to the sham management company, of which $129,000 was distributed to the customer's Roth IRA). The customer also owed at least $35,370 in penalty assessments made for years 1999 through 2005. Thus, at Davison's direction and as part of this tax-fraud scheme, this customer understated his income by at least $150,000 and accrued at least $35,370 in excise penalties between 1999 and 2005.

69. Through his promotion of this tax-fraud scheme, Davison makes, furnishes, and causes others to make or furnish material false or fraudulent statements regarding the allowability of certain deductions, the excludability of income, or the securing of tax benefits derived from participation in the scheme. Davison knows and/or has reason to know that these statements are false or fraudulent. Through his promotion of this tax-fraud scheme, Davison also prepares, procures, or advises with respect to the preparation of documents knowing (or having reason to

believe) that they will be used in connection with material tax matters, and knowing that if they are so used they will result in understatements of customers' federal tax liabilities.

Tax-Fraud Scheme No. 3: The Sham Management Company-Sham Retirement Plan

70. Davison promotes a tax-fraud scheme that uses unlawfully structured retirement plans sponsored by sham management companies and funded exclusively by large insurance contracts to help customers evade federal income tax. He began promoting this scheme in or around 2003.

71. Section 412(i) of the I.R.C. allows an employer to establish and maintain certain retirement plans for employees that accumulate tax-free income. One such plan is funded exclusively by life insurance contracts. In order to qualify as tax-exempt, these plans must meet certain criteria. One requirement is that the contributions that the employer makes to the plan as its sponsor and then takes as a deduction must correspond to the dollar amount that the employee, who is the plan's beneficiary, claims as income received from the plan in the same year. *See* I.R.C. § 412.

72. Under the scheme, Davison initially establishes a sham management company for a customer as described above. (*See* ¶¶18-31). Davison then directs that sham management company to hire the customer as the management company's only employee and the only intended participant in the retirement plan.

73. Davison directs the sham management company to sponsor a retirement plan for the customer. The retirement plan, in turn, purchases high-premium life insurance contracts to fund the plan. Davison directs his customers to the life insurance plans that Hartford Life Insurance

Company underwrites. The sham management company makes contributions to the plan, and the plan then pays the annual life insurance premiums. Davison directs his customers to purchase these high-premium life insurance policies, because their sham management companies can claim the entire cost of the annual insurance premium as a deductible business expense taken on the company's federal corporate tax returns. Often, the annual premiums are as much as $250,000 per year for maintenance of this plan.

74. In order to disguise the true nature of these claimed deductions, Davison directs his customers or their tax preparers (who are Davison associates) to falsely itemize these annual high-premium payments as "professional fees," under the "other deductions" line on the sham management company's corporate federal income tax return. By mis-describing these high-premium payments as "professional fees," and not disclosing that these fees are for funding a retirement plan, Davison conceals the true funding source of his customers' tax-exempt retirement plans, in order to help his customers evade taxes and penalties.

75. For example, Davison helped one customer, who co-owns a car dealership in Kansas, become the sole shareholder and sole employee of a sham management C corporation, which sponsors a retirement plan funded entirely by life insurance contracts. In 2003, Davison established a sham management company for this customer, and Davison registered the company in Las Vegas. The sham management company purports to offer administrative services to the car dealership. The other owner of the car dealership is another Davison customer, who with Davison's help became sole owner and sole employee of his own separate sham management

company, which sponsors his retirement plan and also purports to provide management services to the car dealership.

76. In 2004, the dealership, which is an S corporation, reported $10,795,979 in gross profit and $2,721,445 in deductions, including $1,041,638 in deductions that, at Davison's direction, the dealership claimed for unspecified administrative costs on its federal corporate income tax return. These unspecified administrative costs were actually bogus management fees paid to each co-owner's sham management company for purported management services. Ultimately, in 2004, the dealership reported only $131,748 in ordinary income, which passed through as pro rata income to each co-owner of the dealership.

77. Also in 2004, as part of the scheme and at Davison's direction, the first dealership owner's sham management company reported $1,114,165 in income on its C corporation federal tax return; the majority of this income was received from the dealership's payment of purported management fees. During that same year, this sham management company contributed approximately $250,000 to the first dealership owner's retirement plan for it to use to pay annual life insurance premiums. On its 2004 corporate federal tax return, the sham management company deducted the retirement plan contribution. At Davison's direction the first dealership owner and his tax preparer (who is a Davison associate) itemized the retirement plan contribution deduction falsely as "professional fees" on the sham management company's corporate federal tax return. Also as part of the tax-fraud scheme and at Davison's direction, the customer and his tax preparer (a Davison associate) claimed deductions of $567,364 for purported employee salary and wages and $172,961 for purported compensation of the company's officer on the sham

management company's 2004 corporate federal income tax return. The first dealership owner was the sham management company's only employee and its only officer and shareholder. Thus, on its 2004 income tax return, at Davison's direction, the sham management company took more than $1 million in deductions, which offset all but $37,485 of the sham management company's reported income.

78. As a result of Davison's scheme, the car dealership, an S corporation, reported $13,567,702 in gross receipts in 2004, but for that same year, the first owner's reported individual federal income tax liability was $10,174, including the pass-through income he received from the dealership, and the second owner's reported individual federal income tax liability, including pass-through income, was $35,930.

79. As part of this tax-fraud scheme's design, after five years the retirement plan is designed to terminate, so that the life insurance policy distributes to Davison's customers.

80. After five years, the policy's guaranteed cash value will be a fraction of the policy's total accrued value, which is equal to the annual premiums paid plus 2% to 4% interest compounded during the five year period. The policy's face value is artificially suppressed, because the policy carries very high surrender fees (fees the customer would have to pay for selling the policy during a particular year). For example, a policy's guaranteed cash value may be $87,000, but its accrued value could equal more than $625,000. As part of the tax-fraud scheme's design, when the life insurance policy is distributed, Davison's customers will pay taxes only on the policy's face value at the time of its distribution and not on the policy's actual value.

81. Within a few years after the policy is distributed to Davison's customers, the policy's surrender fees will diminish as part of the tax-fraud scheme's design. Davison's customers will then receive a windfall of cash, equal to the life insurance policy's actual value, which is far greater than its apparent face value at the time it was distributed. As part of the tax-fraud scheme's design, Davison's customers will never pay additional income taxes on this windfall of cash.

82. Thus, through Davison's tax-fraud scheme, his customers' sham management companies claim inflated deductions for high life insurance premiums they pay as sponsors of the retirement plans, but the customers, as plan beneficiaries, never pay taxes on the corresponding income they receive from the policy's actual cash value.

83. The discrepancies between deductions and income disqualify these retirement plans from their tax-exempt status. In order to be a retirement plan that qualifies for tax-exempt treatment, the sham management company's deduction and the customer's inclusion in income must be claimed during the same year. *See* I.R.C. § 404(a). In Davison's tax-fraud scheme, the corporation's deductions are accelerated through the payment of very high life insurance premiums, and the customer's income statements are delayed (and ultimately understated), because the life insurance policy's face value is artificially suppressed at the time of its distribution (due to inflated surrender fees). Moreover, the sham management company claims deductions (for its contributions to the retirement plan) that are substantially greater than the amount of income the customer (as policy owner) will ultimately claim from receipt of the life insurance policy's cash value.

84. Because the customer is sole shareholder of the sham management company and also the sole beneficiary of the retirement plan, this tax-fraud scheme reduces the customer's reported taxable income on both ends of the transaction.

85. On March 8, 2004, the IRS issued Notice 2004-20, which states that sham-management-company/sham-retirement plan schemes like the ones Davison promotes are "listed transactions." This means that the schemes that Davison promotes are the "same or substantially similar to one of the types of transactions that the IRS has determined to be a tax avoidance transaction," and are thus unlawful. *See* 26 CFR § 1.6011-4 (Treasury Regulations).

86. Treasury Regulations require that taxpayers who participate in listed transactions, disclose their participation by filing certain forms with their federal income tax returns.

87. Davison has not instructed his customers to file these disclosure forms. Indeed, on information and belief, Davison has knowingly and falsely or fraudulently instructed his customers that they need not disclose their sham management company-sham retirement plan arrangements.

88. The I.R.C. also requires that a promoter of listed transactions, such as Davison, file a report with the IRS identifying and describing the listed transaction and the potential tax benefits expected to result from the transaction. A promoter must furnish the IRS with this information as to each occurrence of each listed transaction that he promotes. If a promoter fails to provide the IRS with this information, he is subject to penalties. *See* I.R.C. § 6707(a).

89. Davison has failed to file any such reports with the IRS for any of these tax-fraud schemes that he has promoted. All of the sham management company-sham retirement plan

arrangements that he has executed for his customers are listed transactions within the meaning of Notice 2004-8 and I.R.C. § 6707(a).

90. During 2004 and in prior years, the federal tax laws required promoters of tax shelters, such as Davison, to register their tax shelters with the IRS, and also to provide the IRS with a description of the potential tax benefits expected to result from these tax shelters. Promoters were required to provide the IRS with all of this information no later than the day on which the promoter first offered the tax shelter (or an interest in the tax shelter) for sale to customers. If a promoter failed to provide the IRS with this information by the date on which it was due, he was subject to penalties. *See* I.R.C. § 6707 (prior version; effective for tax returns due before October 22, 2004).

91. Davison failed to register any such tax shelters with the IRS. He also failed to provide the IRS with any information describing the tax shelters' tax benefits. All of the sham management company-sham retirement plan arrangements that he executed for his customers were tax shelters within the meaning of the prior version of I.R.C. § 6707.

92. Through his promotion of this scheme, Davison makes, furnishes, and causes others to make or furnish material false or fraudulent statements regarding the allowability of certain deductions, the excludability of income, and the securing of tax benefits derived from participation in the scheme. Davison knows and/or has reason to know that these statements are false or fraudulent. Through his promotion of this tax-fraud scheme, Davison also prepares, procures, or advises with respect to the preparation of documents knowing (or having reason to

believe) that they will be used in connection with material tax matters, and knowing that if they are so used they will result in understatements of customers' federal tax liabilities.

Tax-Fraud Scheme No. 4: The Sham Chicken-Farmer Claim

93. Davison also promotes a scheme in which his customers, through his direction and coordination, falsely claim on their federal income tax returns that they are small farmers, in order to take advantage of certain deductions that actual farmers who operate small farms are entitled to claim.

94. Federal tax law allows a small farmer to use a cash basis method of accounting. *See* I.R.C. § 464. Small farmers "may deduct the cost of baby chicks and egg-laying hens in the year of payment therefor, provided such method is consistently followed and clearly reflects income." 26 C.F.R. § 1.162-12. Thus, if in December of Year 1 a small farmer purchases a flock of egg-laying hens whose eggs will hatch in the spring of Year 2, that small farmer may use a cash basis method of accounting and deduct the entire cost of the chicken flock on Year 1's tax return.

95. In addition, the I.R.C. limits deductions of losses from passive activities. Losses may be incurred and deducted only in connection with activities in which the "taxpayer actively participates." I.R.C. § 469(c). In order to claim an ordinary deduction for their flock purchases, Davison's customers must actively participate in any of the farm-related activities that give rise to the purported expenses for which they claim deductions.

96. In the Sham Chicken Farmer Scheme, Davison directs and coordinates the formation of sham family farm partnerships for his customers. These partnerships are the entities through which his customers engage in this tax-fraud scheme.

97. Davison also directs and coordinates his customers' sham chicken flock purchase contracts. These contracts give the appearance that Davison's customers, who are not farmers, are part of a small farm operation that uses a cash basis method of accounting and purchases flocks of chickens (or layer hens).

98. Davison further facilitates this scheme through his own company, Cedar Valley Bird Company, LLP (CVB), which is a conduit for the sham flock purchases made by Davison customers.

99. Under the scheme, a Davison customer, through his sham family farm partnership, signs a bogus flock contract with one or more chicken farms that house egg-laying hens and collect the eggs for sale. The contracts claim that the Davison customer has acquired or will acquire flocks of egg-laying hens and that he will deliver these flocks of hens to the farms in exchange for payment the following year.

100. The Davison customer writes CVB a check for a specified amount, such as $250,000 at or near the end of December of the current year (Year 1) to make it appear as though this customer is acquiring one or more flocks of egg-laying hens per the sham contract.

101. After CVB receives checks from Davison's customer for the flock purchase, Davison (through CVB) writes a check for the same amount, less 3% (which he takes as a cut for himself), to an actual farm company that raises egg-laying chickens.

102. In early January of the following year (Year 2), that farm company deposits the Davison customer money into its checking account.

103. Later during that following year (Year 2), that same amount of money, plus annual interest is returned to the Davison customer. The Davison customer then reports this money as income in the year in which it is received, *i.e.* Year 2. At the end of that year, *i.e.*, Year 2, the Davison customer then writes another check to CVB for another "flock expense," again claiming this amount as a "deduction" for farm-related purchases made at the end of Year 2. This deduction offsets most, if not all, of the money the Davison customer received from his return on the flock contract (*i.e.*, "flock expense" from Year 1, plus interest).

104. As part of this scheme, Davison directs his customers to increase the amount of their "flock expenses" each succeeding year, thus ensuring that the flock expense deduction in the current year more than offsets the "income" derived from the "flock expense" paid in the preceding year. For example, a Davison customer who paid $250,000 in Year 1 and then received $250,000 plus interest back as income in Year 2, might pay $400,000 in purported flock expenses in Year 2 to ensure that his $400,000 deduction more than offsets the income received that same year from the preceding purported flock expense.

105. Davison's customers pass their flock expense income through sham family farm partnerships in order to further disguise the true nature of these transactions.

106. Davison's customers are not small farmers and they are not actively involved in the farm-related activities for which they claim deductions.

107. For example, one Davison customer, who is an affluent insurance broker living in Mission Hills, Kansas, participated in this scheme. In 2002, Davison established for this customer a sham family farm partnership that was purportedly based in Las Vegas. The customer had a 99% ownership in the partnership, and his wife had a 1% interest.

108. In 2002 through 2005, the customer through his sham family farm partnership entered into a sham flock contract with one or more chicken farms that house egg-laying hens and collect the eggs for sale. For each year, the bogus flock contract included identical language, claiming that the customer:

> owns, or is in the process of acquiring approximately [a number] of Layer Hens to be delivered to Cedar Valley [Egg Farm LLP] for use in an egg production operation, . . . [and that the customer] and Davison desire to enter into a Flock Contract for the Layer Hens at a fixed price payable over a determinable period of time.

109. In December of 2002, the bogus flock contract required that the customer would purportedly provide 135,000 layer hens for which his sham family farm partnership would receive a payment of $259,000. The customer then took a $259,000 deduction for purported family farm flock expenses on his 2002 partnership federal tax return, which passed through as a deduction on his 2002 individual tax return. In actuality, the customer directly paid Davison $250,000 at the end of 2002, and Davison took a cut of this money, and then Davison forwarded the remaining funds to an egg production facility, which is operated by a Davison associate. In the following year, the customer received a return on his loan through two payments made on June 1, 2003 and on November 1, 2003, and totaling $259,200. Thus, the customer claimed a bogus deduction of $259,000 for flock expenses on his 2002 tax return.

110. In December of 2003, at Davison's direction, the customer entered into another bogus flock contract in which the customer purportedly agreed to provide 125,000 layer hens for which the customer would receive $514,000 in ten monthly installments during 2004. In actuality, the customer wired $500,000 to Davison's company on December 31, 2003, Davison took a cut, and then Davison forwarded the remaining funds to the same egg processing facility.

The customer, at Davison's direction, then took $500,000 as a deduction for purported family farm flock expenses on his 2003 partnership federal income tax return. Between March 1, 2004 and December 1, 2004, the customer then received ten monthly payments of $51,444, equal to $514,440 ($500,000, plus interest). Thus, the customer claimed a bogus deduction of $500,000 for flock expenses on his 2003 tax return.

111. In December of 2004, at Davison's direction, the customer entered into another bogus flock contract in which the customer agreed to provide an unspecified number of layer hens for which the customer would receive $513,855 in eleven monthly installments during 2004 and 2005. In actuality, on December 30, 2004, the customer delivered a cashiers check for $500,000 to Davison, who then signed and deposited the check into his company's bank account, took a cut, and then Davison forwarded the remaining funds to the same egg processing facility. At Davison's direction, the customer then claimed $500,000 as a deduction for purported family farm flock expenses on his 2004 partnership federal tax return. Between March 1, 2004 and February 1, 2005 (before the customer even paid Davison), the customer received monthly payments of $46,714, equal to $513,855, which is $500,000 plus interest; the customer reported the $513,855 as income on his 2005 family farm partnership federal income tax return. Thus, the customer took a bogus deduction of $500,000 for flock expenses on his 2004 tax return.

112. During the IRS's audit of this arrangement, Davison claimed that the customer's flock expense deductions were justified, because the customer had purchased a flock of hens from one of the chicken farms that houses egg-laying chickens, and then sold that same flock of hens back to that farm. The customer, however, admitted that he had never been a farmer or owned any flocks of hens, and that, in actuality, he is a highly compensated insurance broker.

The customer also never purchased any feed for any hens, or any equipment used to feed or raise the layer hens. Nor did the customer ever own or purchase any farm buildings to house hens or any equipment to collect their eggs. The customer also never hired or paid for any farm workers to care for the hens. In addition, the customer's purported family farm partnership never claimed any income that was connected to the price of the eggs at the time of their sale or to the overall production of the eggs when they were gathered. The customer had no relationship to any farm.

113. At Davison's direction, the customer, an insurance broker, did nothing more than loan at least $1.2 million to egg-producing farms, on which the customer received interest, and improperly claimed $1.2 million in deductions spanning three years for bogus flock expenses incurred in connection with a non-existent family farm business. These deductions substantially reduced the customer's taxable income reported on his individual federal income tax returns for 2002, 2003 and 2004.

114. For example, in 2002, the customer reported $633,262 in pass-through income received from his work as an insurance broker, and he reported $277,200 in pass-through losses for bogus flock expenses on his individual tax return (this amount included $250,000 in flock expenses, plus nearly $18,000 in bogus contract labor costs and other bogus expenses). Ultimately, the customer reported a $100,469 loss on his individual tax return and paid no income taxes for the 2002 tax year. During an audit of the customer's 2002 individual federal tax return, the IRS concluded that the customer's corrected taxable income should be $423,381 and that he should have paid $134,184 in taxes for 2002. The customer, ultimately, conceded that the flock expenses he took were bogus expenses.

115. In 2003, the customer reported $1,045,779 in pass-through income received from his work as an insurance broker. He claimed $649,053 in pass-through losses, of which $602,815 was attributed to his purported small farmer flock expenses, including approximately $18,000 for purported contract labor expenses. Thus, the customer's bogus flock expenses alone reduced his pass-through income by nearly 58% to $442,964 ; the customer reported $396,726 in pass-through income and a total of $407,495 for all income on his 2003 individual tax return.

116. In response to the IRS's audit of the customer's 2003 and 2004 tax returns, neither the customer nor his representative, Davison, has agreed that the flock expenses claimed as deductions in 2003 and 2004 were bogus expenses, even though the customer conceded that he has never been a farmer and that he is actually a highly compensated insurance broker.

117. Through his promotion of this scheme, Davison makes, furnishes, and causes others to make or furnish material and false or fraudulent statements regarding the allowability of certain deductions, the excludability of income, and the securing of tax benefits derived from participation in the scheme. Davison knows and/or has reason to know that these statements are false or fraudulent. Through his promotion of this tax-fraud scheme, Davison also prepares, procures, or advises with respect to the preparation of documents knowing (or having reason to believe) that they will be used in connection with material tax matters, and knowing that if they are so used they will result in understatements of customers' federal tax liabilities.

Tax-Fraud Scheme No. 5: Sham Property and Sham Asset Claims: Inflated Basis and Depreciation

118. Davison promotes at least two types of tax-fraud schemes involving sham property and asset claims. One scheme involves the sham inflation of basis in shares of stock in closely held corporations. The other scheme involves sham claims of depreciation. On information and belief, Davison has promoted these schemes since the mid-1990s.

The Inflated Basis Scheme

119. A taxpayer's tax "basis" in property, used for purposes of computing gain or loss on its disposition, is generally its cost at purchase, plus or minus various amounts specified by law. The cost is the amount paid in cash, debt obligations, other property, or services. The basis is generally subtracted from the later sale price of the stock or asset in order to determine the owner's overall gain or loss on the sale. The I.R.C. permits a taxpayer to adjust the basis upwards in certain instances for which the taxpayer must provide substantiation. An increase in basis of an asset decreases the amount of gain (or increases the amount of loss) when the asset is later sold.

120. As part of the inflated-basis scheme, Davison directs his customers and their tax preparers (who are Davison associates) to claim an inflated basis in shares of stock of their closely held corporations. These basis adjustments derive from sham claims that the closely held company received capital contributions from its shareholders or sham claims that the company incurred contingent liabilities during the year in which the adjustments are made.

121. For example, in 2002 one Kansas-based Davison customer had a nearly 50% interest in a health technology company that was sold to a larger healthcare concern; he received

approximately $24 million from the sale of his shares. In order to reduce this customer's reported tax liability on his gain from this sale, Davison fraudulently increased the customer's basis in his stock by $9,788,721. Davison directed his customer and his tax preparer (a Davison associate) to claim that a provision in the stock sale agreement constituted a contingent liability and that this contingency increased the customer's basis in the company's shares and reduced his overall reportable gain from sale of his company. Neither Davison, his customer, nor his customer's tax preparer (a Davison associate) could provide the IRS with any substantiation for this nearly $9.8 million adjustment. In support of the sham basis adjustment, Davison (and his associate who prepared the customer's tax return) submitted only a one-page document comprising numbers that had no relationship to the valuation of the purported contingency provision. Ultimately, the customer conceded to the IRS that he had no justification for inflating the basis in his company's stock, and he paid the Government approximately $2 million in additional taxes.

122. Instead of charging his customers fees for each tax-fraud scheme he implements on their behalf as he customarily does with other schemes, for this scheme Davison receives fees in the form of commissions equal to approximately 12% of the tax savings he promises to his customers. Tax promoters or preparers are barred from receiving payment in the form of a contingent-fee commission. *See* 31 C.F.R. § 10.27.

The Inflated Depreciation Scheme

123. A property owner may claim a tax deduction for property depreciation under certain circumstances. Among other things, the taxpayer claiming the depreciation must own the property, and the property must be used in that taxpayer's business or other income-producing

activity. In addition, as the taxpayer claims property depreciation each year, he must accordingly reduce his basis in the property. *See* I.R.C. § 179(b).

124. Davison promotes a scheme in which depreciation in the same property is fraudulently claimed on the tax returns of numerous taxpayers. As part of his scheme, Davison's customers and their tax preparers (who are Davison associates) also fail to decrease (and may even increase) the depreciated property's basis.

125. For example, one Arizona-based Davison customer, who is a professional gambler and who also owns and operates a construction company, has a residential vacation property in the Ozark Mountains that is worth about $1.4 million. The Ozark property is not used for any business purpose, as the customer uses it for himself and his family. At Davison's direction, the customer and his tax preparers (who are Davison associates) falsely claimed on the customer's 2003 and 2004 federal income tax returns that the property generated rental income of $50,000 and $30,000, respectively. Davison, who represented the customer during the IRS's audit of the customer's 2003-2004 tax returns, could not provide the IRS with any documents that show the source or amount of the purported rental income. During a subsequent interview with the IRS, the customer acknowledged that the Ozark property was not a rental property and that he used the Ozark property for his own recreation and enjoyment.

126. Furthermore, at Davison's direction the customer's partnership (which is a 50-50 split ownership between the customer and his son) claimed a total depreciation of $363,887 for the Ozark vacation property on the partnership's 2003 federal income tax return. In 2004 at Davison's direction, the customer's S corporation also claimed depreciation equal to $218,678 for the same vacation property on the customer's S corporation's federal income tax return.

Furthermore, in 2004 the Ozark vacation property's basis was not adjusted to reflect the depreciation the customer's partnership previously claimed on the 2003 partnership federal income tax return.

127. Neither Davison nor the customer has provided any proof that the customer's S corporation purchased the Ozark property in 2004 from the customer's partnership. Instead, at Davison's direction, the customer and his tax preparer (who is a Davison associate) brazenly switched the Ozark vacation property from the partnership to the S corporation so that the customer could double the amount of bogus depreciation claimed on the property, which was never used for business purposes and thus ineligible for any depreciation deductions.

128. The depreciation claimed by the customer's partnership in 2003 (in which he had a 50% interest) and his S corporation in 2004 passed through to the customer's individual tax returns in both of these years. In 2003, for example, the customer claimed a net loss of $1,173,993 on his individual tax returns, and consequently, the customer paid no income taxes; $181,943 of this loss derived from the bogus depreciation claimed by the customer's partnership that year. In 2004, the customer also paid no income taxes, because he claimed a net loss of $2,040,011 on his federal income tax returns; $218,678 of this loss was derived from the bogus depreciation claims taken by the customer's S corporation in 2004.

129. Through his promotion of the tax-fraud schemes described in ¶¶ 118-128, Davison makes, furnishes, and causes others to make or furnish material and false or fraudulent statements regarding the allowability of certain deductions, the excludability of income, and the securing of tax benefits derived from participation in the scheme. Davison knows and/or has reason to know that these statements are false or fraudulent. Through his promotion of these tax-

fraud schemes, Davison also prepares, procures, or advises with respect to the preparation of documents knowing (or having reason to believe) that they will be used in connection with material tax matters, and knowing that if they are so used they will result in understatements of customers' federal tax liabilities.

Tax-Fraud Scheme No. 6: Sham Disabled Access Credit

130. Davison also promotes a scheme in which his customers, through his direction and coordination, falsely claim on their federal income tax returns that they are entitled to a disability access tax credit. I.R.C. § 44 permits a small business to obtain a tax credit equal to 50% of the total expenses that the small business incurs in making its workplace compliant with the Americans With Disabilities Act of 1990 (the "ADA"), provided that the expenses are (a) reasonable; (b) between $250 and $10,250; and © substantiated. *See* I.R.C. § 44(a)-(b).

131. Davison directs his customers, who own small businesses, and their tax preparers (who are Davison associates) to claim disabled access tax credits on their corporate income tax returns, even when his customers have incurred no expenditures in making their workplaces accessible for individuals with disabilities.

132. For example, a California-based Davison customer who owns a consulting company that services the chemical industry, claimed a $6,000 expenditure for disabled access credit expense on his sham management company's 2001 corporate federal income tax return. As part of this tax-fraud scheme and at Davison's direction, the customer and his tax preparer (who is a Davison associate) claimed that the customer incurred these expenses while making his home office accessible for his disabled clients.

133. The IRS, during its audit of the customer's tax returns, repeatedly requested that the customer provide some substantiation for the claim that he incurred expenses associated with making his home office ADA compliant. The customer never produced any canceled checks or receipts that would document these expenses. Nor did the customer ever provide any documentation that he actually conducted business with his clients at his home office. Instead, the customer and his representative, who is a Davison associate, provided the IRS with photographs of the customer's home office, including pictures of his desks, furniture and computer. Also as part of the tax-fraud scheme and at Davison's direction, the customer and his tax preparer claimed a nearly-identical expenditure for disabled access credit on the customer's operating company's 2002 corporate federal income tax return for expenses purportedly incurred by the customer in making the same home office ADA compliant. Neither the customer nor his representative substantiated that disabled access credit claim.

134. Even though the customer lacks substantiation for his disabled access credit that he has claimed for two different years on the tax returns of two different entities, neither he nor his representative has admitted that these claims are fraudulent.

135. Through his promotion of the this tax-fraud scheme, Davison makes, furnishes, and causes others to make or furnish material and false or fraudulent statements regarding the allowability of certain deductions, the excludability of income, and the securing of tax benefits derived from participation in the scheme. Davison knows and/or has reason to know that these statements are false or fraudulent. Through his promotion of this tax-fraud scheme, Davison also prepares, procures, or advises with respect to the preparation of documents knowing (or having

reason to believe) that they will be used in connection with material tax matters, and knowing that if they are so used they will result in understatements of customers' federal tax liabilities.

Harm to the United States

136. Since at least the mid-1990s, Davison has promoted and continues to promote numerous tax-fraud schemes, including but not limited to the schemes described above.

137. These schemes have caused substantial harm to the Government by helping taxpayers evade taxes and obstructing the IRS's efforts to administer the federal tax laws.

138. The United States is harmed because the IRS must continually devote limited resources to detecting and examining inaccurate returns filed by Davison customers, and to attempting to assess and collect unpaid taxes.

139. The amount of tax loss resulting from Davison's promotion of numerous tax-fraud schemes is incalculable but well into the hundreds of millions of dollars.

COUNT I: Injunction Under I.R.C. § 7408 For Violation Of I.R.C. §§ 6700, 6701 and 6707

140. The United States incorporates by reference the allegations in paragraphs 1 through 139.

141. Section 7408 of the I.R.C. authorizes a court to enjoin persons who have engaged in any conduct subject to penalty under I.R.C §§ 6700, 6701, or 6707 if the Court finds that injunctive relief is appropriate to prevent recurrence of such conduct.

142. Section 6700 of the I.R.C. penalizes any person who organizes or sells a plan or arrangement and in connection therewith makes or furnishes or causes another person to make or furnish a statement regarding the securing of a tax benefit that the person knows or has reason to know is false or fraudulent as to any material matter.

143. Through his promotion of the tax-fraud schemes described above, as well as other tax-fraud schemes that he promotes, Davison makes and furnishes material false or fraudulent statements regarding the allowability of certain deductions, the excludability of income, and the securing of tax benefits derived from participation in the schemes. Davison knows and/or has reason to know that these statements are false or fraudulent within the meaning of I.R.C. § 6700.

144. Section 6701 of the I.R.C. penalizes any person who prepares or aids, assists, or advises with respect to the preparation of a document that he has reason to believe will be used in connection with any material matter arising under the internal revenue laws and who knows that the document, if so used, would result in an understatement of another person's tax liability.

145. Davison prepares, aids, assists and advises with respect to the preparation of his customers' tax returns and other related documents that he knows would, if used, result in understatements of his customers' tax liability.

146. Section 6707 of the I.R.C. penalizes any person who fails to file with the IRS a return or statement that identifies and describes any reportable or listed transaction, any potential benefits expected to result from that transaction, and any other information required by statute if that person is required to file this information with the IRS. During and before 2004, section 6707 of the I.R.C. penalized any person who failed to register a tax shelter with the IRS no later than the first day on which that person offered that tax shelter (or an interest in that tax shelter) for sale to any customer, if that person was required by statute to provide this information to the IRS.

147. Davison has failed to file with the IRS a return or statement that identifies or describes any of the reportable or listed transactions that he has continued to promote to

customers. He is required by statue to file this information with the IRS. In addition, during and before 2004, Davison also failed to register with the IRS the tax shelters that he promoted to his customers. At all relevant times, Davison was required to provide this tax shelter information to the IRS.

148. If Davison is not enjoined, he is likely to continue to promote tax-fraud schemes.

COUNT II: Injunction Under I.R.C. § 7402 For Unlawful Interference With Enforcement Of The Internal Revenue Laws And The Appropriateness Of Injunctive Relief

149. The United States incorporates by reference the allegations in paragraphs 1 through 148.

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

151. Davison, through the actions described above, has engaged in conduct that substantially interferes with the administration and enforcement of the internal revenue laws.

152. Davison's conduct results in irreparable harm to the United States. Davison's conduct is causing and will continue to cause substantial revenue loss to the United States Treasury, much of which may be unrecoverable.

153. Unless Davison is enjoined, the IRS will have to continue devoting substantial time and resources auditing each of Davison's customers individually and assessing their tax penalties, some portion of which may be impossible to recover. The burden of pursuing Davison's customers may be an insurmountable obstacle given the IRS's limited resources.

154. If Davison is not enjoined, he is likely to continue to engage in conduct subject to penalty under I.R.C. §§ 6700, 6701, and 6707 in conduct that interferes with the enforcement of the internal revenue laws.

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

A. That the Court find that defendant has engaged in conduct subject to penalty under I.R.C. §§ 6700, 6701, and 6707 and that injunctive relief under I.R.C. § 7408 is appropriate to prevent a recurrence of that conduct;

B. That the Court find that defendant has engaged in conduct interfering with the enforcement of the internal revenue laws, and that injunctive relief is appropriate to prevent the recurrence of that conduct pursuant to the Court's inherent equity powers and under I.R.C. § 7402(a);

C. That pursuant to I.R.C. §§ 7402 and 7408, Davison and anyone acting in concert with him be permanently enjoined and restrained from, directly or indirectly, by use of any means or instrumentalities:

a. Organizing, promoting, marketing, or selling any plan or arrangement – including but not limited to the tax schemes described in this complaint and any other tax scheme identified through further discovery in this case – that advises or assists others in violating or attempting to violate the internal revenue laws or unlawfully evading the assessment or collection of their federal tax liabilities;

b. Engaging in conduct subject to penalty under I.R.C. § 6700, *i.e.*, prohibiting the making, furnishing, or causing another to make or furnish material and false or fraudulent statements regarding the allowability of certain deductions, the excludability of income, and the securing of tax benefits derived from participation in a false or fraudulent arrangement, when the actor knows or has reason to know that these statements are false or fraudulent;

c. Engaging in conduct subject to penalty under I.R.C. §6701, *i.e.*, preparing or assisting in the preparation of, or advising with respect to a document related to a matter material to the internal revenue laws that includes a position that he knows will, if used, result in an understatement of tax liability;

d. Engaging in conduct subject to penalty under I.R.C. §§ 6707(a), *i.e.*, failing to file a return or statement with the IRS that identifies and describes any reportable or listed transaction, any potential tax benefits expected to result from that transaction, as well as other information required by statute;

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

f. Providing any individual or entity with any advice relating to federal taxes; and

g. Aiding, assisting, and or advising with respect to the preparation of any federal income tax return or representing customers before the IRS.

D. That this Court, pursuant to I.R.C. §§ 7402 and 7408, enter an injunction requiring Davison to contact, within thirty days of the Court's order, all persons whom he has assisted or advised with respect to any tax-fraud scheme, including but not limited to those schemes described in this complaint or identified through further discovery, and inform these persons of the Court's findings and the fact that an injunction has been entered against him;

E. That this Court, pursuant to I.R.C. §§ 7402 and 7408, enter an injunction requiring Davison to produce to the United States, within thirty days of the Court's order, any records in his possession, custody or control, identifying the names, addresses, telephone numbers, e-mail addresses, and Social Security and federal tax identification numbers of all persons and entities who have participated in any tax scheme that Davison has promoted;

F. That the Court order that the United States is permitted to engage in post-injunction discovery to ensure compliance with the permanent injunction.

G. That this Court retain jurisdiction over this action for purposes of implementing and enforcing this Final Judgment of Permanent Injunction.

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

Dated: February 21, 2008

Respectfully submitted,

John F. Wood
United States Attorney

By: ***/s/ Charles M. Thomas***

Charles M. Thomas, Mo. Bar No. 28522
Assistant United States Attorney
Charles Evans Whittaker Courthouse
400 East Ninth Street, Room 5510
Kansas City, Missouri 64106
Telephone: (816) 426-3130
Facsimile: (816) 426-3165
E-Mail: charles.thomas@usdoj.gov

/s/ Allyson B. Baker

ALLYSON B. BAKER, DC Bar No. 478073
Trial Attorney, Tax Division
U.S. Department of Justice
Post Office Box 7238
Washington, D.C. 20044
Telephone: (202) 353-8031
Facsimile: (202) 514-6770
E-Mail: allyson.b.baker@usdoj.gov

Attorneys for the United States