IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF NEW YORK

UNITED STATES OF AMERICA, Plaintiff, v. ROBERT L. SCHULZ; WE THE PEOPLE FOUNDATION FOR CONSTITUTIONAL EDUCATION, INC.; and WE THE PEOPLE CONGRESS, INC., Defendants.	))))) Civil No. 1:07-cv-352-TJM-RFT)) UNITED STATES' RESPONSE IN) OPPOSITION TO DEFENDANTS') MOTION TO DISMISS AND) CROSS-MOTION FOR) SUMMARY JUDGMENT)

The United States files this opposition to defendants' motion to dismiss and cross-motion for summary judgment pursuant to Fed. R. Civ. P. 56(c) and L.R. 7.1(c).

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IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF NEW YORK

UNITED STATES OF AMERICA,	)
	)
Plaintiff,	)
	)
v.	) Civil No. 1:07-cv-352-TJM-RFT
	)
ROBERT L. SCHULZ;	) UNITED STATES' BRIEF
WE THE PEOPLE FOUNDATION FOR	) IN OPPOSITION TO DISMISSAL
CONSTITUTIONAL EDUCATION, INC.; and	) AND CROSS-MOTION FOR
WE THE PEOPLE CONGRESS, INC.,	) SUMMARY JUDGMENT
	)
Defendants.	)

I. STATEMENT OF THE NATURE OF THE CASE

The Government seeks to enjoin Robert L. Schulz, We the People Foundation for Constitutional Education, Inc., and We the People Congress, Inc., (collectively "We the People") under §§ 7402 and 7408 of the Internal Revenue Code (IRC) (26 U.S.C.) from further promoting abusive tax schemes. The evidence submitted herewith, coupled with defendants' filings, establish that Robert L. Schulz and We the People are marketing a tax-fraud scheme designed to assist others to violate the internal revenue laws. Injunctions to stop violations of the law are typically permitted "because [they] merely require the enjoined party to obey the law." *United States v. Campbell*, 897 F.2d 1317, 1324 (5th Cir. 1990).

II. ARGUMENT

A. MOTION TO DISMISS STANDARD.

A party is not entitled to dismissal pursuant to Fed. R. Civ. P. 12(b)(6) "unless it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him [] to relief."[1] Rule 12(b) and Second Circuit case law mandates conversion of a 12(b)(6) motion into one for summary judgment when the party "seeks to introduce affidavits...

[1] *Sweet v. Sheahan*, 235 F.3d 80, 83 (2nd Cir. 2000).

or other extraneous documents not set forth in the complaint."[2] Because defendants have filed affidavits and other extraneous materials that were not referenced or alluded to in the complaint, the United States construes their motion as one for summary judgment and responds in kind.[3] Under this standard, defendants' motion should be denied, and the United States' cross-motion for summary judgment should be granted.

B. SUMMARY JUDGMENT STANDARD.

Summary judgment should be granted if there is no genuine issue as to any material fact and the moving party is entitled to judgment as a matter of law. Fed. R. Civ. P. 56(c). The party moving for summary judgment bears the burden of persuasion on the relevant issues.[4] The non-moving party may survive a motion for summary judgment only by producing "evidence from which a [fact finder] might return a verdict in his favor."[5] These rules apply with equal force to suits for an injunction under IRC §§ 6700, 6701, 7402, and 7408.[6]

This Court has authority to grant injunctive relief under IRC § 7408 if the Government proves that the defendants engaged in conduct subject to penalty under IRC §§ 6700 and 6701 and injunctive relief is appropriate to prevent the recurrence of that conduct. The Court is also authorized under IRC § 7402 to issue an injunction "as may be necessary or appropriate for the enforcement of the internal revenue laws." Where, as in IRC § 7408, an injunction is explicitly authorized by statute, the traditional prerequisites for equitable relief need not be established; the

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[2]*Cortec Indus., Inc. v. Sum Holding L.P.*, 949 F.2d 42, 47 (2nd Cir. 1991) (noting conversion "is now mandatory.")

[3]*GFF Corp. v. Associated Wholesale Grocers*, 130 F.3d 1381, 1384 (W.D. Okla. 1997).

[4]*Celotex Corp. v. Catrett,* 477 U.S. 317, 323 (1986).

[5]*Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 257 (1986).

[6]*See United States v. Raymond*, 78 F. Supp.2d 856 (E.D. Wis. 1999), *aff'd,* 228 F.3d 804 (7th Cir. 2000)(grant of summary judgment under IRC § 7408 enjoining sales of defendants' "De-Taxing America Program").

injunction should be issued when the statutory requirements are met.[7]

III. DEFENDANTS SHOULD BE ENJOINED UNDER IRC § 7408 FOR ENGAGING IN CONDUCT SUBJECT TO PENALTY UNDER § 6700 AND § 6701.

IRC §§ 6700, 6701, and 7408 all were enacted as part of the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA), Pub. L. No. 97-248, §§ 320-321, 96 Stat. 324, 611-612, 615-616. Section 6700 was intended to prevent "[t]he widespread marketing and use of tax shelters," which "undermines public confidence in the fairness of the tax system and in the effectiveness of the existing enforcement provisions." S. Rep. No. 97-494, vol. 1 at 266 (1982), *reprinted in* 1982 U.S.C.C.A.N. 781, 1014. Section 6701 was intended to "help protect taxpayers from advisors who seek to profit by leading innocent taxpayers into fraudulent conduct" and to provide for "more effective enforcement of the tax laws by discouraging those who would aid others in the fraudulent underpayment of their tax." S. Rep. No. 97-494, vol. 1 at 275, *reprinted in* 1982 U.S.C.C.A.N. at 1022. Congress included IRC § 7408 as part of this framework because it believed that injunctive relief was the most effective way to attack abusive tax shelter schemes. S. Rep. No. 97-494, vol. 1 at 268, *reprinted in* 1982 U.S.C.C.A.N. at 1016.

A. DEFENDANTS ENGAGE IN CONDUCT SUBJECT TO IRC § 6700 PENALTY.

To establish a violation of § 6700 warranting an injunction under § 7408, the United States must show that:

> (1) the defendants organized or sold, or participated in the organization or sale of, an entity, plan, or arrangement; (2) made or caused to be made, false or fraudulent statements concerning the tax benefits to be derived from the entity, plan, or arrangement; (3) knew or had reason to know that the statements were false or fraudulent; (4) the false or fraudulent statements pertained to a material matter; and (5) an injunction is necessary to prevent recurrence of this conduct.

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[7]Because § 7408 expressly provides for an injunction, the traditional guidelines for equitable relief do not have to be established for an injunction to issue. *Id.*; *United States v. White*, 769 F.2d 511, 515 (8th Cir. 1985); *United States v. Buttorff*, 761 F.2d 1056, 1059 (5th Cir. 1985) ("When an injunction is explicitly authorized by statute, proper discretion usually requires its issuance if the prerequisites for the remedy have been demonstrated and the injunction would fulfill the legislative purpose.").

United States v. Estate Pres. Servs., 202 F.3d 1093, 1098 (9th Cir. 2000).[8]

(1) Defendants organized and sold a plan or arrangement.

By its terms, § 6700 is not limited to any particular type of tax shelter or scheme, and courts have included all sorts of abusive tax-reduction schemes within its broad sweep.[9] There is no question that defendants organized or sold a plan or arrangement. Defendants charge for participation in parts of the programs and other parts are offered for free. Defendants market their programs in seminars and on their websites. Thus, defendants' tax termination package is organized and sold within the meaning of IRC § 6700.

Defendants contend, however, that dismissal is warranted because this requirement is not met, and that the United States failed to name participants as necessary parties. To begin with, these requirements are disjunctive. The United States need only prove that defendants organized *or* sold their plan, not that they did both.[10] Because there is no requirement that the fraudulent scheme be carried out, their customers are not necessary parties, as they argue. These contentions are silly and baseless.

(2) Defendants made false or fraudulent statements regarding the tax benefits associated with their program.

Practically every statement made by defendants regarding the tax benefits associated with their program is false or fraudulent. The main theme of defendants' programs is that ordinary citizens are not "taxpayers" and thus not subject to the nation's tax laws. Defendants define "taxpayers" as only those who have volunteered to pay taxes through written agreements with

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[8]*See also Abdo v. United States Internal Revenue Service*, 234 F. Supp.2d 553, 561 (M.D.N.C. 2002).

[9]*See, e.g., Raymond*, 228 F.3d 804, 811-15 (step-by-step instructions for removing the purchaser from the tax system); *Abdo v. United States*, 234 F. Supp. 2d 553, 562 (M.D.N.C. 2002) ("wages are not income" program), *aff'd without published op.*, 63 Fed. Appx. 163 (4th Cir. 2003), *cert. denied*, 540 U.S. 1120 (2004); *United States v. Savoie*, 594 F. Supp. 678, 680 (W.D. La. 1984).

[10]*United States v. Hansen*, 2006 U.S. Dist. LEXIS 54496, at *20-28 (S.D. Cal. 2006) (noting that (1) some of the enjoined materials were provided for "free," and (2) there is no requirement that a participant's reliance be proven.)

their employers. According to defendants, the Internal Revenue Code (which defendants claim is unconstitutional) does not apply to an individual that has unilaterally revoked their consent to pay taxes. In that regard, defendants contend that customers participating in their program can withhold taxes and stop filing tax returns until defendants' questions regarding the legality of the income tax have been answered. Furthermore, they tell their customers that federal taxes only apply to persons earning foreign source income — the § 861 Argument. Along those same lines, defendants advise customers that they can opt-out of paying taxes, including Social Security contributions, if they simply stop volunteering to pay taxes. These are tired tax protest arguments that have been repeatedly rejected by courts as false.[11]

Defendants' contention that their materials do not relate to tax benefits ignores the substance of everything they filed. Defendants' statements made in connection with their scheme include that customers can "minimize company income tax reporting requirements to almost nothing," "eliminate payment of [] FICA taxes," and "stop issuing W-2 and 1099 forms."[12] Put simply, defendants' twisted misrepresentation that their program deals with "wage withholding" — as if that is somehow different from tax withholding — is unavailing.

In that respect, defendants misrepresent the tax benefits of their tax termination program. Defendants' claim that an individual can revoke his or her requirement to pay taxes or file returns is unfounded. There are numerous court cases in which individuals have attempted to stop paying taxes through a unilateral act of withdrawal like the one urged here. None of them

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[11]*See, e.g., United States v. Gerads*, 999 F.2d 1255 (8th Cir. 1993); *Lonsdale v. United States*, 919 F.2d 1440 (10th Cir. 1990) (rejecting a host of tax protester arguments); *In re Becraft*, 885 F.2d 547; *Betz v. United States*, 40 Fed. Cl. 286 (Fed. Cl. 1998).

[12]Indeed, their tax evasions materials, entitled "Legal Termination of Tax Withholding," makes no mention of any "Right to Redress" as they contend. In fact, these documents deal exclusively with tax withholding, nothing more. It is evident that defendants are trying interject irrelevant issues into this matter in order to further their campaign against the income tax. Their efforts to create a sideshow out of the issues of this case should not be indulged.

has been successful.[13] Courts have similarly rejected the same proposition with regard to paying Social Security taxes.[14]

Defendants further maintain that their customers are not subject to federal tax payment requirements because the income tax is unconstitutional, or only applies to foreign source income. There is no support for these claims. These are shopworn tax protest arguments that have been repeatedly rejected by courts as false.[15] As one court made clear, "[a]s a United States citizen, [individuals are] required to pay federal income tax. Section 1(c) of the IRC provides that a tax shall be 'imposed on the taxable income of every individual.'"[16]

The power of Congress to impose a federal income tax system on citizens and residents of the United States derives from the Sixteenth Amendment.[17] Moreover, every court considering constitutional challenges to the validity of the Sixteenth Amendment has unanimously rejected those claims as frivolous.[18] It is well established that "All individuals,

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[13]*E.g.*, *United States v. Ferguson*, 793 F.2d 828, 830–31 (7th Cir. 1986) (upholding conviction of taxpayer who submitted Affidavits of Revocation *in lieu* of tax returns); *United States v. Luman*, 95 A.F.T.R.2d 2414 (N.D. Ga. 2005) ("one may not remove oneself from the jurisdiction of the federal tax laws by filing a 'Notice of Rescission'"); *United States v. Sasscer*, 86 A.F.T.R.2d 6174 (D. Md. 2000) ("a person may not elect to opt out of the federal tax laws by a unilateral act of revocation and rescission"); *Damron v. Yellow Freight Sys.*, 18 F. Supp. 2d 812, 818–19 (E.D. Tenn. 1998) (federal tax obligations cannot be "unilaterally revoked"); *Alaska Computer Brokers v. Morton*, 76 A.F.T.R.2d 6458 (D. Alaska 1995) (same).

[14]*E.g.*, *United States v. Sasscer*, 86 A.F.T.R.2d 6174 (D. Md. 2000) ("a person may not elect to opt out of the federal tax laws by a unilateral act of revocation and rescission"); *Damron v. Yellow Freight Sys.*, 18 F. Supp. 2d 812, 818–19 (E.D. Tenn. 1998) (federal tax obligations cannot be "unilaterally revoked"; *Alaska Computer Brokers*, 76 A.F.T.R.2d 6458 (same); *Lonsdale*, 919 F.2d 1440.

[15]*See, e.g., Bell,* 414 F.3d 474, 475 (3rd Cir. 2005), *aff'g* 238 F. Supp. 2d 696 (M.D. Pa. 2003); *Lonsdale*, 919 F.2d 1440 (rejecting constitutional challenge as frivolous); *In re Becraft*, 885 F.2d 547 (9th Cir. 1985); *Kotmair v. Commissioner*, 86 T.C. 1253, 1262 (1986) (Kotmair's Section 861 Argument rejected as "meritless, frivolous, wrongheaded, and even stupid.")

[16]*Betz v. United States*, 40 Fed.Cl. at 296.

[17]*Lonsdale v. Commissioner*, 661 F.2d 71, 72 (5th Cir. 1981); *United States v. Updegrave*, 97-1 U.S. Tax Cas. (CCH) ¶ 50,465 (E.D. Pa. 1997).

[18]*United States v. Sitka,* 845 F.2d 43 (2nd Cir. 1988) ("the [16lth Amendment was proposed by Congress in a joint resolution passed in 1909... The amendment was subsequently ratified by the requisite three-fourths of the states, in accordance with Article V of the Constitution, and was duly certified by proclamation of the Secretary of State"); *Ferguson*, 793 F.2d 828, 830–31 (7th Cir. 1986); *United States v. Thomas,* 788 F.2d 1250 (7th Cir. 1986); *United States v. Foster,* 789 F.2d 457 (7th Cir. 1986); *United States v. Miller*, 868 F.2d 236 (7th Cir. 1988); *United States v.*

natural or unnatural, must pay federal income tax on their wages."[19] The Internal Revenue Code imposes a duty on individuals to file tax returns and pay the appropriate amount of tax. IRC § 6012 states that an individual shall file a tax return if taxable income exceeds a specified amount.[20]

Also, contrary to the defendants' statements, it is clear that the filing of tax returns or the payment of federal income taxes is not voluntary, but mandatory.[21] The requirement to file an income tax return is plainly set forth in IRC §§ 6011(a), 6012(a), *et seq.*, and 6072(a). *See also* 26 CFR § 1.6011-1(a). The requirement to pay tax is contained in IRC § 6151. As stated above, any taxpayer who has received more than the statutory amount of gross income is obligated to file a return and pay the appropriate tax.[22]

Moreover, employers are required to withhold income and social security taxes from the wages paid to their employees.[23] This requirement is also mandatory.[24] In fact, failure to file and pay employment taxes could cause the noncomplying employer to be subject to civil and

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Stahl, 792 F.2d 1438 (9th Cir. 1986); *In re Becraft*, 885 F.2d at 548 n.2.

[19]*Lovell v. United States*, 755 F.2d 517, 519 (7th Cir. 1984); *Coleman v. Commissioner*, 791 F.2d 68 (7th Cir. 1986); *see also* IRC § 7701(a)(30); *United States v. Ward*, 833 F.2d 1538, 1539 (11th Cir. 1987); *In re Becraft*, 885 F.2d at 548 n.2.

[20]*United States v. Drefke*, 707 F.2d 978, 981 (8th Cir. 1983).

[21]*Schiff v. United States*, 919 F.2d 830, 834 (2nd Cir. 1990); *Wilcox v. Commissioner*, 848 F.2d 1007, 1008 (9th Cir. 1988).

[22]*See Raymond*, 228 F.3d at 812 (paying taxes is not a voluntary activity); *Gerads*, 999 F.2d 1255 (claim that payment of federal income tax is voluntary clearly lacks substance); *Lonsdale*, 919 F.2d at 1448 (position is "completely lacking in legal merit and patently frivolous'); *United States v. Tedder*, 787 F.2d 540, 542 (10th Cir. 1986).

[23]*Berg v. Yellow Transportation, Inc.*, 2006 U.S. Dist. LEXIS 18852 (N.D. N.Y. 2006); 26 U.S.C. §§ 3102 & 3402; N.Y. Tax Law § 671 ("Every employer ... making payment of wages shall deduct and withhold from such wages for each payroll period a tax").

[24]*United States v. Lee*, 455 U.S. 252, 258 (1982); *Yellow Freight Sys.*, 18 F. Supp. 2d 812, 818–19.

criminal penalties, including fines and imprisonment.[25]

In simple terms, defendants' program is a rehash of oft-rejected anti-tax arguments about what constitutes income. For federal income tax purposes, "gross income" means all income from whatever source derived and includes compensation for services. *See* IRC § 61. Any income, from whatever source, is presumed to be income under § 61, unless the taxpayer can prove that it is specifically exempt or excluded.[26] If a taxpayer is not able to sustain the burden that his income is excluded, then that amount must be included as income. All compensation for personal services, no matter what the form of payment, must be included in gross taxable income. This includes salary or wages paid in cash, as well as the value of property and other economic benefits received because of services performed, or to be performed in the future.[27] Defendants' statements made in connection with the tax benefits associated with their program, including the tax termination package, are false or fraudulent.[28]

(3) Defendants knew or had reason to know that their tax statements were false or fraudulent.

Defendants knew or had reason to know that their statements regarding the tax consequences of purchasing their scheme were false or fraudulent. To satisfy this requirement

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[25]*Simkanin*, 420 F.3d 397 (5th Cir. 2005); *United States v. Buttorff*, 572 F.2d 619 (8th Cir. 1978) (sustaining conviction under IRC § 7205 of promoters who instructed other to file false Forms W-4 despite their First Amendment defense); *see also* IRC §§ 6651, 6654, 6672, 7202, 7203, 7204, 7205 & 7206.

[26]*Reese v. United States*, 24 F.3d 228, 230 (Fed. Cir. 1994).

[27]*Commissioner v. Kowalski*, 434 U.S. 77 (1977); *Commissioner v. Glenshaw Glass Co.*, 348 U.S. 426, 431 (1955) (income not limited to gains or profits); *Ledford v. Commissioner*, 297 F.3d 1378, 1381 (Fed. Cir. 2002); *United States v. Connor*, 898 F.2d 942, 943-44 (3rd Cir.) ("Every court which has ever considered the issue has unequivocally rejected the argument that wages are not income."), *cert. denied,* 497 U.S. 1029 (1990); *Casper v. Commissioner*, 805 F.2d 902 (10th Cir. 1986); *Coleman*, 791 F. 2d 68 (all individuals must pay income tax on their wages); *Stelly v. Commissioner*, 761 F.2d 1113, 1115 (5th Cir. 1985) (finding argument that taxing wages and salary is unconstitutional, because compensation for labor is an even exchange, obviously frivolous); *Connor v. Commissioner*, 770 F.2d. 17, 20 (2nd Cir. 1985).

[28]Unfortunately, some of defendants' statements made in support of their programs are accurate, such as their assertions that by participating in the program customers add considerably to the IRS's effort and expense when attempting to determine and collect taxes. The fact that defendants are honest when making these particular statements should not be lauded. Rather, they prove the necessity of an injunction.

for an injunction, the Government need not show that defendants had actual knowledge that their statements were false; rather, the Government need only demonstrate that a reasonable person would have discovered the falsity of these statements.[29]

The "knew or had reason to know" standard includes "what a reasonable person in the [defendants'] . . . subjective position would have discovered."[30] This standard "allows imputation of knowledge so long as it is commensurate with the level of comprehension required by the speaker's role in the transaction.[31] As shown above, the law is well settled that the tax statements made by defendants of promises to "leave the tax system" through the use of fraudulent "We the People" forms are false. "[T]he average citizen knows that the payment of income taxes is legally required."[32] Schulz is an educated man. A modicum of research (which Schulz contends he has done) would have revealed to him that his statements in support of his programs are simply rehashes of the discredited positions espoused by tax protesters. The writings on defendants' website demonstrate that he has delved deeply into the subject of taxes. In fact, Schulz admits that he created We The People to document his research into the tax code and has uncovered numerous decisions rejecting his position.[33]

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[29]*Estate Pres. Servs.*, 202 F.3d at 1093; *White*, 769 F.2d at 515 (person knew or had reason to know of false or fraudulent statements because such statements had been consistently rejected by courts); *Buttorff,* 761 F.2d at 1062. Of course, if it is clear beyond any doubt that a scheme is illegal under established principles of tax law, then the participants have fair notice of its illegality even if no court has so ruled. *See United States v. Ingredient Technology Corp.*, 698 F.2d 88 (2nd Cir. 1983).

[30]*Estate Pres. Servs.*, 202 F.3d at 1103.

[31]*Estate Pres. Servs.*, 202 F.3d at 1103.

[32]*Schiff v. United States*, 919 F.2d at 834.

[33]In fact, in his declaration Schulz summarizes numerous court decisions rejecting his own arguments and those of other tax protesters. For his own purposes, Schulz rejects those courts' findings that do not advance his ridiculous position regarding the income tax laws. Furthermore, knowledge on Schulz's part can be inferred from his well-documented obstructionist and uncooperative behavior explained in his declaration. *United States v. Harkins*, 355 F. Supp.2d 1175, 1180 (D. Ore. 2004).

(4) Defendants' false or fraudulent statements were material.

In proving materiality, the Government need not demonstrate that a purchaser has relied on the promoter's misrepresentations.[34] Rather, "[m]aterial matters are those which would have a substantial impact on the decision-making process of a reasonably prudent investor and includes matters relevant to the availability of a tax benefit."[35] Defendants' promises of tax exemption undoubtedly had, and were intended to have, a substantial impact on people's decisions whether to purchase the tax termination program.[36] In fact, defendants' customers have used the tax termination program for its intended purpose: (1) to forestall assessment and collection of taxes and (2) to "voluntarily" withdraw from the federal tax system.

(5) An injunction is appropriate and necessary to prevent future violations of IRC § 6700.

The need for injunctive relief in order to prevent future violations of IRC § 6700 in the present case is readily apparent. Through their marketing techniques, defendants are canvassing the country advising and assisting persons to put into practice discredited theories of federal tax laws. The harm caused by defendants is grave. Their customers have been harmed by the abusive promotions because the customers have paid defendants significant sums to purchase worthless We the People forms. In this regard, defendants have demonstrated careless indifference for their customers by distributing their worthless tax termination package, which they know has been discredited.

Similarly, defendants have willfully misled customers by advertising that employers and other individuals have legally stopped paying taxes. For years, defendants have provided thousands of copies of their scam package, and continue to falsely advertise the legality of the

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[34]*Hansen*, 2006 U.S. Dist. LEXIS 54496, at *20-28.

[35]*Campbell*, 897 F.2d 1317, 1320.

[36]*See Estate Pres. Servs.*, 38 F. Supp. 2d 846, 855 (E.D. Cal. 1998), *aff'd*, 202 F.3d 1093; *Buttorff*, 761 F.2d at 1062; *Raymond*, 78 F. Supp. 2d 856, 880 (E.D. Wis. 1999), *aff'd*, 228 F.3d 804.

scheme, while they know others have faced criminal sanctions for following the same plan.

Consequently, the United States is harmed because defendants' customers are not paying the correct amount of taxes to the United States Treasury. Moreover, given the IRS's limited resources, identifying and recovering all revenues lost from defendants' abusive schemes may be impossible, resulting in a permanent loss to the Treasury. The public is harmed because the IRS is forced to devote its limited resources to identifying and attempting to recover revenue lost as a result of the defendants' program.

The extent of the defendants' participation in the abusive program is broad. Defendants are attempting to wrench tax statutes out of context to encourage a willful misreading of the law. The conduct is recurrent and defendants have never renounced the promised tax aspects of their program, which has been sold for at least four years to numerous customers. Schulz promotes himself as knowledgeable about the income tax laws and the tax termination program. Absent an injunction there is no indication that defendants will cease engaging in violations of the tax code.

The defendants are wrong to assert that this requirement is not met because a purported requirement of the plan is that customers first seek professional tax advice.[37] Implicit in their reasoning is that no competent tax professional would endorse defendants' discredited, illegal program. Whether their customers actually embrace or use the scheme is irrelevant.

B. DEFENDANTS ENGAGE IN CONDUCT SUBJECT TO IRC § 6701 PENALTY.

IRC § 6701 imposes a penalty on any person who aids in or advises with respect to the preparation of any portion of a tax return, claim for refund or other document that the person knows, if used, would result in an understatement of another person's tax liability. Here,

[37]Defendants' position is untenable based on Schulz's own exhibits filed in this case (H-I), which demonstrate that his customers have followed the scheme. Arguing on the one hand that no one would use the illegal plan after receiving competent advice, while touting that others have benefitted from the plan simply shows their willfulness.

defendants advise customers to prepare and file, or assist them in preparing and filing, false or fraudulent tax withholding forms, and other documents purporting to enable customers to legally stop filing returns and paying taxes. Defendants provide sample returns and instructions. Defendants know that their advice and those documents, if used, would result in the understatement of their customers' tax liabilities. Defendants know that both the courts and the IRS reject their positions; they simply refuse to accept the rejections. Defendants' conduct violates IRS § 6701, and further grounds thus exist for an injunction under IRC § 7408.

IV. AN INJUNCTION SHOULD ISSUE UNDER IRC § 7402 TO PREVENT DEFENDANTS FROM ENGAGING IN ACTIVITIES THAT INTERFERE WITH THE ENFORCEMENT OF THE IRC.

This Court is authorized by IRC § 7402 to issue an injunction "as may be necessary or appropriate for the enforcement of the internal revenue laws." That statute manifests "a Congressional intention to provide the district courts with a full arsenal of powers to compel compliance with the internal revenue laws,"[38] and "has been used to enjoin interference with tax enforcement even when such interference does not violate any particular tax statute."[39] The legislative history accompanying § 7408 explicitly states that "the court will continue to have full authority under [§ 7402] and will continue to possess the great latitude inherent in equity jurisdiction to fashion appropriate relief."[40] Courts interpreting this section have concluded that the traditional equitable injunction factors should be considered in determining the propriety of a preliminary injunction.[41] Those factors are: (1) the likelihood that the plaintiff will sustain

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

[39]*United States v. Ernst & Whinney*, 735 F.2d 1296, 1300 (11th Cir. 1984). *See United States v. Kaun*, 633 F. Supp. 406, 409 (E.D. Wis. 1986) ("federal courts have routinely relied on [§ 7402(a)] . . . to preclude individuals . . . from disseminating their rather perverse notions about compliance with the Internal Revenue laws or from promoting certain tax avoidance schemes"), *aff'd*, 827 F.2d 1144 (7th Cir. 1987).

[40]S. Rep. No. 97-494, 97th Cong., 2d Sess. at 266 (1982 U.S. Code Cong. & Ad. News 781, 1014).

[41]*Ernst & Whinney*, 735 F.2d at 1301; *Bell,* 238 F. Supp. 2d 696 (M.D. Pa. 2003), *aff'd*, 414 F.3d 474 (3rd Cir. 2005).

irreparable injury as a result of the defendants' conduct; (2) the likelihood of harm to the defendants if an injunction is entered; (3) the likelihood the plaintiff will ultimately prevail on the merits; and (4) the public interest.

Here, injunctive relief under § 7402 is appropriate to prevent defendants from continuing to interfere with tax enforcement. By design defendants' false tax advice to customers and their abusive program interferes with the enforcement of the internal revenue laws by delaying examination and collection and by helping their customers violate the internal revenue laws. The defendants' activities undermine public confidence in the fairness of the federal tax system and incite violations of the internal revenue laws. The defendants' promotion causes the Government irreparable harm and the Government's remedies at law are inadequate.[42]

Customers who follow defendants' advice file improper, inaccurate tax returns or do not file tax returns at all, and in either case do not report or pay their proper federal income taxes. In short, defendants' activities cause irreparable harm to the Government, the public, and their customers unless they are enjoined. The injunction causes no harm to defendants, on the other hand, because it only requires them to follow the law. Because defendants's tax-fraud scheme has been thoroughly discredited, the Government's likelihood of success is unquestionable. Injunctive relief under § 7402 is therefore necessary and appropriate to prevent defendants from continuing to disrupt the federal tax system.

V. THE FIRST AMENDMENT DOES NOT PRECLUDE AN INJUNCTION AGAINST THE DEFENDANTS' ILLEGAL ACTIVITIES.

An injunction banning defendants from promoting their abusive tax programs would not infringe on their right to free speech. The Supreme Court has made clear that banning a course

[42]Other remedies available to the Government involve actions against each individual taxpayer who purchases the defendants' program. Due to the number of customers, this would be extremely burdensome. Also, because many of these individuals do not file tax returns (as advised by the defendants), especially in the tax termination program, even identifying these persons might be impossible.

of conduct does not violate the First Amendment "merely because the conduct was in part initiated, evidenced, or carried out by means of language, either spoken, written, or printed."[43] As pertinent here, the Supreme Court has emphasized that the First Amendment "does not shield fraud."[44] With regard to instructing as to tax crimes, the Ninth Circuit has held that speech that goes beyond "advocat[ing] tax noncompliance as an abstract idea" and assists tax evasion is not protected by the First Amendment.[45]

Although the permanent injunction at issue here imposes a prior restraint on some of defendants' speech, "[p]rior restraints are not unconstitutional *per se*."[46] In particular, false commercial speech and speech related to illegal conduct are not protected by the First Amendment and thus may be banned.[47] Appellate courts have recently addressed First Amendment challenges to injunctions in the contexts of abusive tax schemes, including *United States v. Estate Preservation Services*[48] and *United States v. Schiff*.[49] As the court held in *Schiff*, the Government can regulate or ban entirely commercial speech that is false, misleading, deceptive, or related to unlawful activity.[50] Commercial speech has been described both as

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[43]*Ohralik v. Ohio St. Bar Ass'n*, 436 U.S. 447, 456 (1978) (citation omitted).

[44]*Madigan v. Telemarketing Assocs.*, 123 S.Ct. 1829, 1836 (2003).

[45]*United States v. Freeman*, 761 F.2d 549, 551-52 (9th Cir. 1985).

[46]*Southeastern Promotions, Ltd. v. Conrad*, 420 U.S. 546, 558 (1975).

[47]*Central Hudson Gas & Elec. Corp. v. Public Serv. Comm'n of New York*, 447 U.S. 557, 563 (1980) ("there can be no constitutional objection to the suppression of commercial messages that do not accurately inform the public about lawful activity"); *Penn Advertising of Baltimore, Inc. v. Mayor and City Council of Baltimore*, 63 F.3d 1318, 1325 (4th Cir. 1995) ("for commercial speech to be entitled to any First Amendment protection, the speech must first concern lawful activity and not be misleading").

[48]202 F.3d 1093 (9th Cir. 2000), *aff'g* 38 F. Supp.2d 846 (E.D. Cal. 1998).

[49]379 F.3d 621 (9th Cir. 2004), *aff'g* 269 F. Supp.2d 1269 (D. Nev. 2003).

[50]379 F.3d at 626.

"expression related solely to the economic interests of the speaker and its audience,"[51] and as "speech proposing a commercial transaction."[52]

Defendants' promotion constitutes commercial speech. Defendants are selling products and services to customers, and as part of this marketing spiel are giving false statements regarding the tax benefits associated with their products. Moreover, defendants include with their tax-evasion programs advertisements for their other programs and they solicit sales and donations with these products.[53] This type of speech may be enjoined.

In *Estate Preservation*, the court approved an injunction similar to the one sought here. There, the promoters had produced a manual that contained false statements regarding the tax benefits of a trust. The First Amendment challenge to the injunction of the scheme was rejected because, *inter alia*, the injunction "proscribes only fraudulent conduct."[54] The Court of Appeals concluded that a tax promoter's statements regarding the tax benefits of his scheme "'constitute commercial speech,'" and if such statements violate 26 U.S.C. § 6700 they are "'not protected by the First Amendment.'"[55] Because the manual contained speech that was unprotected by the First Amendment, the court enjoined both advertising the manual and selling it.[56]

Like the defendants in the above cases, defendants market a line of tax evasion products and services. Statements they make regarding the alleged tax benefits associated with their

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[51]*Central Hudson Gas & Elec. Corp. v. Public Serv. Comm'n*, 447 U.S. 557, 561 (1980).

[52]*Id.* at 562.

[53]Schulz's claim that because We the People are non-profit organizations the $20 price is necessarily a "donation" is nonsensical. Defendants are peddling false tax-elimination devices. IRC § 501(c)(3), in conjunction with § 501(a), exempts from federal income tax organizations "organized and operated exclusively for [or charitable] . . . purposes." The exempt purposes are religious, charitable, scientific, public safety, literary, educational, or prevention of cruelty to children or animals. Tax avoidance is not one of the specified exempt purposes. 26 CFR § 1.501(c)(3)-1(d)(1)(ii).

[54]202 F.3d at 1106.

[55]*Id.* (quoting *Buttorff*, 761 F.2d at 1066).

[56]*Estate Preservation*, 202 F.3d. at 1096 n.3 (enjoining "promoting, marketing, or selling" the manual).

products and services are intended to help increase sales of those products and services. Marketing and selling tax-evasion instructions and programs may be enjoined consistent with the First Amendment as both fraudulent conduct and false commercial speech.[57] In *We the People v. United States*[58] the court reached this conclusion, collecting cases that unequivocally establish that defendants' illegal conduct is afforded no First Amendment protection. Similarly, in *Buttorff*,[59] the Eighth Circuit rejected the defendant's First Amendment defense from prosecution under IRC § 7205 for aiding others in filing false Forms W-4, which was limited to orally advising persons to file false Forms W-4.[60] Here, defendants have clearly gone a step further by creating and marketing a commercial product designed to effectuate the same scheme of falsifying forms W-4.

In addition to their commercial products, defendants' websites also feature their views on the federal tax system and their protestations concerning the Government and the IRS generally. That is, some of the material on the websites *may* be considered noncommercial speech. This situation was addressed by the Third Circuit in *United States v. Bell*.[61] In *Bell* the court held that the commercial portions of the promoter's speech could be enjoined because it was false and that the noncommercial portions could be enjoined because it aided and abetted violations of the tax laws. The court found that Bell was not merely advocating tax violations, but instead was aiding and assisting others in their violation.[62] In the present case, defendants are not just making

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[57]*Estate Preservation*, 202 F.3d. at 1096, 1106.

[58]2005 WL 2473698 (D. D.C. 2005) ("[Schulz and We the People] do not [] have a First Amendment right to withhold money owed to the government and to avoid governmental enforcement actions because they object to government policy.")

[59]572 F.2d 619.

[60]IRC § 7205, along with 18 U.S.C. § 2, provides criminal sanctions for assisting in preparing false forms W-4.

[61]414 F.3d 474 (3rd Cir. 2005).

[62]414 F.3d 474 (3rd Cir. 2005).

abstract statements advocating reform of or noncompliance with the tax laws, they are expressly offering how-to-do-it assistance and advice that is meant for their audience to use to circumvent the law.

Numerous courts have applied the illegal-conduct and commercial-speech doctrines to Congress's regulation of tax-evasion products and have determined that speech incorporated into those products is *not* protected by the First Amendment and can properly be penalized under IRC § 6700 and enjoined under IRC § 7408.[63] Indeed, not a single court has refused on First Amendment grounds to enjoin speech that violates §§ 6700 or 6701. Dismissal based on First Amendment grounds is unwarranted, and the injunction sought is authorized. The injunction the Government seeks in this case is tailored after the injunction orders entered by the courts in *Estate Preservation Services*, *Schiff* and *Bell*. It only would proscribe illegitimate conduct.

VI. DEFENDANTS' REMAINING ARGUMENTS DO NOT SUPPORT DISMISSAL.

On April 3, 2007, the United States commenced this action to enjoin the defendants under IRC §§ 7402(a) and 7408 from interfering with the administration of the internal revenue laws, from organizing and selling tax-fraud schemes, and from assisting in the preparation of false documents relating to federal tax matters. On May 23, 2007, defendants filed a motion to dismiss and strike on various grounds. Each of their arguments are baseless.

First, defendants argue that dismissal is warranted under Fed. R. Civ. P 12(b)(6) because the First Amendment precludes an injunction, and that the United States cannot establish the requirement for IRC § 6700 are met. In framing their argument defendants fail to note that dismissal is warranted only if it appears, taking all the allegations as true, "that the plaintiff can

[63] *See, e.g., Bell*; *Schiff; Estate Preservation*; *Raymond*, 228 F.3d at 807, 815; *United States v. Kaun*, 827 F.2d 1144, 1152 (7th Cir. 1987); *Smith*, 657 F. Supp. at 648-49, 658, *aff'd per curiam*, 814 F.2d 1086 (5th Cir. 1987); *Buttorff*, 761 F.2d at 1057 n.1, 1065 n.11, 1066; *White*, 769 F.2d at 512, 516-517 (8th Cir. 1985).

prove no set of facts in support of his claim which would entitle him to relief."[64] They do not attack the factual allegations, they simply reassert the same argument — that they have a First Amendment right to commit fraud. Defendants are wrong. The complaint clearly and specifically details a legitimate cause of action for engaging in conduct under IRC §§ 6700 *and* 6701, which defendants fail to address.

Next, defendants contend that the United States failed to name employers using their scheme as necessary parties. As detailed above, neither IRC §§ 6700 or 6701 requires that defendants' customers use the scheme. And even if that were required, that would not make the employers essential parties.

Defendants further argue that the complaint fails to allege fraud with specificity as required by Fed. R. Civ. P. 9(b). As part of their argument, defendants confuse facts necessary to satisfy Rule 9's requirements in connection with IRC § 6700. To begin with, the complaint details the *precise* period defendants engaged in fraudulent conduct, March 15, 2003 until now.[65] The complaint further provides details of defendants' program, including the name of every document used, and the fact that they sell it to customers on the websites listed. Moreover, the complaint spells out that defendants' program, purporting to "legally terminate withholding of taxes" is fraudulent because it relies of the § 861 Argument, the false claim that the 16th Amendment was not ratified, and other frivolous arguments that courts have unanimously rejected. Put simply, the factual allegations satisfy Rule 9(b)'s requirements. The complaint states specifically when defendants started selling their scheme (until now), what materials are at issue, how the materials are used, why the claims are false, and to whom defendants make false

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[64]*Global Network Communs., Inc. v. City of New York*, 458 F.3d 150 (2nd Cir. 2006).

[65]*United States v. Hempfling*, 431 F. Supp. 2d 1069, 1075 (E.D. Cal. 2006) "Where fraud allegedly occurred over a period of time, however, Rule 9(b)'s requirement that the circumstances of fraud to be stated with particularity are less stringently applied.") However, here, the exact time frame is set. Here again, defendants are of the mistaken belief that the identity of the participants are necessary. They are wrong.

representations.

Lastly, defendants request that the terms "customers," to describe participants in their fraudulent scheme, and "Tax Termination Package" be struck as "scandalous, prejudicial" material. As a threshold matter, motions to strike are disfavored and will be denied "unless it can be shown that no evidence in support of the allegation would be admissible." Indeed, "courts [do] not tamper with the pleadings unless there is a strong reason for so doing."[66] This motion is disingenuous and should be denied on that basis. First, the term "customer" accurately describes the defendants' relationship with participants and this term does not rise to the level of being "scandalous" or "prejudicial." In fact, this exactly how other courts have described the relationship.[67] Moreover, defendants are wrong that the words "Tax Termination" do not appear in their materials. In fact, these words appear in the title of their package contained in Schulz's Exhibit B. The fact that the words do not appear consecutively does not change the fact that this shorthand description accurately portrays defendants' scheme, which is advertised to allow customers to stop withholding of taxes. In that regard, Schulz has proffered evidence demonstrating that point, making this motion to strike inappropriate.

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[66]*Lipsky v. Commonwealth United Corp.*, 551 F.2d 887, 893 (2nd Cir. 1976); 5A Wright & Miller, *Federal Practice and Procedure*, § 1380, p. 647-649 (1969) ("Both because striking a portion of a pleading is a drastic remedy and because it often is sought by the movant simply as a dilatory tactic, motions under Rule 12(f) are viewed with disfavor and are infrequently granted.")

[67]*United States v. Schulz*, 2006-2 U.S. Tax Cas. (CCH) P50,481 (D. Neb. 2006); *United States v. Schulz*, 97 A.F.T.R.2d (RIA) 815 (N.D. Cal. 2005); *United States v. Schulz*, 2006 96 A.F.T.R.2d (RIA) 6554 (N.D. Cal. 2005). It is more likely defendants object to this term under a mistaken belief that the United States must prove they sell the scheme, reasoning that striking the term would invalidate a cause of action. Moreover, even if this program were legal, defendants cannot receive "donations" in exchange for participation. 26 CFR § 1.501(c)(3)-1(d)(1)(ii).

VII. CONCLUSION

Defendants' activities have caused, and are causing, substantial harm — to their clients, to the Government, and to taxpayers who pay their proper tax liabilities. The Court should permanently enjoin defendants to prevent further harm, and deny defendants motion to dismiss and strike.

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CERTIFICATE OF SERVICE

IT IS HEREBY CERTIFIED that service of the foregoing has been made upon the following by depositing a copy in the United States mail, postage prepaid, this 18th day of June, 2007.

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