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SUITE N-129
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WWW.PSGWEBNET.COM

September 10, 2004

Dear HealthIER Plan Client, Sponsor and/or Administrator,

We have been made aware of the recent attempt by the Department of Justice to contact our clients in order to discuss the Healthier Plan. As you are presumably aware, the Department of Justice has filed a civil law suit in Federal Court, claiming in part, that the HealthIER Plan reimburses premiums that have been pre taxed through a section 125 Cafeteria Plan.

We have responded to the complaint and also filed a countersuit that seeks a declaratory judgment in favor of our plan. At this time the DOJ is attempting to dismiss our counterclaim by claiming Governmental Immunity.

We are committed to backing the HealthIER Plan and are confident that we will prevail based on the applicable facts and Law. As always, we urge you to maintain and administer your HealthIER Plan in conformity with your Plan Documents.

On our website, we have published a copy of the DOJ claim against Paradigm, a copy of our response & the counter claim we filed against the Government and their response to our counter claim for your review.

In order to view all this information, please visit our website www.PSGwebnet.com and click on the "What's in the News" tab. The File is called DOJ Info. We will personally contact you to discuss this further and answer any questions you may have.

Sincerely,
Paradigm Solutions Group, LLC

RECEIVED

APR 15 2004

IN THE UNITED STATES DISTRICT COURT FOR THE
NORTHERN DISTRICT OF ILLINOIS
CHICAGO DIVISION

MICHAEL W. DOBBINS
CLERK, U.S. DISTRICT COURT

UNITED STATES OF AMERICA,

Plaintiff,

v.

CARMELO ZANFEI; WILLIAM P. CROUSE,
JR.; PARADIGM SOLUTIONS GROUP, LLC;
and SUPERIOR SOLUTIONS GROUP, INC.

Defendants.

Civil No.

04C 2703

Judge: JUDGE NORDBERG

MAGISTRATE JUDGE DENLOW

**COMPLAINT FOR PERMANENT INJUNCTION
AND OTHER RELIEF**

The plaintiff, the United States of America, alleges as follows:

1. The United States brings this complaint pursuant to §§ 7402(a) and 7408 of the Internal Revenue Code (26 U.S.C.) (IRC) to restrain and enjoin the defendants from:

- a. engaging in any activity subject to penalty under IRC § 6700, including organizing or selling a plan or arrangement and, in connection with that activity, making a statement regarding the excludability of income or securing of any other tax benefit that they know or have reason to know is false or fraudulent as to any material matter;
- b. engaging in any other activity subject to penalty under IRC §§ 6700;
- c. engaging in other, similar conduct that unlawfully interferes with the proper administration and enforcement of the internal revenue laws.

Parties

2. The plaintiff is the United States of America.

3. The defendant Carmelo Zanfei resides at 318 Royal Oak Court, Steger, Illinois, 60475. He regularly conducted business from offices in Calumet City and Chicago Heights, Illinois. He is within this Court's jurisdiction.

4. The defendant William P. Crouse, Jr., resides at 4181 Waterbrook Way, Greenwood, Indiana, 46143-9307. He regularly conducted business from offices in Calumet City and Chicago Heights, Illinois. He is within this Court's jurisdiction.

5. The defendant Paradigm Solutions Group, LLC (PSG) is a limited liability company formed in the state of Delaware. Its registered agent is Registered Agents, Ltd, Ste 606, 1220 N. Market Street, Wilmington, Delaware. PSG carries on systematic business activities within the state of Illinois. It is subject to this Court's jurisdiction.

6. Defendants Zanfei and Crouse are officers and managers of PSG.

7. The defendant Superior Solutions Group, Inc., [SSG] is a Nevada Corporation with a business address of 211 N. Buffalo Drive, Suite A, Las Vegas, Nevada, 89145. SSG carries on systematic business activities within the state of Illinois and is subject to this Court's jurisdiction. The registered agent for SSG is Christopher Rhodes, 5172 E. 65th St., Suite 105, Indianapolis, Indiana, 46220.

8. Defendants Zanfei and Crouse are the sole shareholders of SSG.

Jurisdiction and Venue

9. This Court has jurisdiction over this action under 28 U.S.C. §§ 1340 and 1345 and §§ 7402(a) and 7408 of the IRC.

10. This action has been requested by the Acting 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 the provisions of IRC §§ 7402 and 7408.

11. Venue is proper in this Court pursuant to 28 U.S.C. § 1391.

Defendants' Activities

12. Defendants Zanfei and Crouse, through various entities, including The Redwood Group, LLC; The Redwood Group, Inc., TRG Marketing, LLC, and defendants SSG and PSG, are organizing and marketing abusive tax schemes to help customers unlawfully avoid federal income and employment taxes. The schemes are shelters, plans, or arrangements within the meaning of IRC § 6700.

13. Defendants sell schemes called the Health Incentive Plan (HI Plan) and the HealthIER Plan to employers. The schemes are designed to cause the customers to unlawfully underreport wages paid on their quarterly federal employment tax returns and on IRS Form W-2 wage statements given annually to the customers' employees. This in turn results in the employer-customers underreporting and underpaying their federal employment taxes and in the employees underreporting and underpaying their federal income taxes. This underreporting also results in employers understating wages to the Social Security Administration. The underreporting arises from unlawfully excluding from wages certain amounts that the employer-customers pay to employees as purported accident and health insurance premiums and purported reimbursements of employees' medical expenses. Zanfei began selling the HI Plan in January of

2000. Crouse started selling the HI Plan in Spring 2000. Defendants began promoting the HealthIER Plan in 2003.

14. The HI Plan causes the defendants' customer-employers to unlawfully underreport wages paid on federal employment tax returns and W-2 forms by reducing reported wages twice for employer-paid health insurance premiums, using the following steps:

Step 1: The customer-employers pay health insurance premiums for employees and correctly exclude those amounts from reported wages on the customer-employers' federal employment tax returns and the W-2 forms issued to employees.

Step 2: In addition to paying employees' health insurance premiums directly, the defendants' customer-employer also purportedly "reimburses" the employees in an amount approximately equal to the amount of health insurance premiums paid by the employer. These "reimbursements," which under the scheme are excluded from reported wages, are in fact nothing of the sort. They are simply wages disguised as reimbursements in order to reduce reported wages paid on the employer's federal employment tax returns.

IRC § 105(b) excludes under specified circumstances employer reimbursements of employees' medical care expenses from gross income and wages for employment taxes. But amounts paid under the defendants' HI Plan are not "reimbursements;" therefore there is no lawful basis for the exclusion.

15. The HealthIER Plan unlawfully causes the defendants' customer-employers to underreport and underpay federal employment taxes by excluding from wages reported on employment tax returns amounts paid to employees as medical expense "reimbursements" for

expenses that have not been incurred. The HealthIER Plan uses the following steps to implement this fraudulent scheme:

Step 1: As with the HI Plan, under the HealthIER Plan the defendants' customer-employers paid accident and health insurance premiums on behalf of employees, and properly excluded those payments from reported wages on their federal employment tax returns.

Step 2: But in addition, under the HealthIER Plan the defendants' customer-employers set up a stand-alone medical reimbursement plan. The HealthIER Plan calls for the customer-employer to automatically make "advance reimbursements" of employees' medical expenses. These advance reimbursements are made regardless of whether employees have actually incurred medical expenses. Stated simply, the so-called reimbursements are not reimbursements at all—they are wages disguised as reimbursements, to allow the customer-employers to fraudulently underreport wages paid on their federal employment tax returns and on W-2 wage statements. This results in the customer-employers under-reporting and underpaying their employment taxes and results in the employees under-reporting and underpaying their federal income and social security taxes.

16. Defendants charge their customer-employers a fee of \$10 per employee to sign up for the HealthIER Plan. Defendants also charge a fee of \$20 per month per employee for the HealthIER Plan scheme. Although it is the customer-employers who contract with the defendants for the scheme, the monthly fees are taken out of the paychecks of customers' employees, resulting in the employees paying for their employers' participation in the scheme.

17. Under defendants' schemes, customer-employers reduce the wages of their employees who participate in the HealthIER Plan. A sample worksheet entitled "Flexible Savings Estimate" from defendants' training materials shows that the customer-employers using the scheme actually reduce their employees' wages by more than the HealthIER Plan "reimbursements." A copy of the sample worksheet is attached as Exhibit A to this Complaint. The net result is that employees' take-home paychecks are about the same as before using the plan, with most or all of the economic benefits of participating in the bogus scheme going to the employer. Nevertheless the employees earn less in future social security benefits because of the wage understatements. Once the employer's participation in the scheme is detected and unraveled, the employees will be found to owe substantial additional taxes and interest. As a result employees are unwittingly caught up in a fraudulent scheme that exposes them to substantial future expenses.

18. The defendants' customer-employers that use the HI Plan and/or the HealthIER Plan have failed to report and pay substantial amounts of employment taxes. The customers' employees have under-reported and underpaid both FICA taxes and federal income taxes.

19. Defendants promote their schemes through sales agents and on the Internet at www.PsgWebNet.com. On information and belief, defendants also promote a similar scheme to self-employed persons at the site www.mrp-ssg.com.

20. Defendants' promotional materials claim that the accounting firm of Wohlenberg Ritzman & Co. in Yankton, South Dakota, provides "administration" services for the plans. Wohlenberg Ritzman & Co. receives compensation directly from HI Plan or HealthIER Plan fees that defendants' customer-employers withhold from their employees. Blaine Meier, a Certified Public Accountant, and partner with Wohlenberg Ritzman, has written opinions endorsing the HI

Plan and the HealthIER Plan. These opinions do not disclose that Meier or Wohlenberg Ritzman & Co. have a financial interest in the plans. Blaine Meier claims that neither Wohlenberg Ritzman & Co. or the "Processing Center" (which consists of employees of Wohlenberg Ritzman & Co. and which purportedly processes the HealthIER Plan) have access to either a customer list or an employee list.

21. Defendants have sold these fraudulent tax promotions to more than 200 customer-employers.

22. Defendants Zanfei and Crouse have refused to identify to the IRS any of their sales agents or any of their customers. Crouse failed to comply with an IRS summons requiring him to provide documents which identify defendants' customers. Thus, the IRS cannot identify most of the defendants' customer-employers, and cannot determine how many employees of the more than 200 customer-employers are affected by the fraud.

23. One customer-employer the IRS has identified is a large medical services provider in California which employs more than 300 people.

24. The IRS estimates that defendants' schemes have cost the U.S. Treasury losses of \$12 million to \$63 million so far. If defendants are not enjoined, and their scheme dismantled, the United States will lose an additional estimated \$6 million to \$24 million in tax revenue each year. Every paycheck the defendants' customer-employers pay their employees causes harm to the United States, by understating taxable wages.

Defendants' False and Fraudulent Statements

25. Defendants, in connection with these schemes, made statements relating to material matters under the internal revenue laws that they knew or had reason to know were false or fraudulent.

26. Defendants have made the following false and fraudulent statements to their prospective customers:

a. that the prospective customer-employers do not have to pay employment taxes on the amounts paid to employees as so-called medical reimbursement. Because these payments are not reimbursements, this statement is false.

b. that the employees of the prospective customer-employers will not have to pay federal income tax or FICA tax on amounts paid to them as purported medical reimbursements. Because these payments were not reimbursements, this statement is false.

c. that the \$20-per-employee-per-month promoter's fees withheld from employees wages can be excluded from employees' income for federal-income-tax purposes.

Defendants' Knowledge that the Statements Were False and Fraudulent

27. Zanfei and Crouse hold themselves out to the public as experts on health reimbursement arrangements. Therefore, they had reason to know about false or fraudulent statements made in connection with their promotion.

28. In April 2001, Stuart Sobel of Stuart Sobel Consulting, Inc., sent a tax opinion on the HI Plan to Zanfei that focused on the HI Plan's purported reimbursement aspects. The

opinion stated that “it was most probable” that the amounts defendants advised their customers to exclude from taxable income under the HI Plan “are includable and not excludible in compensation for healthcare reimbursement.” Defendants nevertheless continued to promote their scheme.

29. Rev. Rul. 2002-3, 2002-3 I.R.B. 316 (January 22, 2002) held that the exclusions from gross income under I.R.C. §§ 106(a) and 105(b) do not apply to amounts that an employer pays to employees to reimburse the employees for amounts paid by the employer for health insurance coverage that are excluded from gross income under IRC § 106(a) (including salary reduction amounts pursuant to a cafeteria plan under I.R.C. § 125 that are applied to pay for such coverage). Defendants Zanfei and Crouse were aware of Rev. Rul. 2002-3 when it was published. Yet they continued to promote their schemes.

30. Rev. Rul. 2002-80, 2002-49 I.R.B. 925 (December 9, 2002) amplified Rev. Rul. 2002-3 to clarify that amounts paid to an employee as advance reimbursements or purported loans without regard to whether the employee has incurred medical expenses are not excludable from the employee’s gross income under IRC § 105(b), that such advance reimbursements or purported loans are included in the employee’s gross income, and that such amounts are subject to employment taxes. Zanfei and Crouse became aware of Rev. Rul. 2002-80 when it was published, yet they continued to promote the HealthIER Plan.

31. Zanfei and Crouse knew of articles published by the Employers Council on Flexible Compensation (ECFC), Employee Benefit Institute of America (EBIA) and other tax professionals that advised that plans like the HI Plan and the HealthIER Plan were unsound.

32. Both the HI Plan promotion and the later HealthIER Plan version of the promotion required prospective customer-employers to sign comprehensive confidentiality agreements to prevent the prospective customer-employers from disclosing information about the promotions to anyone other than the customers' confidential consultants and their employees. Zanfei and Crouse required this in order to keep their fraudulent scheme from being detected.

33. The U.S. Department of Labor sued Zanfei and Crouse, alleging that they violated ERISA when they failed to hold assets of a health plan in trust, failed to charge adequate premiums, and failed to establish appropriate underwriting procedures. As a result, participants were left with between \$5 and \$17.5 million in unpaid medical claims. The suit also alleges that Zanfei and Crouse diverted money targeted to pay health benefits for personal enrichment. *Chao v. Crouse et al.*, Civ. No. 1:03 -cv-01585-DFH-TAB (S.D. Ind.).

An injunction under Section 7408

34. Section 7408 of IRC authorizes a court to enjoin persons who have engaged in conduct subject to penalty under IRC §§ 6700 or 6701.

35. In relevant part, IRC § 6700 imposes a penalty on any person who organizes (or assists in the organization of) any shelter, plan, or arrangement, or participates (directly or indirectly) in the sale of any interest in an entity or plan or arrangement; and makes or furnishes or causes another person to make or furnish (in connection with such organization or sale) a statement regarding any deduction, credit, or the excludability of income; which the person knows or has reason to know is false or fraudulent as to any material matter.

36. Defendants' conduct as described above is subject to penalty under IRC § 6700.

37. An injunction is necessary and appropriate to stop defendants' conduct subject to the IRC § 6700 penalties and other violations of the internal revenue laws.

38. Defendants are therefore subject to injunction under IRC § 7408.

Injunction under IRC § 7402

39. The United States incorporates herein as if fully restated, the allegations in paragraphs 1 through 38.

40. Unless the Court enjoins defendants they are likely to continue to engage in the conduct described in paragraphs 1 through 37 of this complaint.

41. Defendants' conduct described in paragraphs 1 through 37 has resulted and continues to result in irreparable harm to the United States.

42. The United States has no adequate remedy at law to halt this irreparable harm. The United States is entitled to an injunction under IRC § 7402.

43. The United States, as a result of the promotion, has lost and will continue to lose substantial revenues that should have been paid as income tax and employment tax.

44. The detection and audit of customers who have used defendants' scheme, and of those customers' employees, will place serious burdens on the IRS's limited resources.

45. The IRS estimates that 3,000 to 20,000 employees of defendants' customer-employers receive incorrect W-2 wage statements and consequently underreport their state and federal income taxes each year. The task of identifying these employees, examining their income tax returns, determining and assessing deficiencies, collecting unpaid taxes, and correcting Social Security records, is enormous.

46. The customers of defendants, and the employees of their customers, have been harmed financially to the extent they have underpaid their federal tax liabilities and may become liable for additional taxes, penalties and interest, and have paid (and continue to pay) defendants for participation in a fraudulent scheme. Defendants' employees have been further harmed to the extent that underreporting of their wages will lead to reduced social security benefits.

47. If defendants are not enjoined, they likely will continue to engage in unlawful conduct that interferes with the enforcement of the internal revenue laws, thereby undermining the federal tax system.

WHEREFORE, the plaintiff United States prays for the following:

A. That the Court find that the defendants have engaged in conduct subject to penalty under IRC §§ 6700 and 6701, and that injunctive relief is appropriate under IRC § 7408 to prevent them and anyone acting in concert with them from engaging in any further such conduct;

B. That the Court find that the defendants have engaged in conduct that interferes with the enforcement of the internal revenue laws, and that injunctive relief against them and anyone acting in concert with them is appropriate to prevent the recurrence of that conduct, pursuant to the Court's inherent equity powers and IRC § 7402(a);

C. That the Court, pursuant to IRC §§ 7402 and 7408, enter a permanent injunction prohibiting the defendants and their representatives, agents, servants, employees, attorneys, and those persons in concert or participation with them, from directly or indirectly by means of false, deceptive, or misleading commercial speech:

- (1) Organizing, promoting, marketing, or selling (or assisting therein) the Health Incentive Plan, the HealthIER Plan, or any other abusive tax shelter, plan or arrangement that incites taxpayers to attempt to violate the internal

revenue laws, unlawfully evade the assessment or collection of their federal tax liabilities, or unlawfully claim improper tax refunds;

- (2) Further engaging in any conduct subject to penalty under IRC § 6700, *i.e.*, making or furnishing, in connection with the organization or sale of an abusive shelter, plan, or arrangement, a statement they know or have reason to know is false or fraudulent as to any material matter;
- (3) Further engaging in any conduct that unlawfully interferes with the administration and enforcement of the internal revenue laws by the IRS.

D. That this Court, pursuant to IRC §§ 7402 and 7408, enter an injunction requiring the defendants to contact, in writing, by first class mail:

- (1) all persons who purchased the HI Plan, or HealthIER Plan, or any other shelter, plan, or arrangement from the defendants, or from their representatives, agents, servants, employees, attorneys, or other persons acting in concert or participation with them, at any time since January 1, 2000;
- (2) all persons who purchased any shelter, plan, or arrangement at any time since January 1, 2000, from the defendants or any entity (including without limitation any corporation, partnership, limited partnership, limited liability company, proprietorship or other organization or association) in which or with which the defendants have had (a) any ownership interest, (b) any employment relationship, (c) any contractual arrangement, (d) or any other commercial or business affiliation;

- (3) all persons on whose behalf the defendants, or their representatives, agents, servants, employees, attorneys, or other persons acting in concert or participation with them, prepared and/or assisted in the preparation of any federal or state income-tax returns or tax-related documents at any time since January 1, 2000; and
- (4) all persons who contacted the defendants, their representatives, agents, servants, employees, attorneys, or other persons acting in concert or participation with them, regarding the purchase of any shelter, plan or arrangement at any time since January 1, 2000;
- (5) all current and former employees of defendants' customer-employers who at any time since January 1, 2000, participated in the HI Plan or the HealthIER Plan,

and to provide each of those persons with a true, correct and complete copy of the Court's findings and order of permanent injunction, and further, to inform those persons, using a memorandum approved by the Court of the falsity of the representations made by the defendants, of the falsity of any tax returns prepared based on the defendants' plans, of the possibility of the imposition of penalties against them, of the possibility that the United States may seek to recover additional taxes and any erroneous refund they may have received, and of the fact that a permanent injunction has been entered against the defendants.

E. That this Court, pursuant to IRC §§ 7402 and 7408, enter an injunction requiring the defendants to produce to the United States all records in their possession, custody, or control or to which they have access that identify (1) the persons to whom they gave or sold or otherwise provided, directly or indirectly, any documents or other information related to the HI Plan, the

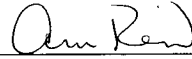
HealthIER Plan, or any other medical reimbursement plan or similar plan or arrangement that the defendants have sold or promoted since January 1, 2000; (2) the persons who assisted in the preparation or marketing of materials used by the defendants or by their representatives, agents, servants, employees, attorneys, or other persons acting in concert or participation with them since January 1, 2000; (3) all individuals or entities for whom the defendants, or their representatives, agents, servants, employees, attorneys, or other persons acting in concert or participation with them, have prepared or have assisted in the preparation of any tax-related documents, including Forms 940, 941, and 5500; and (4) all individuals or entities who purchased or used any other tax shelter, plan, or arrangement with which the defendants have been involved since January 1, 2000.

F. That this Court, pursuant to IRC § 7402, enter an injunction requiring defendants and their representative, agents, servants, employees, attorneys, and those persons in active concert or participation with them, including their distributors, to remove from their websites, including www.PsgWebNet.com and www.mrp-ssg.com, all abusive tax scheme promotional materials, false commercial speech, and materials designed to incite others imminently to violate the law (including the tax laws), to display prominently on the first page of those websites a complete copy of the Court's permanent injunction, and to maintain the web sites for one year with a complete copy of the Court's permanent injunction so displayed throughout that time;

G. That the Court grant the United States its costs in bringing this action.

H. That the Court grant such other relief as the Court deems appropriate.

PATRICK FITZGERALD
United States Attorney



ANN REID
STEPHANIE PAGE
Trial Attorneys, Tax Division
U.S. Department of Justice
Post Office Box 7238
Ben Franklin Station
Washington, D.C. 20044
Telephone: (202) 514-6636
Fax: (202) 514-6770



Flexible Savings Estimate
for

Date Prepared
9-Mar-2002

XYZ, Inc.

Assumptions:

>	Average Employee Monthly Gross Compensation	\$ 2,500.00
>	Average Employer Monthly Contribution to Qualified Benefit Plans*	\$ 203.33
>	Average Employee Monthly Contribution to Qualified Benefit Plans*	\$ 21.67
>	Average Number of Employees Participating in Qualified Benefit Plans*	30

Employee	Current Plan	HealthIER Plan
Monthly Compensation	\$ 2,500.00	\$ 2,500.00
Employee Pre-tax Contribution to Qualified Benefit Plans*	\$ (21.67)	\$ (225.00)
HealthIER Plan Administrative Fee	Not Applicable	\$ (20.00)
Taxable Income for Employee	\$ 2,478.33	\$ 2,255.00
Tax Withholdings		
Federal Withholding Tax	\$ (371.75)	\$ (338.25)
State Income Tax	\$ (74.35)	\$ (67.65)
Municipal Income Tax	\$ (18.59)	\$ (16.91)
FICA	\$ (189.59)	\$ (172.51)
Net Pay	\$ 1,824.05	\$ 1,659.68
HealthIER Plan Reimbursement	\$ -	\$ 165.87
Take-home Pay	\$ 1,824.05	\$ 1,825.55

Employer	Current Plan	HealthIER Plan
Salary/Wage Expense	\$ 2,500.00	\$ 2,500.00
Health Insurance Expense	\$ 203.33	Not Applicable
HealthIER Plan Reimbursement	Not Applicable	\$ 165.87
Employer FICA Match	\$ 189.59	\$ 172.51
Total Monthly Cost per Employee	\$ 2,892.93	\$ 2,838.38

Employer's Estimated Monthly HealthIER Savings per Employee	\$ 54.55
Employer's Estimated Monthly HealthIER Plan Total Savings	\$ 1,636.35
Employer's Estimated Annual HealthIER Plan Total Savings	\$ 19,636.20
Employer's Daily Cost of Waiting	\$ 55.16
Employer's Estimated Minimum Savings Guarantee	\$ 5,589.38

The savings estimated in this illustration have been provided by the Prospect.



This Custom Savings Estimate is not a firm forecast.
Final calculations per employee will be done during the implementation phase.

The Redwood Group LLC
Copyright 2002
Private Confidential
27

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2. The plaintiff is the United States of America.

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18. The defendants' customer-employers that use the HI Plan and/or the HealthIER Plan have failed to report and pay substantial amounts of employment taxes. The customers' employees have under-reported and underpaid both FICA taxes and federal income taxes.

19. Defendants promote their schemes through sales agents and on the Internet at www.PsgWebNet.com. On information and belief, defendants also promote a similar scheme to self-employed persons at the site www.mrp-ssg.com.

20. Defendants' promotional materials claim that the accounting firm of Wohlenberg Ritzman & Co. in Yankton, South Dakota, provides "administration" services for the plans. Wohlenberg Ritzman & Co. receives compensation directly from HI Plan or HealthIER Plan fees that defendants' customer-employers withhold from their employees. Blaine Meier, a Certified Public Accountant, and partner with Wohlenberg Ritzman, has written opinions endorsing the HI

Plan and the HealthIER Plan. These opinions do not disclose that Meier or Wohlenberg Ritzman & Co. have a financial interest in the plans. Blaine Meier claims that neither Wohlenberg Ritzman & Co. or the "Processing Center" (which consists of employees of Wohlenberg Ritzman & Co. and which purportedly processes the HealthIER Plan) have access to either a customer list or an employee list.

21. Defendants have sold these fraudulent tax promotions to more than 200 customer-employers.

22. Defendants Zanfei and Crouse have refused to identify to the IRS any of their sales agents or any of their customers. Crouse failed to comply with an IRS summons requiring him to provide documents which identify defendants' customers. Thus, the IRS cannot identify most of the defendants' customer-employers, and cannot determine how many employees of the more than 200 customer-employers are affected by the fraud.

23. One customer-employer the IRS has identified is a large medical services provider in California which employs more than 300 people.

24. The IRS estimates that defendants' schemes have cost the U.S. Treasury losses of \$12 million to \$63 million so far. If defendants are not enjoined, and their scheme dismantled, the United States will lose an additional estimated \$6 million to \$24 million in tax revenue each year. Every paycheck the defendants' customer-employers pay their employees causes harm to the United States, by understating taxable wages.

Defendants' False and Fraudulent Statements

25. Defendants, in connection with these schemes, made statements relating to material matters under the internal revenue laws that they knew or had reason to know were false or fraudulent.

26. Defendants have made the following false and fraudulent statements to their prospective customers:

a. that the prospective customer-employers do not have to pay employment taxes on the amounts paid to employees as so-called medical reimbursement. Because these payments are not reimbursements, this statement is false.

b. that the employees of the prospective customer-employers will not have to pay federal income tax or FICA tax on amounts paid to them as purported medical reimbursements. Because these payments were not reimbursements, this statement is false.

c. that the \$20-per-employee-per-month promoter's fees withheld from employees wages can be excluded from employees' income for federal-income-tax purposes.

Defendants' Knowledge that the Statements Were False and Fraudulent

27. Zanfei and Crouse hold themselves out to the public as experts on health reimbursement arrangements. Therefore, they had reason to know about false or fraudulent statements made in connection with their promotion.

28. In April 2001, Stuart Sobel of Stuart Sobel Consulting, Inc., sent a tax opinion on the HI Plan to Zanfei that focused on the HI Plan's purported reimbursement aspects. The

opinion stated that “it was most probable” that the amounts defendants advised their customers to exclude from taxable income under the HI Plan “are includable and not excludible in compensation for healthcare reimbursement.” Defendants nevertheless continued to promote their scheme.

29. Rev. Rul. 2002-3, 2002-3 I.R.B. 316 (January 22, 2002) held that the exclusions from gross income under I.R.C. §§ 106(a) and 105(b) do not apply to amounts that an employer pays to employees to reimburse the employees for amounts paid by the employer for health insurance coverage that are excluded from gross income under IRC § 106(a) (including salary reduction amounts pursuant to a cafeteria plan under I.R.C. § 125 that are applied to pay for such coverage). Defendants Zanfei and Crouse were aware of Rev. Rul. 2002-3 when it was published. Yet they continued to promote their schemes.

30. Rev. Rul. 2002-80, 2002-49 I.R.B. 925 (December 9, 2002) amplified Rev. Rul. 2002-3 to clarify that amounts paid to an employee as advance reimbursements or purported loans without regard to whether the employee has incurred medical expenses are not excludable from the employee’s gross income under IRC § 105(b), that such advance reimbursements or purported loans are included in the employee’s gross income, and that such amounts are subject to employment taxes. Zanfei and Crouse became aware of Rev. Rul. 2002-80 when it was published, yet they continued to promote the HealthIER Plan.

31. Zanfei and Crouse knew of articles published by the Employers Council on Flexible Compensation (ECFC), Employee Benefit Institute of America (EBIA) and other tax professionals that advised that plans like the HI Plan and the HealthIER Plan were unsound.

32. Both the HI Plan promotion and the later HealthIER Plan version of the promotion required prospective customer-employers to sign comprehensive confidentiality agreements to prevent the prospective customer-employers from disclosing information about the promotions to anyone other than the customers' confidential consultants and their employees. Zanfei and Crouse required this in order to keep their fraudulent scheme from being detected.

33. The U.S. Department of Labor sued Zanfei and Crouse, alleging that they violated ERISA when they failed to hold assets of a health plan in trust, failed to charge adequate premiums, and failed to establish appropriate underwriting procedures. As a result, participants were left with between \$5 and \$17.5 million in unpaid medical claims. The suit also alleges that Zanfei and Crouse diverted money targeted to pay health benefits for personal enrichment. *Chao v. Crouse et al.*, Civ. No. 1:03 -cv-01585-DFH-TAB (S.D. Ind.).

An injunction under Section 7408

34. Section 7408 of IRC authorizes a court to enjoin persons who have engaged in conduct subject to penalty under IRC §§ 6700 or 6701.

35. In relevant part, IRC § 6700 imposes a penalty on any person who organizes (or assists in the organization of) any shelter, plan, or arrangement, or participates (directly or indirectly) in the sale of any interest in an entity or plan or arrangement; and makes or furnishes or causes another person to make or furnish (in connection with such organization or sale) a statement regarding any deduction, credit, or the excludability of income; which the person knows or has reason to know is false or fraudulent as to any material matter.

36. Defendants' conduct as described above is subject to penalty under IRC § 6700.

37. An injunction is necessary and appropriate to stop defendants' conduct subject to the IRC § 6700 penalties and other violations of the internal revenue laws.

38. Defendants are therefore subject to injunction under IRC § 7408.

Injunction under IRC § 7402

39. The United States incorporates herein as if fully restated, the allegations in paragraphs 1 through 38.

40. Unless the Court enjoins defendants they are likely to continue to engage in the conduct described in paragraphs 1 through 37 of this complaint.

41. Defendants' conduct described in paragraphs 1 through 37 has resulted and continues to result in irreparable harm to the United States.

42. The United States has no adequate remedy at law to halt this irreparable harm. The United States is entitled to an injunction under IRC § 7402.

43. The United States, as a result of the promotion, has lost and will continue to lose substantial revenues that should have been paid as income tax and employment tax.

44. The detection and audit of customers who have used defendants' scheme, and of those customers' employees, will place serious burdens on the IRS's limited resources.

45. The IRS estimates that 3,000 to 20,000 employees of defendants' customer-employers receive incorrect W-2 wage statements and consequently underreport their state and federal income taxes each year. The task of identifying these employees, examining their income tax returns, determining and assessing deficiencies, collecting unpaid taxes, and correcting Social Security records, is enormous.

46. The customers of defendants, and the employees of their customers, have been harmed financially to the extent they have underpaid their federal tax liabilities and may become liable for additional taxes, penalties and interest, and have paid (and continue to pay) defendants for participation in a fraudulent scheme. Defendants' employees have been further harmed to the extent that underreporting of their wages will lead to reduced social security benefits.

47. If defendants are not enjoined, they likely will continue to engage in unlawful conduct that interferes with the enforcement of the internal revenue laws, thereby undermining the federal tax system.

WHEREFORE, the plaintiff United States prays for the following:

A. That the Court find that the defendants have engaged in conduct subject to penalty under IRC §§ 6700 and 6701, and that injunctive relief is appropriate under IRC § 7408 to prevent them and anyone acting in concert with them from engaging in any further such conduct;

B. That the Court find that the defendants have engaged in conduct that interferes with the enforcement of the internal revenue laws, and that injunctive relief against them and anyone acting in concert with them is appropriate to prevent the recurrence of that conduct, pursuant to the Court's inherent equity powers and IRC § 7402(a);

C. That the Court, pursuant to IRC §§ 7402 and 7408, enter a permanent injunction prohibiting the defendants and their representatives, agents, servants, employees, attorneys, and those persons in concert or participation with them, from directly or indirectly by means of false, deceptive, or misleading commercial speech:

- (1) Organizing, promoting, marketing, or selling (or assisting therein) the Health Incentive Plan, the HealthIER Plan, or any other abusive tax shelter, plan or arrangement that incites taxpayers to attempt to violate the internal

revenue laws, unlawfully evade the assessment or collection of their federal tax liabilities, or unlawfully claim improper tax refunds;

- (2) Further engaging in any conduct subject to penalty under IRC § 6700, *i.e.*, making or furnishing, in connection with the organization or sale of an abusive shelter, plan, or arrangement, a statement they know or have reason to know is false or fraudulent as to any material matter;
- (3) Further engaging in any conduct that unlawfully interferes with the administration and enforcement of the internal revenue laws by the IRS.

D. That this Court, pursuant to IRC §§ 7402 and 7408, enter an injunction requiring the defendants to contact, in writing, by first class mail:

- (1) all persons who purchased the HI Plan, or HealthIER Plan, or any other shelter, plan, or arrangement from the defendants, or from their representatives, agents, servants, employees, attorneys, or other persons acting in concert or participation with them, at any time since January 1, 2000;
- (2) all persons who purchased any shelter, plan, or arrangement at any time since January 1, 2000, from the defendants or any entity (including without limitation any corporation, partnership, limited partnership, limited liability company, proprietorship or other organization or association) in which or with which the defendants have had (a) any ownership interest, (b) any employment relationship, (c) any contractual arrangement, (d) or any other commercial or business affiliation;

- (3) all persons on whose behalf the defendants, or their representatives, agents, servants, employees, attorneys, or other persons acting in concert or participation with them, prepared and/or assisted in the preparation of any federal or state income-tax returns or tax-related documents at any time since January 1, 2000; and
- (4) all persons who contacted the defendants, their representatives, agents, servants, employees, attorneys, or other persons acting in concert or participation with them, regarding the purchase of any shelter, plan or arrangement at any time since January 1, 2000;
- (5) all current and former employees of defendants' customer-employers who at any time since January 1, 2000, participated in the HI Plan or the HealthIER Plan,

and to provide each of those persons with a true, correct and complete copy of the Court's findings and order of permanent injunction, and further, to inform those persons, using a memorandum approved by the Court of the falsity of the representations made by the defendants, of the falsity of any tax returns prepared based on the defendants' plans, of the possibility of the imposition of penalties against them, of the possibility that the United States may seek to recover additional taxes and any erroneous refund they may have received, and of the fact that a permanent injunction has been entered against the defendants.

E. That this Court, pursuant to IRC §§ 7402 and 7408, enter an injunction requiring the defendants to produce to the United States all records in their possession, custody, or control or to which they have access that identify (1) the persons to whom they gave or sold or otherwise provided, directly or indirectly, any documents or other information related to the HI Plan, the

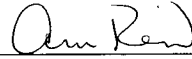
HealthIER Plan, or any other medical reimbursement plan or similar plan or arrangement that the defendants have sold or promoted since January 1, 2000; (2) the persons who assisted in the preparation or marketing of materials used by the defendants or by their representatives, agents, servants, employees, attorneys, or other persons acting in concert or participation with them since January 1, 2000; (3) all individuals or entities for whom the defendants, or their representatives, agents, servants, employees, attorneys, or other persons acting in concert or participation with them, have prepared or have assisted in the preparation of any tax-related documents, including Forms 940, 941, and 5500; and (4) all individuals or entities who purchased or used any other tax shelter, plan, or arrangement with which the defendants have been involved since January 1, 2000.

F. That this Court, pursuant to IRC § 7402, enter an injunction requiring defendants and their representative, agents, servants, employees, attorneys, and those persons in active concert or participation with them, including their distributors, to remove from their websites, including www.PsgWebNet.com and www.mrp-ssg.com, all abusive tax scheme promotional materials, false commercial speech, and materials designed to incite others imminently to violate the law (including the tax laws), to display prominently on the first page of those websites a complete copy of the Court's permanent injunction, and to maintain the web sites for one year with a complete copy of the Court's permanent injunction so displayed throughout that time;

G. That the Court grant the United States its costs in bringing this action.

H. That the Court grant such other relief as the Court deems appropriate.

PATRICK FITZGERALD
United States Attorney



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Flexible Savings Estimate
for

Date Prepared
9-Mar-2002

XYZ, Inc.

Assumptions:

>	Average Employee Monthly Gross Compensation	\$ 2,500.00
>	Average Employer Monthly Contribution to Qualified Benefit Plans*	\$ 203.33
>	Average Employee Monthly Contribution to Qualified Benefit Plans*	\$ 21.67
>	Average Number of Employees Participating in Qualified Benefit Plans*	30

Employee	Current Plan	HealthIER Plan
Monthly Compensation	\$ 2,500.00	\$ 2,500.00
Employee Pre-tax Contribution to Qualified Benefit Plans*	\$ (21.67)	\$ (225.00)
HealthIER Plan Administrative Fee	Not Applicable	\$ (20.00)
Taxable Income for Employee	\$ 2,478.33	\$ 2,255.00
Tax Withholdings		
Federal Withholding Tax	\$ (371.75)	\$ (338.25)
State Income Tax	\$ (74.35)	\$ (67.65)
Municipal Income Tax	\$ (18.59)	\$ (16.91)
FICA	\$ (189.59)	\$ (172.51)
Net Pay	\$ 1,824.05	\$ 1,659.68
HealthIER Plan Reimbursement	\$ -	\$ 165.87
Take-home Pay	\$ 1,824.05	\$ 1,825.55

Employer	Current Plan	HealthIER Plan
Salary/Wage Expense	\$ 2,500.00	\$ 2,500.00
Health Insurance Expense	\$ 203.33	Not Applicable
HealthIER Plan Reimbursement	Not Applicable	\$ 165.87
Employer FICA Match	\$ 189.59	\$ 172.51
Total Monthly Cost per Employee	\$ 2,892.93	\$ 2,838.38

Employer's Estimated Monthly HealthIER Savings per Employee	\$ 54.55
Employer's Estimated Monthly HealthIER Plan Total Savings	\$ 1,636.35
Employer's Estimated Annual HealthIER Plan Total Savings	\$ 19,636.20
Employer's Daily Cost of Waiting	\$ 55.16
Employer's Estimated Minimum Savings Guarantee	\$ 5,589.38

The savings estimated in this illustration have been provided by the Prospect.



This Custom Savings Estimate is not a firm forecast.
Final calculations per employee will be done during the implementation phase.

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UNITED STATES DISTRICT COURT FOR THE
NORTHERN DISTRICT OF ILLINOIS
CHICAGO DIVISION

UNITED STATES OF AMERICA,)	
	)	Civil No. 04C 2703
Plaintiffs,)	
	)	Judge: Judge Nordberg
v.)	
	)	Magistrate Judge Denlow
CARMELO ZANFEI; WILLIAM P.)	
CROUSE, JR; PARADIGM SOLUTIONS)	
GROUP, LLC; AND SUPERIOR SOLUTIONS)	
GROUP, INC.,)	
)	
Defendants.)	

PARADIGM SOLUTIONS GROUP, LLC.,)	
)	
Counter-Plaintiff,)	
)	
v.)	
)	
UNITED STATES OF AMERICA,)	
)	
Counter-Defendant.)	

**DEFENDANT PARADIGM SOLUTIONS GROUP, LLC'S ANSWER AND
COUNTERCLAIM TO COMPLAINT FOR PERMANENT INJUNCTION
AND OTHER RELIEF**

NOW COMES Defendant, PARADIGM SOLUTIONS GROUP, LLC, by and through its attorneys, and for [his](#)its Answer to Plaintiff UNITED STATES OF AMERICA'S Complaint states as follows:

1. The United States brings this complaint pursuant to §§7402(a) and 7408 of the Internal Revenue Code (26 U.S.C.) (IRC) to restrain and enjoin the defendants from:
 - a. engaging in any activity subject to penalty under IRC §6700, including organizing or selling a plan or arrangement and, in connection with that activity, making a statement regarding the excludability of income or

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

- b. engaging in any other activity subject to penalty under IRC §§6700;
- c. engaging in other, similar conduct that unlawfully interferes with the proper administration and enforcement of the internal revenue laws.

ANSWER: Defendant states that inasmuch as the allegations of paragraph 1 and its subparts constitutes conclusions of law, no response is required. To the extent a response is required, Defendant is without sufficient knowledge or information to form a belief as to the truth or falsity of paragraph 1, and, accordingly, denies same. Defendant denies the allegations contained in subparts 1a, b and c.

- 2. The plaintiff is the United States of America.

ANSWER: Defendant admits the allegations contained in paragraph 2.

- 3. The defendant Carmelo Zanfei resides at 318 Royal Oak Court, Steger, Illinois, 60475. He regularly conducted business from offices in Calumet City and Chicago Heights, Illinois. He is within this Court's jurisdiction.

ANSWER: Defendant denies the allegations contained in the first sentence of paragraph 3. Defendant admits the allegations contained in the second sentence of paragraph 3, but answering further, states that most of the business conducted by Zanfei from Calumet City and Chicago Heights did not pertain to the subject matter of the instant Complaint, and business is no longer conducted from either site and has not been since 2001. To the extent not admitted, Defendant denies the allegations contained in paragraph 3.

- 4. The defendant William P. Crouse, Jr., resides at 4181 Waterbrook Way, Greenwood, Indiana, 46143-9307. He regularly conducted business from offices in Calumet City and Chicago Heights, Illinois. He is within this Court's jurisdiction.

ANSWER: Defendant admits that William P. Crouse, Jr. resides at 4181 Waterbrook Way, Greenwood, Indiana 46143-9307. Defendant denies the remaining allegations contained in paragraph 4.

5. The defendant Paradigm Solutions Group, LLC (PSG) is a limited liability company formed in the state of Delaware. Its registered agent is Registered Agents, Ltd, Ste 606, 1220 N. Market Street, Wilmington, Delaware. PSG carries on systematic business activities within the state of Illinois. It is subject to this Court's jurisdiction.

ANSWER: Defendant admits the allegations contained in the first two sentences of paragraph 5. Defendant denies the remaining allegations contained in paragraph 5.

6. Defendants Zanfei and Crouse are officers and managers of PSG.

ANSWER: Defendant admits that Zanfei and Crouse are member managers of PSG. Defendant denies the remaining allegations contained in paragraph 6.

7. The defendant Superior Solutions Group, Inc., [SSG] is a Nevada Corporation with a business address of 211 N. Buffalo Drive, Suite A, Las Vegas, Nevada, 89145. SSG carries on systematic business activities within the state of Illinois and is subject to this Court's jurisdiction. The registered agent for SSG is Christopher Rhodes, 5172 E. 65th St., Suite 105, Indianapolis, Indiana, 46220.

ANSWER: Defendant admits the allegations contained in the first sentence of paragraph 7. Defendant denies the remaining allegations contained in paragraph 7.

8. Defendants Zanfei and Crouse are the sole shareholders of SSG.

ANSWER: Defendant admits the allegations contained in paragraph 8.

Jurisdiction and Venue

9. This Court has jurisdiction over this action under 28 U.S.C. §§1340 and 1345 and §§7402(a) and 7408 of the IRC.

ANSWER: Defendant states that inasmuch as the allegations of paragraph 9 constitute conclusions of law, no response is required. To the extent a response is required, Defendant is without sufficient knowledge or information to form a belief as to the truth or falsity of the allegations contained in paragraph 9 and, accordingly, denies same.

10. This action has been requested by the Acting 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 the provisions of IRC §§7402 and 7408.

ANSWER: Defendant is without the sufficient knowledge or information to form a belief as to the truth or falsity of the allegations contained in paragraph 10 and, accordingly, denies same.

11. Venue is proper in this Court pursuant to 28 U.S.C. §1391.

ANSWER: Defendant states that inasmuch as the allegations of paragraph 11 constitute conclusions of law, no response is required. To the extent a response is required, Defendant denies the allegations contained in paragraph 11.

Defendants' Activities

12. Defendants Zanfei and Crouse, through various entities, including the Redwood Group, LLC; the Redwood Group, Inc., TRG Marketing, LLC, and defendants SSG and PSG, are organizing and marketing abusive tax schemes to help customers unlawfully avoid federal income and employment taxes. The schemes are shelters, plans, or arrangements within the meaning of IRC §6700.

ANSWER: Defendant denies the allegations contained in paragraph 12.

13. Defendants sell schemes called the Health Incentive Plan (HI Plan) and the HealthIER Plan to employers. The schemes are designed to cause the customers to unlawfully underreport wages paid on their quarterly federal employment tax returns and on IRS Form W-2 wage statements given annually to the customers' employees. This in turn results in the employer-customers underreporting and underpaying their federal income taxes. This underreporting also results in employers understating wages to the Social Security Administration. The underreporting arises from unlawfully excluding from wages certain amounts that the employer-customers pay to employees as purported accident and health insurance premiums and purported reimbursements of employees' medical expenses. Zanfei began selling the HI Plan in January of 2000. Crouse started selling the HP Plan in Spring 2000. Defendants began promoting the HealthIER Plan in 2003.

ANSWER: Defendant admits that Zanfei began selling the HI Plan in or about January of 2000 and Crouse in or about the Spring of 2000. To the extent not admitted, Defendant denies the remaining allegations contained in paragraph 13.

14. The HI Plan causes the defendants' customer-employers to unlawfully underreport wages paid on federal employment tax returns and W-2 forms by reducing reported wages twice for employer-paid health insurance premiums, using the following steps:

Step 1: The customer-employers pay health insurance premiums for employees and correctly exclude those amounts from reported wages on the customer-employers' federal employment tax returns and the W-2 forms issued to employees.

Step 2: In addition to paying employees' health insurance premiums directly, the defendants' customer-employer also purportedly "reimburses" the employees in an amount approximately equal to the amount of health insurance premiums paid by the employer. These "reimbursements," which under the scheme are excluded from reported wages, are in fact nothing of the sort. They are simply wages disguised as reimbursements in order to reduce reported wages paid on the employer's federal employment tax returns.

IRC §105(b) excludes under specified circumstances employer reimbursements of employees' medical care expenses from gross income and wages for employment taxes.

But amounts paid under the defendants' HI Plan are not "reimbursements;" therefore there is no lawful basis for the exclusion.

ANSWER: Defendant admits that IRC §105(b) excludes from gross income under specified circumstances employer reimbursements of employees' medical care expenses. Except as admitted herein, Defendant denies the allegations contained in paragraph 14.

15. The HealthIER Plan unlawfully causes the defendants' customer-employers to underreport and underpay federal employment taxes by excluding from wages reported on employment tax returns amounts paid to employees as medical expense "reimbursements" for expenses that have not been incurred. The HealthIER Plan uses the following steps to implement this fraudulent scheme:

- Step 1: As with the HI Plan, under the HealthIER Plan the defendants' customer-employers paid accident and health insurance premiums on behalf of employees, and properly excluded those payments from reported wages on their federal employment tax returns.
- Step 2: But in addition, under the HealthIER Plan the defendants' customer-employers set up a stand-alone medical reimbursement plan. The HealthIER Plan calls for the customer-employer to automatically make "advance reimbursements" of employees' medical expenses. These advance reimbursements are made regardless of whether employees have actually incurred medical expenses. Stated simply, the so-called reimbursements are not reimbursements at all they are wages disguised as reimbursements, to allow the customer-employers to fraudulently underreport wages paid on their federal employment tax returns and on W-2 wage statements. This results in the customer-employers under-reporting and underpaying their employment taxes and results in the employees under-reporting and underpaying their federal income and social security taxes.

ANSWER: Defendant denies the allegations contained in paragraph 15.

16. Defendants charge their customer-employers a fee of \$10 per employee sign up for the HealthIER Plan. Defendants also charge a fee of \$20 per month per employee for the HealthIER Plan scheme. Although it is the customer-employers who contract with the defendants for the scheme, the monthly fees are taken out of the paychecks of

customers' employees, resulting in the employees paying for their employers' participation in the scheme.

ANSWER: Defendant admits that PSG charges customer-employers a one-time setup fee of \$10 per employee and a monthly back office service fee of \$20 per employee per month. Answering further, Defendant states that the customer-employers decide whether to pass the fees charged by PSG to their participating employees. To the extent not admitted herein, Defendant denies the allegations contained in paragraph 16.

17. Under defendants' schemes, customer-employers reduce the wages of their employees who participate in the HealthIER Plan. A sample worksheet entitled "Flexible Savings Estimate" from defendants' training materials show that the customer-employers using the scheme actually reduce their employees' wages by more than the HealthIER Plan "reimbursements." A copy of the sample worksheet is attached as Exhibit A to this Complaint. The net result is that employees' take-home paychecks are about the same as before using the plan, with most or all of the economic benefits of participating in the bogus scheme going to the employer. Nevertheless the employees earn less in future social security benefits because of the wage understatements. Once the employer's participation in the scheme is detected and unraveled, the employees will be found to owe substantial additional taxes and interest. As a result employees are unwittingly caught up in a fraudulent scheme that exposes them to substantial future expenses.

ANSWER: Defendant denies the allegations contained in paragraph 17.

18. The defendants' customer-employers that use the HI Plan and/or the HealthIER Plan have failed to report and pay substantial amounts of employment taxes. The customers' employees have under-reported and underpaid both FICA taxes and federal income taxes.

ANSWER: Defendant denies the allegations contained in paragraph 18.

19. Defendants promote their schemes through sales agents and on the Internet at www.PsgWebNet.com. On information and belief, defendants also promote a similar scheme to self-employed persons at the site www.mrp-ssg.com.

ANSWER: Defendant admits that PSG markets the HealthIER Plan through independent sales agents and uses the website www.PsgWebNet.com as a marketing

tool for the HealthIER Plan. Defendant admits that SSG markets and sells a medical reimbursement plan to self-employed individuals and utilizes the website www.mrp-ssg.com as a marketing tool. To the extent not admitted herein, Defendant denies the allegations contained in paragraph 19.

20. Defendants' promotional materials claim that the accounting firm of Wohlenberg Ritzman & Co. in Yankton, South Dakota, provides "administration" services for the plans. Wohlenberg Ritzman & Co. receives compensation directly from HI Plan or HealthIER Plan fees that defendant's customer-employers withhold from their employees. Blaine Meier, a Certified Public Accountant, and partner with Wohlenberg Ritzman, has written opinions endorsing the HI Plan and the HealthIER Plan. These opinions do not disclose that Meier or Wohlenberg Ritzman & Co. have a financial interest in the plans. Blaine Meier claims that neither Wohlenberg Ritzman & Co. or the "Processing Center" (which consists of employees of Wohlenberg Ritzman & Co. and which purportedly processes the HealthIER Plan) have access to either a customer list or an employee list.

ANSWER: Defendant is without sufficient knowledge or information to form a belief as to the truth or falsity of the allegations contained in the first sentence of paragraph 20 and, accordingly, denies same. Answering further, Defendant states that PSG pays fees to Wohlenberg Ritzman & Co. for services rendered to PSG, and that the fees are paid from PSG revenues which revenues include fees paid by PSG customer-employers. Answering further, Defendant is without sufficient knowledge or information to form a belief as to whether Wohlenberg Ritzman & Co. would be deemed to have a "financial interest" in the plans as that term is used in paragraph 21. Defendant otherwise admits the allegations contained in the third and fourth sentences of paragraph 20. Defendant is without sufficient knowledge or information to form a belief as to the truth or falsity of the allegations contained in the fifth sentence of paragraph 20. To the extent not admitted herein, Defendant denies the allegations contained in paragraph 20.

21. Defendants have sold these fraudulent tax promotions to more than 200 customer-employers.

ANSWER: Defendant denies the allegations contained in paragraph 21.

22. Defendants Zanfei and Crouse have refused to identify to the IRS any of their sales agents or any of their customers. Crouse failed to comply with an IRS summons requiring him to provide documents which identify defendants' customers. Thus, the IRS cannot identify most of the defendants' customer-employers, and cannot determine how many employees of the more than 200 customer-employers are affected by the fraud.

ANSWER: Defendant admits the allegations contained in the first sentence of paragraph 22. Answering further, Defendant is not aware of Crouse receiving a summons from the IRS but Crouse did receive a Form 4564 Information Document Request, and accordingly denies the allegations contained in the second sentence of paragraph 22. Answering further, Defendant states that the IRS has no right to compel the disclosure of the identity of the sales agents and customers, and that such information is both premature and irrelevant as there have been no findings that the HI Plan or HealthIER Plan do not conform to the Internal Revenue Code or applicable regulations. Defendant is without sufficient knowledge or information to form a belief as to the truth or falsity of the remaining allegations contained in paragraph 22 and, accordingly, denies same.

23. One customer-employer the IRS has identified is a larger medical services provider in California which employs more than 300 people.

ANSWER: Defendant is without sufficient knowledge or information to form a belief as to the truth or falsity of paragraph 23, and, accordingly, denies same.

24. The IRS estimates that defendants' schemes have cost the U.S. Treasury losses of \$12 million to \$63 million so far. If defendants are not enjoined, and their scheme dismantled, the United States will lose an additional estimated \$6 million to \$24 million

in tax revenue each year. Every paycheck the defendants' customer-employers pay their employees causes harm to the United States, by understating taxable wages.

ANSWER: Defendant is without sufficient knowledge or information to form a belief as to the truth or falsity of the first sentence contained in paragraph 24 and, accordingly, denies same. Defendant denies the remaining allegations contained in paragraph 24.

Defendants' False and Fraudulent Statements

25. Defendants, in connection with these schemes, made statements relating to material matters under the internal revenue laws that they knew or had reason to know were false or fraudulent.

ANSWER: Defendant denies the allegations contained in paragraph 25.

26. Defendants have made the following false and fraudulent statements to their prospective customers:

- a. that the prospective customer-employers do not have to pay employment taxes on the amounts paid to employees as so-called medical reimbursements. Because these payments are not reimbursements, this statement is false.
- b. that the employees of the prospective customer-employers will not have to pay federal income tax or FICA tax on amounts paid to them as purported medical reimbursements. Because these payments were not reimbursements, this statement is false.
- c. that the \$20-per-employee-per-month promoter's fees withheld from employees wages can be excluded from employees' income for federal-income-tax purposes.

ANSWER: Defendant denies the allegations contained in paragraph 26 and its subparts. Answering further, Defendant states that the reimbursement of eligible medical care expenses under the HI Plan or the HealthIER Plan are properly excluded

from employee income and, therefore, not subject to employment taxes under §105(b) and other relevant provisions and regulations of the Internal Revenue Code.

Defendants' Knowledge that the Statements were False and Fraudulent

27. Zanfei and Crouse hold themselves out to the public as experts on health reimbursement arrangements. Therefore, they had reason to know about false or fraudulent statements made in connection with their promotion.

ANSWER: Defendant admits that Zanfei and Crouse hold themselves out to third parties as very knowledgeable on medical reimbursement plans. Defendant does not know whether Zanfei and Crouse would be considered experts as that term is used in Paragraph 27. To the extent not admitted herein, Defendant denies the allegations contained in paragraph 27.

28. In April 2001, Stuart Sobel of Stuart Sobel Consulting, Inc., sent a tax opinion on the HI Plan to Zanfei that focused on the HI Plan's purported reimbursement aspects. The opinion stated that "it was most probable" that the amounts defendants advised their customers to exclude from taxable income under the HI Plan "are includable and not excludible in compensation for healthcare reimbursement." Defendants nevertheless continued to promote their scheme.

ANSWER: Defendant admits the allegations contained in the first sentence of paragraph 28. As to the second sentence of paragraph 28, Defendant admits that Sobel's tax opinion contained the quoted language but denies that Defendants' advised customer-employers to exclude from taxable income any reimbursements that were not properly excludible under the Internal Revenue Code. Answering further, Defendant states that the quoted language of the Sobel opinion pertained to employee reimbursement of health insurance premiums paid through pretax dollars under a section 125 cafeteria plan. Answering further, Defendants never advised customer-employers to exclude from employees' taxable income reimbursement of insurance

premiums paid through pretax dollars under a section 125 cafeteria plan. To the extent not admitted herein, Defendant denies the allegations contained in paragraph 28.

29. Rev. Rul. 2002-3, 2002-3 I.R.B. 316 (January 22, 2002) held that the exclusions from gross income under I.R.C. §§106(a) and 105(b) do not apply to amounts that an employer pays to employees to reimburse the employees for amounts paid by the employer for health insurance coverage that are excluded from gross income under IRC § 106(a) (including salary reduction amounts pursuant to a cafeteria plan under I.R.C. §125 that are applied to pay for such coverage). Defendants Zanfei and Crouse were aware of Rev. Rul. 2002-3 when it was published. Yet they continued to promote their schemes.

ANSWER: Defendant states that inasmuch as the allegations contained in the first sentence of paragraph 29 constitute conclusions of law, no response is required. To the extent a response to the first sentence of paragraph 29 is required, Defendant admits same. Defendant admits that the allegations contained in the second sentence of paragraph 29. Defendant denies the allegations contained in the third sentence of paragraph 29. Answering further, Defendant states that neither the HI Plan or the HealthIER Plan are in any manner inconsistent with or violate Rev. Rul. 2002-3. Answering further, Defendant states that neither the HI Plan nor the HealthIER Plan reimburses employees for insurance premiums paid by employers.

30. Rev. Rul. 2002-80, 2002-49 I.R.B. 925 (December 9, 2002) amplified Rev. Rul. 2002-3 to clarify that amounts paid to an employee as advance reimbursements of purported loans without regard to whether the employee has incurred medical expenses are not excludible from the employee's gross income under IRC §105(b), that such advance reimbursements or purported loans are included in the employee's gross income, and that such amounts are subject to employment taxes. Zanfei and Crouse became aware of Rev. Rul. 2002-80 when it was published, yet they continued to promote the HealthIER Plan.

ANSWER: Defendant states that inasmuch as the allegations contained in the first sentence of paragraph 30 constitute conclusions of law, no response is required. To

the extent a response is required, Defendant admits that Rev. Rul. 2002-80 held, in part, what is set forth in the first sentence of paragraph 30. Defendant admits the allegations contained in the second sentence of paragraph 30. Answering further, Defendant denies that the HealthIER Plan is in any manner inconsistent with or violates Rev. Rul. 2002-80.

31. Zanfei and Crouse knew of articles published by the Employers Council on Flexible Compensation (ECFC), Employee Benefit Institute of America (EBIA) and other tax professionals that advised that plans like the HI Plan and the HealthIER Plan were unsound.

ANSWER: Defendant is unable to respond to the allegations contained in paragraph 31 because paragraph 31 fails to identify the specific articles to which reference is being made. Therefore, Defendant is without sufficient knowledge or information to form a belief as to the truth or falsity of the allegations contained in paragraph 31 and, accordingly, denies same.

32. Both the HI Plan promotion and the later HealthIER Plan version of the promotion required prospective customer-employers to sign comprehensive confidentiality agreements to prevent the prospective customer-employers from disclosing information about the promotions to anyone other than the customers' confidential consultants and their employees. Zanfei and Crouse required this in order to keep their fraudulent scheme from being detected.

ANSWER: Defendant admits that a mutual privacy agreement was utilized by the HI Plan and HealthIER Plan barring disclosure of confidential information to parties other than employees and consultants of customer-employers and in certain circumstances the customer-employers were required to sign such agreements. To the extent not admitted, Defendant denies the remaining allegations contained in paragraph 32.

33. The U.S. Department of Labor sued Zanfei and Crouse, alleging that they violated ERISA when they failed to hold assets of a health plan in trust, failed to charge adequate premiums, and failed to establish appropriate underwriting procedures. As a result, participants were left with between \$5 and \$17.5 million in unpaid medical claims. The suit also alleges that Zanfei and Crouse diverted money targeted to pay health benefits for personal enrichment. *Chao v. Crouse et al.*, Civ. No. 1:03 -cv-01585-DFH-TAB (S.D. Ind.).

ANSWER: As to the first and third sentences contained in paragraph 33, Defendant admits that the U.S. Department of Labor sued Zanfei and Crouse, with the allegations being those set forth in the complaint filed in that lawsuit. Answering further, Defendant states that the referenced lawsuit filed by the U.S. Department of Labor had nothing to do with either the HI Plan or the HealthIER Plan, PSG or SSG, and that such lawsuit is irrelevant to the instant proceedings and was cited to by Plaintiff solely for the purpose of prejudicing Defendants. Defendant is without sufficient knowledge or information to form a belief as to the truth or falsity of the allegations contained in the second sentence of paragraph 33, and, accordingly, denies same.

An Injunction Under Section 7408

34. Section 7408 of IRC authorizes a court to enjoin persons who have engaged in conduct subject to penalty under IRC §§6700 or 6701.

ANSWER: Defendant states that inasmuch as the allegations of paragraph 34 constitute conclusions of law, no response is required. To the extent a response is required, Defendant admits the allegations contained in paragraph 34.

35. In relevant part, IRC §6700 imposes a penalty on any person who organizes (or assists in the organization of) any shelter, plan, or arrangement, or participates (directly or indirectly) in the sale of any interest in an entity or plan or arrangement; and makes or furnishes or causes another person to make or furnish (in connection with such organization or sale) a statement regarding any deduction, credit, or the excludability of income; which the person knows or has reason to know is false or fraudulent as to any material matter.

ANSWER: Defendant states that inasmuch as the allegations of paragraph 35 constitute conclusions of law, no response is required. To the extent a response is required, Defendant admits the allegations contained in paragraph 35.

36. Defendants' conduct as described above is subject to penalty under IRC §6700.

ANSWER: Defendant denies the allegations contained in paragraph 36.

37. An injunction is necessary and appropriate to stop defendants' conduct subject to the IRC §6700 penalties and other violations of the internal revenue laws.

ANSWER: Defendant denies the allegations contained in paragraph 37.

38. Defendants are therefore subject to injunction under IRC §7408.

ANSWER: Defendant denies the allegations contained in paragraph 38.

Injunction Under IRC §7402

39. The United States incorporates herein as if fully restated, the allegations in paragraphs 1 through 38.

ANSWER: Defendant realleges and restates his answers to paragraphs 1 through 38 as and for its his answer to paragraph 39.

40. Unless the Court enjoins defendants they are likely to continue to engage in the conduct described in paragraphs 1 through 37 of this complaint.

ANSWER: Defendant denies the allegations contained in paragraph 40.

41. Defendants' conduct described in paragraphs 1 through 37 has resulted and continues to result in irreparable harm to the United States.

ANSWER: Defendant denies the allegations contained in paragraph 41.

42. The United States has no adequate remedy at law to halt this irreparable harm. The United States is entitled to an injunction under IRC §7402.

ANSWER: Defendant denies the allegations contained in paragraph 42.

43. The United States, as a result of the promotion, has lost and will continue to lose substantial revenues that should have been paid as income tax and employment tax.

ANSWER: Defendant denies the allegations contained in paragraph 43.

44. The detection and audit of customers who have used defendants' scheme, and of those customers' employees, will place serious burdens on the IRS' limited resources.

ANSWER: Defendant denies the allegations contained in paragraph 44.

45. The IRS estimates that 3,000 to 20,000 employees of defendants' customer-employers receive incorrect W-2 wage statements and consequently underreport their state and federal income taxes each year. The task of identifying these employees, examining their income tax returns, determining and assessing deficiencies, collecting unpaid taxes, and correcting Social Security records, is enormous.

ANSWER: Defendant is without sufficient knowledge or information to form a belief as to the truth or falsity of the first sentence contained in paragraph 45 and, accordingly, denies same. Answering further, Defendant denies that any employees of Defendants' customer-employers receive incorrect W-2 wage statements or underreport their state and federal income taxes as a result of participating in either the HI Plan or HealthIER Plan. Defendant denies the remaining allegations contained in paragraph 45.

46. The customers of defendants, and the employees of their customers, have been harmed financially to the extent they have underpaid their federal tax liabilities and may become liable for additional taxes, penalties and interest, and have paid (and continue to pay) defendants for participation in a fraudulent scheme. Defendants' employees have been further harmed to the extent that underreporting of their wages will lead to reduced social security benefits.

ANSWER: Defendant denies the allegations contained in paragraph 46.

47. If defendants are not enjoined, they likely will continue to engage in unlawful conduct that interferes with the enforcement of the internal revenue laws, thereby undermining the federal tax system.

ANSWER: Defendant denies the allegations contained in paragraph 47.

WHEREFORE, Defendant PARADIGM SOLUTIONS GROUP, LLC, requests entry of a judgment in its favor and against the Plaintiff, UNITED STATES, and further requests that this Court find that Defendant has not engaged in conduct subject to a penalty under IRC §§6700 or 6701, and further finds that injunctive relief is not appropriate or warranted under IRC §§7408 or 7402, and for such other and further relief as this Court deems warranted.

COUNTER-PLAINTIFF PARADIGM SOLUTIONS GROUP, LLC'S
COUNTERCLAIM FOR DECLARATORY JUDGMENT

NOW COMES Counter-Plaintiff, PARADIGM SOLUTIONS GROUP, LLC ("PSG") and for its Counterclaim against Counter-Defendant, UNITED STATES OF AMERICA, alleges as follows:

1. PSG is a Delaware Limited Liability Company with its principle place of business located at 4181 Waterbrook Way, Greenwood, Indiana 46143. Carmelo Zanfei and William P. Crouse, Jr. are member-managers of PSG.
2. Counter-Defendant is the United States of America (the "United States").
3. The Court has jurisdiction over this action under 28 U.S.C. §§ 1340, 1346 and 2201.
4. This claim constitutes a compulsory counterclaim under Rule 13 of the Federal Rules of Civil Procedure in that the claim arises out of the transaction or occurrence that is the subject matter of the United State's Complaint for Permanent Injunction and Other Relief.
5. In or about July 2002, PSG began to market and sell a self-insured medical reimbursement plan commonly known as the HealthIER Plan.
6. The HealthIER Plan had been formulated and initially issued and sold by The Redwood Group, LLC, a Nevada Limited Liability Company, beginning in or about

January 2002 and continuing through June 2002. The entity ceased all activity in or about June 30, 2002, and is now inactive. A copy of the original issued HealthIER Plan Document is attached hereto and made a part hereof as **Exhibit A**. The HealthIER Plan constitutes an accident and health plan under IRC §105(e).

7. In or about August 2003, the HealthIER Plan Document was revised to include a debit card feature. A copy of the current HealthIER Plan Document is attached hereto and made a part hereof as **Exhibit B**.

8. As defined in IRC §105(h)(6), a self-insured medical reimbursement plan is a plan of an employer to reimburse participating employees (or their dependents) for medical care (as defined in IRC §213(d)) for which reimbursement is not provided under a policy of accident and health insurance. As a self-insured medical reimbursement plan, any payments made under the HealthIER Plan to or on behalf of participating employees (or their dependents) on account of medical or hospitalization expenses in connection with sickness or accident disability are not treated as wages for FICA or FUTA purposes pursuant to IRC §§3121(a)(2) and 3306(b)(2). Similarly, any such payments under the HealthIER Plan are not defined as wages for federal income tax purposes pursuant to IRC §3401(a)(20).

9. Pursuant to Section 105(a) of the Internal Revenue Code (26 U.S.C. §105(a)), amounts received by an employee through accident or health insurance for personal injuries or sickness shall be includable in gross income to the extent such amounts are (i) attributable to contributions by the employer which were not includable in the gross income of the employee, or (ii) paid by the employer. However, IRC §105(b) provides, in part, that gross income shall not include amounts referred to in Section 105(a) if such amounts are paid directly or indirectly to the employee to reimburse the employee for expenses incurred by him (or his spouse and dependents) for medical care as defined in IRC §213(d). Under IRC §213(d), the term medical care includes, in part, amounts paid for the diagnosis, cure, mitigation, treatment, or prevention of disease.

10. At all times, reimbursements from the HealthIER Plan to participating employees (or their dependents) were made (and continue to be made) for the specific and sole purpose of covering their incurred eligible medical care as defined in IRC §213(d) (referred to in the HealthIER Plan as “Qualified Expenses”) which are not paid for under a policy of accident and health insurance. The reimbursements are not treated as wages and excluded from the employees’ gross income under IRC §105(b).

11. Under the HealthIER Plan, in the event a participating employee (or his dependents) uses any part of a reimbursement for non-Qualified Expenses or in excess of Qualified Expenses, the employee (or dependent) is obligated under the HealthIER Plan to repay the Plan the erroneous or excess amounts the earlier of (i) 90 days after the end of the Plan Year in which the Claim was incurred, or (ii) the termination of employment. The Plan sets forth procedures for submitting Claims to the Plan Administrator along with supporting documents to substantiate the Claims.

12. Under the HealthIER Plan, the employer is solely responsible for periodically funding the Plan, and the employer’s contributions are for the sole purpose of paying the Qualified Expenses of participating employees (and their dependents). The HealthIER Plan expressly provides that Qualified Expenses subject to reimbursement under the Plan do not include premiums for insurance covering medical care paid in pretax dollars pursuant to a salary reduction election under Section 125 of the Code. As such, the HealthIER Plan does not violate and is consistent with the holding of Rev. Rul. 2002-3.

13. The HealthIER Plan allows periodic (i.e., weekly, monthly, quarterly, etc.) reimbursement dollars to be made available to participating employees (and their dependents) solely for eligible medical care (Qualified Expenses) as defined in Section 213(d), and participating employees (and their dependents) are required to sign “Medical Expense Reimbursement Acknowledgment” Forms evidencing same. A copy of the Medical Expense Reimbursement Acknowledgment Form is attached hereto and

made a part hereof as **Exhibit C**. As set forth in paragraph 11 above, should any part of periodic reimbursement dollars made available to participating employees (and their dependents) be used for non-Qualified Expenses or in excess of Qualified Expenses, the employee (or dependent) is obligated under the HealthIER Plan to repay the Plan the erroneous or excess amounts.

14. An actual controversy exists between PSG and the United States as to whether employer reimbursements (including periodic reimbursements) to participating employees (or their dependents) under the HealthIER Plan for Qualified Expenses are excluded from gross income of the employee under IRC §105(b), and correspondingly from employment taxes.

15. The issuance of a declaratory judgment would settle the controversy and serve a useful purpose in clarifying the legal questions at issue.

16. There is no alternative remedy to declaratory judgment that would be better or more effective.

17. WHEREFORE, Counter-Plaintiff PARADIGM SOLUTIONS GROUP, LLC respectfully requests that this Court find and declare as follows:

A. The HealthIER Plan constitutes a self-insured medical reimbursement plan as defined in Section 105(h)(6) of the Internal Revenue Code, and meets the definition of an accident and health plan under IRC §105(e);

B. The HealthIER Plan reimburses participating employees (and their dependents) solely for eligible medical care as defined in Section 213(d) of the Internal Revenue Code, and requires participating employees (and their dependents) to pay back to the plan any reimbursement or part thereof which is not used for eligible medical care;

C. The HealthIER Plan does not sanction reimbursing participating employees (or their dependents) for pretax payments of insurance premiums made pursuant to a salary reduction plan (cafeteria plan) under Section 125 of the Internal Revenue Code, and therefore does not violate Rev. Rul. 2002-3;

D. Employer reimbursements to participating employees (or their dependents) under the HealthIER Plan for eligible medical care are excluded from income under section 105(b) of the Internal Revenue Code and do not constitute wages for FICA or FUTA purposes under Sections 3121(a)(2) and 3306(b)(2) or for federal income tax purposes under IRC §3401(a)(20);

E. Under the HealthIER Plan, employers may make periodic reimbursement dollars available to participating employees (or their dependents) for eligible medical care, and such periodic reimbursements do not violate Rev. Rul. 2002-80.

F. The promotion and sale of the HealthIER Plan does not constitute engaging in an activity subject to penalty under IRC §6700.

Respectfully submitted,

PARADIGM SOLUTIONS GROUP, LLC

By: _____
One of its attorneys

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(312) 263-2200
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Firm I.D. 31490

IN THE UNITED STATES DISTRICT COURT FOR THE
NORTHERN DISTRICT OF ILLINOIS
CHICAGO DIVISION

UNITED STATES OF AMERICA,)	
)	
Plaintiff,)	
)	
v.	)	Civil No. 04C-2703
)	
CARMELO ZANFEL; WILLIAM P. CROUSE,	)	Judge Nordberg
JR.; PARADIGM SOLUTIONS GROUP, LLC;)	
and SUPERIOR SOLUTIONS GROUP, INC.	)	Magistrate Judge Denlow
)	
Defendants.)	

**NOTICE OF MOTION TO DISMISS COUNTERCLAIM OF DEFENDANT PARADIGM
SOLUTIONS GROUP, LLC**

To:

Lanc M. Gensburg
Gary Arthur Kanter
Anthony Calandriello
Dale, Jacobs & Gensburg, P.C.
155 North Wacker Drive, Suite 720
Chicago, IL 60603

Please take notice that we will appear before the Honorable Judge John A. Nordberg,
United States District Judge, United States Courthouse, 219 South Dearborn, Chicago, Illinois, in
Room 1801 or the courtroom usually occupied by him, at 2:30 p.m. or as soon thereafter as
counsel may be heard on the 15th day of July 2004, and there and then present the United States'

Motion to Dismiss Counterclaim of Defendant Paradigm Solutions Group, LLC, copies of which are served on you herewith via FedEx.

Dated: July 7, 2004

PATRICK FITZGERALD
United States Attorney



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IN THE UNITED STATES DISTRICT COURT FOR THE
NORTHERN DISTRICT OF ILLINOIS
CHICAGO DIVISION

UNITED STATES OF AMERICA,)	
)	
Plaintiff,)	
)	
v.	)	Civil No. 04C-2703
)	
CARMELO ZANFEI; WILLIAM P. CROUSE,	)	Judge Nordberg
JR.; PARADIGM SOLUTIONS GROUP, LLC;)	
and SUPERIOR SOLUTIONS GROUP, INC.,	)	Magistrate Judge Denlow
)	
Defendants.)	

**MEMORANDUM IN SUPPORT OF MOTION TO DISMISS
COUNTERCLAIM OF DEFENDANT PARADIGM SOLUTIONS GROUP, LLC**

The United States moves this Court to dismiss the counterclaim of Paradigm Solutions Group, LLC, for lack of jurisdiction over the United States.

STATEMENT OF FACTS

The United States brought this Complaint pursuant to §§ 7402(a) and 7408 of the Internal Revenue Code (26 U.S.C.) (I.R.C.) to restrain and enjoin the defendants, including Paradigm Solutions Group, LLC, [Paradigm] from organizing, promoting, marketing, or selling abusive tax shelters, including the HealthIER Plan, that cause customers to attempt to violate the internal revenue laws, unlawfully evade the assessment or collection of their federal tax liabilities, or unlawfully claim improper tax refunds. The complaint alleges that the HealthIER Plan unlawfully causes the defendants' customer-employers to underreport and underpay federal employment taxes by excluding from wages reported on employment tax returns amounts paid to employees as medical expense "reimbursements" for expenses that have not been incurred.

Defendant Paradigm answered and counterclaimed for declaratory judgment. Paradigm requested the Court declare that: the HealthIER Plan constitutes a self-insured medical reimbursement plan as defined under I.R.C. § 105(h)(6) and meets the definition of an accident and health plan under I.R.C. § 105(e); the HealthIER Plan reimburses participating employees solely for eligible medical care as defined in I.R.C. § 213(d); the HealthIER Plan does not violate Rev. Rul. 2002-3 or Rev. Rul 2002-80; employer reimbursements to participating employees under the HealthIER Plan for eligible medical care are excluded from income; and the promotion and sale of the HealthIER Plan does not constitute engaging in an activity subject to penalty under I.R.C. § 6700.

DISCUSSION

Paradigm alleges that this Court has jurisdiction over its counterclaim under 28 U.S.C. §§ 1340, 1346, and 2201. None of these statutes provide a jurisdictional waiver of sovereign immunity for this counterclaim. Section 1340 generally confers original jurisdiction on the federal district courts for “any civil action arising under any Act of Congress providing for internal revenue.” Sovereign immunity, however, is not waived by general jurisdictional statutes such as 28 U.S.C. §§ 1331 and 1340. *See, e.g., Aqua Bar & Lounge, Inc. v. United States*, 539 F.2d 935, 937 (3d Cir. 1976); *Hughes v. United States*, 953 F.2d 531, 539 n. 5 (9th Cir. 1992) (“[t]hese general jurisdictional statutes [28 U.S.C. §§ 1331 and 1340] cannot . . . waive the government's sovereign immunity”); *Lonsdale v. United States*, 919 F.2d 1440, 1443-1444 (10th Cir. 1990); *Smith v. Booth*, 823 F.2d 94, 97 (5th Cir. 1987). The jurisdiction conferred by such statutes is limited to cases where the Government has otherwise consented to be sued; section

1340 does not, by itself, constitute a waiver of sovereign immunity. It merely authorizes proceedings in which the United States has consented to be sued in some other statutory provision. *Murray v. United States*, 686 F.2d 1320, 1324 (8th Cir. 1982), cert. denied, 459 U.S. 1147 (1983).

Neither does 28 U.S.C. § 1346 operate as a waiver of the Government's sovereign immunity in this case. Although that provision confers jurisdiction on the district courts for civil actions seeking the recovery of taxes erroneously or wrongfully collected under the internal-revenue laws, Paradigm has not alleged any erroneous or wrongful collection of taxes.

The Declaratory Judgment Act, 28 U.S.C. § 2201, does not operate to waive sovereign immunity in the present case. The tax exception clause of the Declaratory Judgment Act specifically prohibits declaratory judgments "with respect to Federal taxes." *1/ Commercial National Bank of Chicago v. Demos*, 18 F.3d 485 (7th Cir. 1994). The purpose of the tax exception clause is to protect the administration of the tax system from premature judicial

1/ In pertinent part, Section 2201 provides (emphasis added):

(a) In a case of actual controversy within its jurisdiction, except with respect to Federal taxes other than actions brought under section 7428 of the Internal Revenue Code of 1986, . . . any court of the United States, upon the filing of an appropriate pleading, may declare the rights and other legal relations of any interested party seeking such declaration, whether or not further relief is or could be sought. Any such declaration shall have the force and effect of a final judgment or decree and shall be reviewable as such.

Section 7428, I.R.C., allows declaratory judgments relating to the classification of organizations as tax-exempt under Section 501(c)(3) of the Code, and thus has no relevance here.

interference, and to limit tax litigation generally to Tax Court suits and refund suits. *See Bob Jones University v. Simon*, 416 U.S. 725, 732-33 n.7 (1974); *Flora v. United States*, 362 U.S. 145, 164-65 (1960). The Senate Report accompanying the enactment of the tax exception clause states that:

[t]he application of the Declaratory Judgments Act to taxes would constitute a radical departure from the long-continued policy of Congress . . . with respect to the determination, assessment and collection of taxes. Your committee believes that the orderly and prompt determination and collection of Federal Taxes should not be interfered with by a procedure [the Declaratory Judgment Act] designed to facilitate the settlement of private controversies, and the existing procedure both in the Board of Tax Appeals [the predecessor of the Tax Court] and the courts afford ample remedies for the correction of tax errors.

S. Rep. No. 1240, 74th Cong., 1st Sess. 11 (1935), *reprinted in* 1939-1 Cum. Bull. (Pt. 2) 651, 657. Thus, as the Supreme Court observed in *Bob Jones University*, 416 U.S. at 732 n.7, “[t]he congressional antipathy for premature interference with the assessment or collection of any federal tax also extends to declaratory judgments.” *See also McCabe v. Alexander*, 526 F.2d 963, 965 (5th Cir. 1976).

Paradigm alleges in its counterclaim that the cause of action does not seek to enjoin or restrain the assessment or collection of tax, and therefore the federal tax exclusion to the Declaratory Judgment Act is inapplicable. The prohibition in the Declaratory Judgment Act applies to any request for declaratory relief “with respect to Federal taxes,” and is not limited to requests that are aimed directly at restraining the assessment or collection of any tax. *See Bell v. Rossotti*, 227 F. Supp. 2d 315, 319 (M.D. Penn. 2002)(Declaratory Judgment Act prohibits court

from entering judgment with respect to assertions of tax law as they appear on plaintiff's websites).

The question whether the promotion and sale of the HealthIER Plan trust is an activity subject to penalty under I.R.C. § 6700 is central to the issue of whether the defendants should be enjoined under I.R.C. Section 7408 from further selling the scheme. If, as the United States contends, the HealthIER Plan unlawfully causes the defendants' customer-employers to underreport and underpay federal employment taxes by excluding from wages reported on employment tax returns amounts paid to employees as medical expense "reimbursements" for expenses that have not necessarily been incurred, then the promotion and sale of the HealthIER Plan should be enjoined. If on the other hand, as Paradigm contends, the HealthIER Plan constitutes a self-insured medical reimbursement plan as defined under I.R.C. § 105(h)(6), the United States would not be entitled to an injunction under § 7408. Paradigm's request for declaratory judgment on this issue is thus unnecessary and inappropriate, as well as being beyond the Court's jurisdiction.

CONCLUSION

Paradigm's counterclaim against the United States is barred by the federal tax exception to the Declaratory Judgment Act. The court lacks jurisdiction over the United States with respect to the counterclaim. Accordingly, the counterclaim should be dismissed.

PATRICK FITZGERALD
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IN THE UNITED STATES DISTRICT COURT FOR THE
NORTHERN DISTRICT OF ILLINOIS
CHICAGO DIVISION

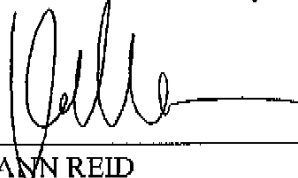
UNITED STATES OF AMERICA,)	
)	
Plaintiff,)	
)	
v.	)	Civil No. 04C-2703
)	
CARMELO ZANFEI; WILLIAM P. CROUSE,	)	Judge Nordberg
JR.; PARADIGM SOLUTIONS GROUP, LLC;)	
and SUPERIOR SOLUTIONS GROUP, INC.	)	Magistrate Judge Denlow
)	
Defendants.)	

NOTICE OF SUBSTITUTION OF COUNSEL

Please enter the appearance of Kari M. Larson of the United States Department of Justice,
Tax Division, in place of Stephanie Page, as attorney for the United States.

Dated: July 7, 2004

PATRICK FITZGERALD
United States Attorney



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CERTIFICATE OF SERVICE

IT IS HEREBY CERTIFIED that service of the foregoing **NOTICE OF MOTION TO DISMISS COUNTERCLAIM OF DEFENDANT PARADIGM SOLUTIONS GROUP, LLC, MOTION TO DISMISS COUNTERCLAIM OF DEFENDANT PARADIGM SOLUTIONS GROUP, LLC, SUPPORTING MEMORANDUM and SUBSTITUTION OF COUNSEL** was made on this 7th day of July, 2004 by mailing a true and correct copy thereof, by FedEx, to the following

Lane M. Gensburg, Esquire
DALE & GENSBURG, P.C.
155 North Wacker - Suite 720
Chicago, Illinois 60606



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