The United States Attorney's Office

Southern District of Illinois

ILLINOIS CAR DEALER AND TAX SCAM PROMOTERS
INDICTED FOR TAX AND WIRE FRAUD SCHEME

WASHINGTON -- A prominent Southern Illinois automobile dealer and three promoters of a tax fraud scheme in the U.S. Virgin Islands were charged with a variety of tax and wire fraud-related charges in an indictment returned last Friday and made public today, the Justice Department and the Internal Revenue Service (IRS) announced.

A federal grand jury in East St. Louis, Ill. returned the 21-count indictment, which charges James A. Auffenberg Jr. of Swansea, Ill., Peter G. Fagan of De Leon, Texas, James W. Ferguson III of Amarillo, Texas, and J. David Jackson of St. Croix, U.S. Virgin Islands, and their related entities including Auffenberg Enterprises of Ill., Inc., Kapok Inc., Kapok Management L.P., St. Clair I LLC, and St. Clair II Holdings VI LLC, with conspiracy; income tax evasion; filing, aiding and assisting in the filing of false individual and corporate income tax returns; and wire fraud. The indictment also seeks the forfeiture of approximately $16.2 million in cash.

The indictment alleges that Mr. Auffenberg joined a partnership, Kapok Management, L.P., which was created and promoted by Ferguson and Fagan in the U.S. Virgin Islands. As part of the scheme, Kapok Management fraudulently used a Virgin Islands economic development program (EDP), designed to promote the development and diversification of the local economy and establish employment opportunities for island residents. Businesses which participated in the EDP, like Kapok Management, received a "beneficiary certificate" which granted them a 90% tax credit on federal and 100 percent exemption on local taxes. In order to claim the tax credit, the certificate holder had to earn income "effectively connected" with the conduct of a trade or a business in the Virgin Islands and be a bona fide resident of the U.S. Virgin Islands.

Ferguson, Fagan and Jackson allegedly promoted the scheme to wealthy individuals, who would join Kapok Management as limited partners. As part of that scheme, the limited partner formed single-member limited liability companies (LLC) in the United States and the U.S. Virgin Islands, respectively. The U.S. LLC entered into a management agreement with Kapok to purportedly manage the partner's stateside business and paid purported "management fees" to Kapok. Within approximately 3-5 days, the monies were returned to the limited partner as "partnership distributions" which were paid to the limited partner's Virgin Islands LLC, less a fee of 5 percent kept by Kapok Management.

According to the indictment, no management services were provided by Kapok Management to the mainland businesses. In addition, the amounts paid as purported "management fees" were determined by each limited partner, not Kapok Management, and the promoters encouraged them to "recycle" the same funds in and out of Kapok Management's bank account, as many times as the limited partner wished, to fraudulently maximize the EDP tax credit.

The indictment also alleges that Auffenberg and other limited partners fraudulently claimed to be U.S. Virgin Islands residents, but never actually became bona fide residents. Instead, they continued to reside in the United States and run their businesses as they had before joining Kapok, generating income from the conduct of business within the mainland United States and not within the Virgin Islands. Auffenberg and other limited partners subsequently prepared and filed false tax returns with the Virgin Islands Bureau of Internal Revenue instead of filing returns with the IRS that reported their U.S. income. As part of the scheme, they filed returns with the Virgin Islands Bureau of Internal Revenue as if they were bona fide residents, and fraudulently claimed the 90% tax credit. The indictment alleges that between 1999 and 2002, more than $300 million was cycled through Kapok accounts and more than $74 million dollars in fraudulent tax credits were claimed.