

EDWARD H. KUBO JR. (2499)
United States Attorney
District of Hawaii

FILED IN THE
UNITED STATES DISTRICT COURT
DISTRICT OF HAWAII

HARRY YEE (3790)
Assistant U.S. Attorney
Room 6-100, PJKK Federal Building
300 Ala Moana Blvd.
Honolulu, Hawaii 96850
Telephone: (808) 541-2850
Facsimile: (808) 541-3752
E-mail: harry.yee@usdoj.gov

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HILARIE E. SNYDER
Trial Attorney, Tax Division
U.S. Department of Justice
P.O. Box 7238
Ben Franklin Station
Washington, D.C. 20044
Telephone: (202) 307-2708
Facsimile: (202) 514-6770
E-mail: hilarie.e.snyder@usdoj.gov

Attorneys for Plaintiff
UNITED STATES OF AMERICA

UNITED STATES DISTRICT COURT
DISTRICT OF HAWAII

UNITED STATES OF AMERICA,)

Plaintiff,)

v.)

MORGAN LIDDELL,)

CHERIE BRIGHT,)

EDWARD CODA,)

LOREN TRENHOLM,)

BRIGHT ENTERPRISES, INC., and)

HAWAII FINANCIAL)

SPECIALISTS, INC.)

Defendants.)

CIVIL NO. 07-00442 SPK

LEK

COMPLAINT AND SUMMONS

COMPLAINT FOR PERMANENT INJUNCTION AND OTHER RELIEF

Plaintiff, United States of America, for its Complaint against Defendants Morgan Liddell, Cherie Bright, Edward Coda, Loren Trenholm, Hawaii Financial Specialists, Inc., and Bright Enterprises, Inc. states as follows:

Nature of Action

1. This action for injunctive relief is brought at the request of the Chief Counsel of the Internal Revenue Service, a delegate of the Secretary of the Treasury, and commenced at the direction of a delegate of the Attorney General of the United States, pursuant to §§ 7402, 7407, and 7408 of the Internal Revenue Code (26 U.S.C.) ("I.R.C.").

Jurisdiction and Venue

2. Jurisdiction is conferred on this Court by 28 U.S.C. §§ 1340 and 1345, and by I.R.C. §§ 7402(a), 7407, and 7408.

3. Venue is proper in this Court pursuant to 28 U.S.C. §§ 1391 and 1396.

Defendants

4. Defendant Morgan Liddell resides in Lihue, Hawaii. Liddell is a certified public accountant and co-owns Defendant Bright Enterprises.

5. Defendant Cherie Bright resides in Kapaa, Hawaii. Bright co-owns Defendant Bright Enterprises and does accounting, bookkeeping, and payroll work.

6. Defendant Edward Coda resides in Honolulu, Hawaii. Coda was a certified public accountant, taught accounting at a local community college, and currently is a certified financial planner.

7. Defendant Loren Trenholm resides in Pukalani, Hawaii. Trenholm is a certified financial planner.

8. Defendant Bright Enterprises, Inc. is a Hawaiian corporation with its principal place of business in Lihue, Hawaii. Morgan Liddell is the registered agent and an officer of Bright Enterprises, Inc. Cherie Bright is also an officer of Bright Enterprises, Inc.

9. Defendant Hawaii Financial Specialists, Inc. is a Hawaiian corporation with its principal place of business in Honolulu, Hawaii. Edward Coda is the treasurer and co-owner of HFS. Tim Geary is the Registered Agent.

Background

10. Defendants' customers are business owners who typically operate their businesses as sole proprietorships or pass-through entities. The IRS estimates that Defendants have at least 100 Hawaiian customers.

11. Defendants sell or assist in the sale of tax-fraud schemes which create false tax deductions and cause the underreporting of income on customers' federal income tax returns. Additionally, Defendants Liddell, Bright, Coda, and Bright Enterprises prepare income tax returns for their customers claiming false tax deductions and underreporting income.

12. The Defendants began this scheme as early as 1997 and, on information and belief, continue to engage in it.

13. Thus far, the IRS has audited approximately 30 of Defendants' customers for tax years 2000, 2001, 2002, and/or 2003. These audits revealed tax losses of approximately \$2.3 million caused by the customers' participation in Defendants' scheme.

The Tax-Fraud Scheme

14. Defendants advise and assist their customers to purchase sham business insurance and/or to transfer monies to sham self-directed individual retirement accounts (“IRAs”) as part of a scheme designed to enable the customers to falsely reduce their reported federal income tax liabilities.

15. After their customers transfer funds to Defendants for purported business insurance or IRAs, Defendants cause the purported insurance premiums or IRA contributions (less a large commission to a foreign company) to be returned to the customer through a sham loan, a foreign credit card, and/or a fake scholarship program.

16. Defendants tell their customers to expect to receive back approximately eighty percent of the purported “premiums” paid or purported contributions to IRAs.

17. Defendants falsely advise their customers that they can claim federal income tax deductions for the sham insurance premiums and the sham interest on the sham loans. Further, Defendants tell their customers that they need not report funds paid to the sham IRAs as income on their tax returns and need not report the monies returned to them as income.

18. In effect Defendants’ scheme takes money from one of their customers’

pockets and—often simultaneously—puts the same money back (less 20%) into the customers' other pocket, while purporting to provide the customers with tax benefits for the sham transaction.

1. Money Out - Asia Pacific Insurance Or Global Pacific Capital.

19. Defendants advise their customers to purchase purported supplemental, excess business insurance from Asia Pacific Mutual Insurance Company, Ltd., a corporation purportedly organized under the laws of Vanuatu.

20. Asia Pacific is not licensed to do business in Hawaii, is not rated, and does not have a certificate of authority from the Hawaii Commissioner of Insurance. Asia Pacific maintains the same Lihue mailing address as Defendant Bright Enterprises, as well as an address in Vanuatu.

21. Unlike a genuine insurance company, Asia Pacific does not pool risks and does not guarantee payment in the event of a loss.

22. Unlike with real insurance, Defendants' customers' sham insurance premiums are determined by the customers, in conjunction with Defendants, and are dictated by the customers' tax situation rather than by their insurance needs. The sham premiums are not based on an assessment of the customer's risk. And in the event of a loss, Asia Pacific purports to pay (but does not guarantee) the customer's "premium" less a 20% "administrative charge."

23. Defendants also advise their customers to transfer monies from legitimate retirement accounts to a self-directed IRA, which purportedly invests the funds in a Puerto Rican company, Global Pacific Capital, Inc.

24. From there, the monies are transferred to foreign accounts.

25. Defendants' Hawaiian customers participating in these schemes have transferred at least \$20 million to Asia Pacific through 2005, and \$25 million to Global Pacific through 2003.

2. Money Back In - Colony Mortgage, Weathshare, Or Horizon Credit Card.

26. Customers receive back the funds paid to Asia Pacific and Global Pacific (less a 20% commission to Asia Pacific and Global Pacific for their role in the scheme) through additional transactions, designed and implemented by the Defendants to disguise the fact that customers are merely getting their own money back. These transactions take one or more of three forms—phony loans, phony scholarships, or use of offshore credit cards.

27. Defendants direct their customers to Colony Mortgage Company, Limited for the phony loans. Colony Mortgage purports to be a Barbados entity and is not registered to do business in Hawaii. Colony Mortgage maintains the same Lihue mailing address as Defendant Bright Enterprises and Asia Pacific, as well as a phony Barbados address.

28. The phony loan is ostensibly made to fund the purchase or construction of a home, or assist with a customer's business. The customers who obtain the Colony Mortgage "loan" are typically not responsible for repaying the principal, although, at times, the customers make interest payments.

29. Customers who get their funds back by way of phony scholarships for their children's tuition get the purported scholarships from an offshore entity called Wealthshare Foundation.

30. Neither the customers nor their children apply for these scholarships, but tuition payments are nonetheless sent directly to the children's schools.

31. Customers who get their funds back by way of offshore credit cards get the cards from Hallmark Bank & Trust Limited, which purports to be a registered trust company in the Turks and Caicos Islands. Hallmark issues a Horizon credit card to Defendants' customers.

32. Defendants' customers who use the Horizon card to recover their money never receive a credit card bill and never pay their charges. Rather the card spending is simply funded through the funds that the customers used to pay sham insurance premiums or sham IRA investments.

3. False Tax Statements.

33. Defendants falsely tell their customers that 100% of the "premiums"

sent to Asia Pacific are tax-deductible business expenses.

34. Defendants falsely tell their customers that they can deduct on their federal income tax returns the “interest” paid on their sham Colony Mortgage loan as either a business expense or as a home mortgage interest deduction.

35. Defendants falsely advise their customers that the money they withdraw from their legitimate IRA Accounts and transfer to sham self-directed IRAs need not be reported as income on the customers’ federal income tax returns.

36. Defendants falsely advise their customers that when their transferred funds are repaid to them by way of the Colony Mortgage sham loans, the Horizon Credit Card, and/or the Wealthshare Foundation phony scholarships, those funds need not be reported as income on the customers’ federal income tax returns.

37. Defendants’ schemes of having customers transfer funds and then receive them back through disguised transactions are shams with no business purpose or economic substance aside from tax evasion. The “premiums” customers paid to Asia Pacific are not necessary or ordinary expenses of the customers’ businesses because they are not paid out for the purpose of insuring anything, or for any other business reason. The sham self-directed IRAs are merely vehicles designed to disguise customers’ transfer of funds out of their legitimate IRAs to the customers without the customers reporting or paying the

taxes that are due on such withdrawals.

38. Defendants Liddell, Bright, Trenholm, and Coda are educated financial and tax professionals.

39. Defendants Liddell, Bright, Bright Enterprises, and Trenholm know or have reason to know that the tax statements described in paragraphs 33-36 are false, but continue to maintain the legitimacy of these statements and to promote the tax-scheme despite IRS challenges and customer audits.

40. Defendant Coda and Hawaii Financial Services know or have reason to know that the tax statements described in paragraphs 33-36 are false. Only after numerous IRS audits of his customers has Coda, on information and belief, stopped making these false statements and stopped marketing the tax-fraud schemes described in this complaint.

41. An injunction is necessary because of the ongoing promotion of the tax-fraud schemes as well as the gravity of the harm caused by the schemes coupled with the Defendants' extensive participation in this recurring, nearly 10-year promotion. Unless they are enjoined, Defendants are likely to continue to promote this or other tax-fraud schemes.

Preparing False Tax Returns

42. Defendants Liddell, Bright, Bright Enterprises, and Coda prepare

income tax returns for their customers claiming improper deductions for the Colony Mortgage sham “interest” and the Asia Pacific sham “insurance premiums.”

43. Defendants Liddell, Bright and Coda know that these deductions are improper and know that the deductions understate their customers’ reported income.

44. Defendant Liddell has prepared at least 24 tax returns for tax years 2000 through 2003 containing the improper Colony Mortgage interest deduction and/or Asia Pacific insurance deduction.

45. Defendant Bright has prepared at least three tax returns for tax years 2002 and 2003 containing the improper Colony Mortgage interest deduction and/or Asia Pacific insurance deduction.

46. Defendant Coda has prepared three tax returns for tax years 2001, 2002, and 2003 containing the improper Colony Mortgage interest deduction and Asia Pacific insurance premium.

CAUSES OF ACTION

Count I - All Defendants

Injunction under I.R.C. § 7408 for Promoting an Abusive Tax-Scheme and Aiding and Abetting Understatements of Tax Liability

47. The United States incorporates by reference the allegations in paragraphs 1 through 46.

48. 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 or 6701 if the court finds that injunctive relief is appropriate to prevent the recurrence of such conduct.

Violation of Section 6700

49. Section 6700 of the I.R.C. penalizes any person who organizes or sells a plan or arrangement and in connection with that organization or sale makes or furnishes a statement with respect to the allowability of any deduction or credit or the securing of any other tax benefit which the person knows or has reason to know is false or fraudulent as to any material matter.

50. Defendants organize and sell plans or arrangements and in doing so falsely tell customers that they will obtain federal income tax benefits that Defendants know or have reason to know are not available.

51. In organizing and selling their plans or arrangements, Defendants make

false or fraudulent statements regarding the allowability of a deduction and credit, as well as false or fraudulent statements regarding the securing of tax benefits.

52. Defendants know or have reason to know that their statements to customers in promoting the Defendants' schemes are false or fraudulent statements within the meaning of I.R.C. § 6700.

53. If Defendants are not enjoined, they are likely to continue to engage in conduct subject to penalty under I.R.C. § 6700.

Violation of Section 6701

54. Section 6701 of the I.R.C. penalizes any person who aids or assists in, procures, or advises with respect to the preparation or presentation of any portion of a return or other document and who knows (or has reason to believe) that such portion will be used in connection with any material matter arising under the internal revenue laws, and who knows that such portion (if so used) would result in an understatement of the liability for tax of another person.

55. Defendants advise their customers to take deductions for Asia Pacific premiums and Colony Mortgage interest, knowing (or having reason to believe) that those deductions will be used in connection with a material matter arising under the internal revenue laws, and also knowing that taking those deductions would result in understating the tax liabilities of their customers. Defendants

similarly falsely and knowingly advise their customers that they need not report as income the funds that they receive back through sham loans, scholarships, or through credit cards.

56. This Court should enter an injunction under I.R.C. § 7408 to prevent Defendants from engaging in conduct subject to penalty under I.R.C. §§ 6700 and 6701, and from engaging in any other conduct subject to penalty under the Internal Revenue Code.

**Count II - Against Liddell, Bright, Coda, and Bright Enterprises
Injunction under I.R.C. 7407 for Understating a Taxpayer's Liability**

57. The United States incorporates by reference the allegations in paragraphs 1 through 56.

58. I.R.C. § 7407 authorizes a court to issue an injunction if an income tax return preparer engages in conduct subject to penalty under I.R.C. § 6694.

59. I.R.C. § 6694(a) penalizes a tax return preparer if (1) the preparer prepares a return that includes an understatement of liability due to a position for which there is not a realistic possibility of being sustained on the merits; (2) the preparer knew (or reasonably should have known) of such position; and (3) the position was not disclosed in accordance with IRC § 6662(d)(2)(B)(ii) or the position was frivolous.

60. I.R.C. § 6694(b) penalizes a tax return preparer who prepares a return with an understatement of liability (1) in a willful attempt to understate the liability or (2) with a reckless and intentional disregard of rules or regulations.

61. Defendants' conduct as described above is subject to penalty under §§ 6694(a) and 6694(b).

62. Defendants have prepared income tax returns that include understatements of their customers' liability which have no realistic possibility of being sustained on the merits. Defendants knew or reasonably should have known about these understatements. Defendants did not disclose them in accordance with IRC § 6662(d)(2)(B)(ii), and the understatements are frivolous. Defendants have thus engaged in conduct subject to penalty under § 6694(a).

63. Defendants prepare returns for customers with false entries in a willful attempt to understate the customers' liability or with a reckless and intentional disregard of rules and regulations. Defendants have thus engaged in conduct subject to penalty under § 6694(b).

Count III - All Defendants
Injunction under I.R.C. 7402(a) for Unlawful Interference
with Enforcement of the Internal Revenue Laws

64. The United States incorporates by reference the allegations in paragraphs 1 through 63.

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

66. Defendants, through the actions described above, have engaged in conduct that interferes substantially with the administration and enforcement of the internal revenue laws.

67. Defendants' conduct results in irreparable harm to the United States because it is causing and will continue to cause substantial revenue losses to the United States Treasury, much of which may be unrecoverable.

68. If Defendants are not enjoined, they are likely to continue to engage in conduct that interferes with the enforcement of the internal revenue laws.

69. While the United States will suffer irreparable injury if the Defendants are not enjoined, the Defendants will not be harmed by being compelled to obey the law.

70. An injunction that stops Defendants' illegal activity is in the public interest.

71. An injunction under § 7402(a) is necessary and appropriate.

72. Thus, the United States is entitled to injunctive relief under I.R.C. § 7402(a).

WHEREFORE, the United States of America, respectfully prays for the

following:

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

B. That the Court find that Defendants Coda, Liddell, Bright, and Bright Enterprises have engaged in conduct subject to penalty under I.R.C. § 6694, and that injunctive relief under I.R.C. § 7407 is appropriate to prevent a recurrence of that conduct;

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

D. That this Court, pursuant to I.R.C. § 7408, enter a permanent injunction prohibiting Defendants and Defendants' representatives, agents, servants, employees, attorneys, and those persons in active concert or participation with them, from directly or indirectly:

1. Engaging in activity subject to penalty under I.R.C. § 6700, including organizing or selling a plan or arrangement and making a statement regarding the allowability of any deduction or credit, or the securing

of any tax benefit, that they know or have reason to know is false or fraudulent as to any material matter;

2. Engaging in activity subject to penalty under I.R.C. § 6701, including advising or assisting with respect to the preparation of a portion of a return or other document knowing (or having reason to believe) that such portion will be used in connection with any material matter arising under the internal revenue laws knowing that such portion (if so used) would result in an understatement of the liability for tax of another person;
3. Organizing, promoting, selling, or helping others to implement the schemes described in the complaint or any substantially similar scheme; and
4. Engaging in any other activity subject to penalty under any provision of the Internal Revenue Code;

E. That this Court, pursuant to I.R.C. § 7402(a), enter a permanent injunction prohibiting Defendants, individually and doing business under the various names listed in this complaint or under any other name or using any other entity, and defendant's representatives, agents, servants, employees, attorneys, and those persons in active concert or participation with them, from directly or

indirectly:

1. Selling or organizing any business arrangement, including the abusive tax schemes described in this complaint, that encourages or assists noncompliance with the income tax laws, misrepresents the tax savings realized by using the arrangement, or conceals the receipt of income; and
2. Engaging in other similar conduct that substantially interferes with the administration and enforcement of the internal revenue laws;

F. That this Court, pursuant to I.R.C. § 7407, enter a permanent injunction prohibiting Defendants Coda, Liddell, Bright and Bright Enterprises, and Defendants' representatives, agents, servants, employees, attorneys, and those persons in active concert or participation with them, from directly or indirectly:

1. Engaging in activity subject to penalty under I.R.C. § 6694 (a), including knowingly preparing income tax returns that include frivolous understatements of their customers' liability which have no realistic possibility of being sustained on the merits and which were not disclosed in accordance with IRC § 6662(d)(2)(B)(ii), and the understatements are frivolous;
2. Engaging in conduct subject to penalty under I.R.C. § 6694(b),

including preparing returns for customers with false entries in a willful attempt to understate the customers' liability or with a reckless and intentional disregard of rules and regulations;

3. Preparing tax returns with interest deductions for Colony Mortgage or insurance deductions for Asia Pacific; and
4. Omitting from gross income retirement monies ostensibly transferred to Global Pacific;

G. That this Court, pursuant to I.R.C. § 7402(a), require Defendants to contact by mail all persons who have purchased the abusive tax scheme described in this complaint and send to them a copy of the permanent injunction against Defendants, and to certify to the Court within eleven days of the permanent injunction that they have complied with this provision;

H. That this Court, pursuant to I.R.C. § 7402(a), enter an injunction requiring Defendants to produce to the United States a list identifying the name, Social Security number, address, email address, and phone number of each person who has purchased Defendants' tax schemes, plans, arrangements, or programs, and to certify to the Court within eleven days of the permanent injunction that they have complied with this provision;

I. That this Court permit the United States to conduct post-judgment


discovery to ensure Defendants' compliance with the permanent injunction; and

J. That this Court grant the United States such other relief, including costs, as is just and equitable.

DATED: August 17, 2007, at Washington, D.C.

Respectfully submitted,

EDWARD H. KUBO, JR.
United States Attorney



HILARIE E. SNYDER
Trial Attorney, Tax Division
U.S. Department of Justice