

AGGRESSIVE TAX PLANNING, UNETHICAL CONDUCT OR TAX FRAUD

**KAREN HAWKINS
CHUCK MEADOWS
CHAD MULLER**

I. PANEL PARTICIPANTS.

- A. KAREN HAWKINS – Karen is Director of Practice for the Internal Revenue Service from Washington, D.C.
- B. CHAD MULLER – Chad is a tax attorney with Strasburger Price out of San Antonio, Texas.
- C. CHUCK MEADOWS – Chuck is a tax attorney/CPA with the firm of Meadows, Collier, Reed, Cousins, Crouch and Ungerman, Dallas, Texas.

II. DIFFERENCES BETWEEN AGGRESSIVE PLANNING AND TAX FRAUD.

- A. Clients – The type of client you have is probably the most important difference. If they are constantly pushing the envelope or engaged in other unlawful activities, the government will view their and your activities through different glasses.
- B. Money – Yes, sometimes it is simple greed or the need to pay the mortgage that pushes people over the line.
- C. Mistakes – Trying to cover up mistakes or hide or make up documents to support deductions or to characterize income in a different way (capital gain vs. ordinary income) sometimes leads professionals to obstruct justice.
- D. Lack of Knowledge – Sometimes we simply do not appreciate the fact that a certain course of action is improper or illegal.

III. USE OF FORMERLY CIVIL STANDARDS TO PROVE TAX FRAUD

- A. Substance over form.
- B. Economic substance.
- C. Civil penalties with no reasonable cause exception 6707A, for example.
- D. Substantial understatement penalties.

IV. GOVERNMENT IS GETTING MORE SERIOUS ABOUT THESE ISSUES.

- A. Arthur Andersen.
- B. KPMG and E&Y cases.
- C. Tax preparer injunction and criminal cases.

V. KAREN HAWKINS – POWER POINT (EXHIBIT A).

- A. Respond to their inquiries.
- B. Failure to communicate with her office.

VI. CHAD MULLER – DISTINGUISHING TAX EVASION FROM AGGRESSIVE BUT LAWFUL TAX REPORTING (EXHIBIT B).

VII. ABILITY TO RELY ON THE ADVISOR.

- A. Taxpayer asks Chuck about how to report transaction on tax return.
- B. Chuck responds: While the issue is not free from doubt, I think you could report the transaction as follows:
- C. Bottom of e-mail response states:

Required Circular 230 Disclosure: To ensure compliance with requirements imposed by the IRS, we inform you that any U.S. federal tax advice contained in this communication (including any attachments) is not intended or written to be used, and cannot be used, for the purpose of (i) avoiding penalties under the Internal Revenue Code or (ii) promoting, marketing or recommending to another party any transaction or matter addressed herein. This advice may not be forwarded (other than within the taxpayer to which it has been sent) without our express written consent.

VIII. ORDINARY CRIMES FOR ORDINARY PEOPLE.

- A. Taking credits which your clients are not entitled to take and failing to disclose.
- B. Making up deductions for clients because they have not paid in enough tax.
- C. Lying or hiding documents from Revenue Agents during the Audit.
- D. Closing your eyes to items you know are improper.

- E. Trying to cover up mistakes and/or avoid civil penalties

IX. EXAMPLES OF RECENT CASES.

- A. Arthur Andersen shredding documents.
- B. KPMG – Lying to the auditor.
- C. E & Y – Destroying documents and lying to the Revenue Agent.
- D. *Fern v. United States* – Misrepresenting whether taxpayer had substantiation for charitable deductions.
- E. In *U.S. v. Aufferberg*, the government brought a criminal tax case against an investor and several promoters of a USVI economic development corporation. The government alleged at trial that the defendants had engaged in a conspiracy involving \$178 million of fraudulent tax credits. The government lost after seven weeks of trial, when the jury returned 99 “NOT GUILTY” verdicts (all defendants – all counts).
- F. Not so lucky were tax professionals in the KPMG case, E & Y case and BDO case. In each of those cases, several tax professionals were convicted.
- G. Approximately, a dozen tax professionals have been convicted or pled guilty in Texas during the last 12 months to crimes involving the preparation of returns.
- H. The prison sentences for these individuals are considerably longer than they were five years ago and geometrically longer than those received 15 years ago. The rules have changed.
- I. The IRS still has approximately the same number of criminal investigators it had 15 years ago. That was before the “war on terror” took approximately 25% of their work time. As a result, the government is working hard to achieve more publicity and higher prison sentences in the cases which make it to trial and the risks for the return preparer have gotten higher.
- J. Clients often cut deals and testify against the preparer so it is important that the return preparer maintain adequate records concerning his/her communication with the taxpayer. I know CPAs who routinely return all original records to the taxpayer after completing a tax return. This may be a good practice as far as storage costs are concerned but it leaves the CPA vulnerable to later testimony from the client about the records which he/she produced.

X. **SOME QUESTIONS TO THINK ABOUT.**

- A. “What we have here is a failure to communicate.” – The main theme of the movie starring Paul Newman. **Cool Hand Luke** (1967).
- B. Failure to communicate properly with clients and governmental investigators is one of the greatest causes of problems for professionals, if not the most important problem we face.
- C. It starts off with a failure to get an engagement letter signed which lays out the responsibilities of each party. This letter delineates the obligations of the professional. When you prepare a tax return or give tax advice, are you obligated to represent the taxpayer if there is an audit? Who is responsible for determining if the taxpayer has taken a position for which the IRS requires disclosure? Who is responsible for keeping the records supporting the return or the opinion?
- D. When is the taxpayer able to rely upon the tax advice given in order to avoid penalties?
- E. How far can the professional go in representing the taxpayer before the professional can be considered to be misleading the IRS or other governmental investigators? What duty does the client have to disclose information which may conflict with return positions or other financial statements?
- F. What happens when you are rendering advice to more than one party? Is the potential conflict disclosed, waived or even acknowledged? Divorces, partnerships, corporations, shareholders and trusts all can create conflicts, many of which can be waived if acknowledged early on and properly disclosed.
- G. Is the professional who prepared the return or gave the initial advice in a different position than the one who is just representing the taxpayer in the investigation or audit?
- H. What are the obligations of the professional when he/she discovers that the information which has been transmitted to the government or to the other side or to a client who may have a conflicting position, is not correct?
- I. What is the obligation of the professional when he/she discovers that an error has been made on a tax return? Is there a difference if it clearly was a simple mistake or if it was an intentional error in communication?
- J. What difference does it make if the government or adverse party makes a mistake in calculation which is material in resolving an issue with your client?
- K. What happens if the mistake or error is contained in an estate planning document?

- L. In almost all of the above cases, the manner and means of communicating regarding the problem and its solution or correction will help determine the possible consequences?
- M. Some believe it better to ask for “forgiveness” then “permission.” In many cases, the other side will believe the worst if they discover the problem and may believe the worst anyway.
- N. Confession may be good for the soul but not necessarily for the pocketbook!

Enforcement Statistics - Criminal Investigation (CI) Enforcement Strategy

How to Interpret Criminal Investigation Data:

Since actions on a specific investigation may cross fiscal years, the data shown in cases initiated may not always represent the same universe of cases shown in other actions within the same fiscal year.

	FY 2000	FY 2001	FY 2002	FY 2003	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009
Investigations Initiated										
Tax Investigations	1785	1851	2466	2446	2163	2631	2445	2516	2283	2612
Other Financial Crimes	1587	1433	1440	1555	1754	1638	1462	1695	1466	1509
Total	3372	3284	3906	4001	3917	4269	3907	4211	3749	4121
Prosecution Recommendations										
Tax Investigations	1043	1002	1025	1353	1461	1454	1351	1430	1297	1278
Other Financial Crimes	1391	1333	1108	1188	1576	1405	1369	1407	1488	1292
Total	2434	2335	2133	2541	3037	2859	2720	2837	2785	2570
Indictments/ Informations										
Tax Investigations	1122	998	954	1036	1114	1195	1169	1126	1171	1141
Other Financial Crimes	1347	1294	970	1092	1375	1211	1150	1197	1376	1194
Total	2469	2292	1924	2128	2489	2406	2319	2323	2547	2335
Sentenced										
Tax Investigations	1134	906	1023	835	855	1015	996	1112	1016	1113
Other Financial Crimes	1341	1332	1178	933	922	1080	1024	1011	941	1116
Total	2475	2238	2201	1768	1777	2095	2020	2123	1957	2229
Special Agents	2740	2800	2903	2805	2796	2843	2804	2675	2617	2725

Footnotes:

Tax Investigations include all investigations that have a violation of Title 26 (except 26-7203 ML), 18-286, 18-287, 18-371K, 18-371B, or 18-514

Other financial crimes include all money laundering and currency crimes violations not specified under tax investigations.

(See list of [U.S. Code Statutes for which CI has jurisdiction.](#))

Source: Criminal Investigation Management Information System (CIMIS)