

GARDEN STATE CLE LESSON PLAN

A 1.5 credit course

**FREE DOWNLOAD
LESSON PLAN AND EVALUATION**

INTRODUCTION TO INCOME TAX EVASION

With

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Program description

Our government is fueled by money and lots of it. In order to keep the government running we need to collect taxes. Our system is based on the honor system. This 1.5 credit CLE will show you what happens to the people who are less than honest when reporting their taxes.

I. Introduction

- **Criminal Trial Attorney from Public Defender's Office in Monmouth County**
- **Income tax is area of specialty**
- **Graduated law school and completed LLM a few years later**
- **Classes in corporate taxation, partnership taxation, civil tax procedure – understand procedural aspect of tax as well as substantive area of tax**

II. The Process of bringing the case to the US Attorney's Office

- **"willfulness" – government must prove that taxpayer willfully violated obligation to pay taxes**
- **Willfulness is a state of mind**
- **IRS conducts audits and looks for "badges of fraud" – if those badges of fraud are blatantly then referral to criminal investigation – enforcement arm of IRS**
- **Criminal investigation looks into matter as referral from revenue agent then escalate to US Attorney's office**
- **Willfulness = 2 prong approach – prove knowledge and purposefulness to evade the collection of tax**
- **Cannot be merely reckless or negligent**
- **Case may go to Washington for presentation to grand jury when many factors are in the case:**
 - **Pattern – 1 year is not so much a problem as a 4-7 year pattern of under-reporting and sufficient badges of fraud are present**
 - **Tax protestor – someone in the past who has engaged in similar conduct**
 - **Looking for pattern over a course of years and past history where tax payer has engaged in this type of conduct**
- **If only 1 year, attorneys can probably assist the client by pitching to the IRS/US Attorney that it was only a mistake or oversight that this client is "a nobody" and putting him in jail would not benefit anyone**
- **DOJ Tax and IRS have limited resources to pursue criminal prosecutions so they reserve them for high profile cases and specific targets (attorneys, accountants, professionals that should know better)**

- **For normal, everyday person it is a matter of getting on the phone with the IRS and maybe have forensic accountant look at the issue and may find where taxpayer over reported – so what was originally an unreported income, the taxpayer actually paid more taxes – file 1040X to correct**
- **Recommended if you pick up on any errors in prior years you should correct them as soon as possible**
- **For isolated year for client who has no prior record – can work out unofficially – must pay tax, must pay interest and pay penalties, but won't have to deal with federal criminal justice system**
- **Tax protestors - 2 different types:**
 - **People who are not complying with the law on a personal level because don't think it applies to them or some constitutional argument**
 - **Individuals who exercise their rights under the First Amendment**
 - **IRS lumps both into one category and considers them all tax protestors**
 - **On an individual level they may distinguish – but for most purposes they are the same**
- **When tax deficiency in 6 figures over a number of years – it raises eyebrows and is more likely than not to be a tax evasion case**
- **For professionals – making large incomes but so leveraged and have nothing to show for it (mortgages, cars, vacation homes, etc.) – living hand to mouth – opportunity to hide income**
- **Professionals living abroad and have foreign bank accounts - IRS has special amnesty program to come into compliance without risk of prosecution – issue becomes a race because if IRS discovers the tax payer by bank's voluntary reporting first then the tax payer loses the opportunity for amnesty and faces criminal prosecution**
 - **Cayman Islands, Switzerland, Japan, Philippines...**
- **Red flags for the service – computer based algorithms to review returns and certain keys that computer picks up on and will prompt human review**
 - **Income – certain levels – cash businesses, small mom and pop businesses where there is a lot of cash but income reported is less than what should be the case – relationship between income and type of business**

- **Location**
- **Zip Code and income based on zip code**
- **Expenses – expect expenses within a certain range depending on type of business**
- **Home office – could be a trigger – depending on situation – fact specific**
- **Income and expense levels for previous years – one of the biggest cues – look to see change in circumstances as well**
- **Off shore bank – lots of trips overseas (not illegal to have offshore bank account, but need to report it) – if relocate overseas and forget need to continue to report worldwide income, not just income earned in US – even if no longer living in US does not excuse reporting**
- **Sources of income – not regular salary – stocks, sale of stocks, sale of business property (ways to shelter income, i.e. putting property in a trust before selling), basis problems (taxpayer misrepresents underlying value of property that is being sold to minimize profit)**
 - **IRS knows that tax code is difficult to understand therefore IRS understands that there may be errors – lay person vs. tax preparer – government willing to allow for mistakes**
- **Failure to file – not many years must pass in order to raise a flag, taxpayer should not think that just because don't have money now to pay tax then don't need to file – still need to report – strong position by IRS against non-filers**
 - **Inability to pay tax that is assessed – criminal?? – it is if it is willful – government must show that knowing and with purpose and taxpayer knew that he had to pay and willfully did not pay**
- **Deficiency to assessment:**
 - **Audit occurs – if deficiency (difference between what was reported and what IRS believes owes) – 30 day letter/IRS agent's report – explain owes more money than reported on return;**
 - **30 days to contest the deficiency**
 - **Allowed to go to appeals level (department in IRS considered impartial and separate from revenue agent side) – administrative hearing; neutral and detached person;**

opportunity to dispute the merits of the underlying tax liability;

- **If lose appeal, right to challenge underlying tax liability is not gone, taxpayer can still wait for notice of deficiency to arrive and has 90 days to file petition in tax court – have opportunity to present case to a judge**
- **Another option to pay tax and take government to court and sue – must sue in federal court**
- **Tax court don't have to pay deficiency to file claim**
- **Court of claims – must pay tax deficiency to file a claim**
- **If pay taxes then not liable for the interest**
- **Each case should be evaluated on case by case basis**
- **Advise client to pay assessment to stop interest from accruing; sue in court of claims (federal) – if win, get \$\$ back plus interest but then have to pay income tax on the interest that IRS gives you**

III. Innocent Spouse Doctrine

- **Husband and wife who were filing a joint return**
- **Over the course of time, couple separates and “innocent” spouse might find out later that other spouse under-reported income on joint return**
- **Theoretically both liable – both signed return = both liable**
- **Innocent spouse defense – other spouse never told about unreported income**
- **Spouse is jointly and severally liable for the tax**
- **IRS looks at person who is actually liable for the tax**
- **3 elements to use this defense**

IV. Tax policy

- **Single**
- **Married filing separately**
- **Married filing jointly**
- **Lowest rates for married taxpayers**
- **Tax law used to encourage marriage by reducing tax burden for married couples (1950s) – motive by government to keep couples together**
- **As spouses both started working, discourages spouses who are working**
- **If one spouse pays top tax bracket and other spouse goes to work even in minimum paying job – the other spouse pays at top tax**

- bracket as well – so the policy has shifted because there is a “penalty” to remained married**
 - **Now little incentive for other spouse who does not work to find a job**
 - **Purpose of tax laws is to generate revenue for government to function**
 - **Politicians have social agenda items and utilize tax code to promote agenda items – able to tax certain behaviors or not depending on issue**
 - **Should tax laws be devoid of social policy?**
 - **No way to disconnect taxes from social policy**
 - **Recent news items: Walmart – latest criticism is that large number of employees must use food stamps to survive, even if full time, use governmental subsidies to get by; in essence is the average taxpayer subsidizing Walmart because of these subsidies**
 - **Tax payers are subsidizing people who buy property because tax credit for mortgage payments**
- V. Alternative Minimum Tax (AMT)**
- **An income tax imposed by the US government on individuals, corporations, estates, and trusts; imposed at a nearly flat rate on an adjusted amount of taxable income above a certain threshold (exemption); exemption is substantially higher from regular income tax.**
 - **Occasionally comes up on tax evasion issues**
- VI. Defending a tax evasion case**
- **Cases come in at different stages of prosecution**
 - **Typically best case scenario is to get to an attorney sooner than later – on the heels of learning there will be an audit if suspect that there are going to be irregularities**
 - **Have objective evidence about what is going on – have accountant review the returns**
 - **Question client closely**
 - **Determine what IRS is interested in**
 - **“Audit the auditor” – trying to trail what the auditor is doing and keep tabs on who the examiner and the IRS are speaking to – what they are doing**
 - **Revenue agent has obligations – if uncover badges of fraud, examiner cannot hold the case to continue to build the case while**

- conducting a civil audit; the case passes to “fraud specialist” who is supervisor of agent and will look at case whether there are badges of fraud – if yes, then referred to CI**
- **Attorneys know that referred to CI if all of a sudden agent stops communicating with attorneys**
- **Advise clients that after attorney has been retained only attorney will talk to IRS or agent – if anything client feels is important should be communicated to attorney and then attorney will decide whether to disclose – one misstep can trigger a referral to CI**
- **Must cooperate with agent while not providing basis to move case to CI**
- **Most of the time attorneys are able to talk to revenue agent and resolve cases before going to CI in Washington**
- **Agents want to make an iron-clad case for trial**
- **“Proffer” – go to US Attorney’s office and sit with agent and AUSA; must happen before determination made to prosecute; very last event before decision by Washington to prosecute**
- **Cases are typically farmed out to regional US Attorney’s office – before this happens AUSA and taxpayer’s attorney will meet and discuss issue to see if can be resolved**
- **AUSA may be agreeable to resolving case more than the IRS and attorney from chief counsel’s office**
- **Always money on the table – tell client to put money on the table and it must be more than the tax**
- **Cannot always buy your way out as there may be a special need to prosecute, i.e. deterrence – try to save limited resources for biggest cases – media attention**
- **US Attorney’s office has high success rate at trying cases – only try 1% of cases and usually get guilty verdicts**
- **Cases are not supposed to be lost – cases are scrutinized because there must be a payoff for the government at the end of the day – not necessarily monetary payoff – government not in the business of losing cases**
- **Once it is decided to go forward with criminal prosecution the government has inexhaustible resources**
- **Government has time to vet the case and build the case before going to trial – not unique to tax cases**
- **An acquittal is an extremely rare situation**
- **As a defense attorney – majority of cases not dealing with issues of guilt or innocence, client indicted, dealing with sentencing**

- **Once client indicted – opportunity to work case out**
- **Look at US Sentencing Guidelines – contain variables to be reviewed for potential range of sentences**
- **Tax evasion client without prior convictions – lower sentencing category from outset – but does not guarantee no prison – amount of tax deficiency will dictate the potential sentence**
- **In plea negotiations, have a forensic accountant review returns and if there is a different amount of deficiency from what the government is alleging then introduce that to the government during negotiations – and then can become an issue at trial**
- **One element at trial is a tax due and owing – element of the offense that government must prove**
- **Net worth cases are frowned upon**
- **Sentencing guidelines – advisory in nature**
- **Will client plead guilty? – accepts responsibility takes off 2 points on sentencing calculation – can be the difference between prison and probation**
- **Clients can get probation – based on individual circumstances and amount of deficiency – fact sensitive**
- **Can structure a plea deal where there is a potential of prison but the arguments that are made at sentencing may persuade judge to sentence taxpayer to lower range – because sentencing guidelines are advisory**
- **Many factors to take into consideration in sentencing – health of defendant, family issues**
- **Indicia of significant jail term as a sentence: years of under reporting – pattern of 3-4 years – job of attorney is to minimize prison sentence**
- **Some reform needed at the state level regarding obligations that judges and prosecutors have to make referrals to NJ Division of Taxation - if there is a drug case where they feel there was money that was not reported**
- **Section 61 of Income Tax code covers drug proceeds, bribes, robberies – still must declare as income**
- **Reporting on an income tax return when your income is from criminal activity – is this a violation of 5th amendment protection?**

VII. Controversies

- **Taxpayer returns have been turned over to media, politicians, etc.**

- **Political enforcement of tax laws – to punish or shut down debate for those who do not agree with politics**
- **Cannot be part of IRS because encourages people not to file and take system seriously**
- **Must be faith in the system because it is a self disclosure system**
- **Our country is unique because of self disclosure system – we voluntarily submit returns – so we must have full faith in agency**

VIII. Policy questions/issues

- **Should people be removed from duty to submit tax returns? What is the benefit? Why should percentage of population be excused?**
- **Most legislators agree that everyone should pay some tax – but problem is that people are at different earning brackets/tax brackets**
- **Should 10% of population pay for the rest of the people?**
- **Highly contentious political issues**
- **Flat tax?? Will this limit income tax evasion?**
- **Should everyone contribute something?**
- **Our current system needs fixing but no movement to change system to a flat tax situation**

IX. Advice and background

- **LLM helpful – taught theory to understand tax issue but also procedural aspects of challenging a case and going to federal court**
- **Litigation attorney as well as tax practitioner who understands tax code – AUSA knows that you can go head to head – a worth adversary**
- **Get more flies with honey than you can with vinegar**
- **Take basic class in tax in law school**
- **Apply for internship with IRS and private attorneys**
- **Need a basic course in accounting – learn tax forms**
- **Be practical – if client is pleading guilty – damage control**
- **Take proactive steps to set client on the right track**