Dealing with a Decedent's Tax Issues

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I. Overview

Estate tax returns filed with the Internal Revenue Service ("Service") *will* be reviewed and classified for audit potential. Estate and gift tax auditors return for tax authorities more dollars per capita than any other subdivision of tax, and as such, audits in estate and gift tend to be emphasized. These auditors are most typically lawyers who are well-versed in current planning techniques. These auditors are also increasingly looking at fraud, whether by the decedent during his or her lifetime and by the personal representative when settling the estate.

Fraud in the estate and gift tax context takes many forms. The purpose of this outline is two-fold. First, it introduces readers to ways to identify potential fraud during the decedent's lifetime, resolve that fraud with appropriate governmental agencies, and protect fiduciaries from the lingering effect of the fraud. Second, this outline explains common fraud schemes by personal representatives, the varying criminal and civil penalties which can apply to such fraud, and offers strategies to detect and limit that fraud in the administration of the decedent's estate. Throughout this outline, the authors discusses topics of importance in this increasingly global society; namely, how to resolve undisclosed foreign financial accounts and overlooked international form reporting requirements.

II. File Required Returns and Prepare Them With the Audit in Sight

A. Overview: Estate and inheritance tax fraud may arise in the context of personal representatives who are required to (but do not) file Federal or State estate tax returns. It is important to recall when it is required to file a Federal estate tax return, and when it may be prudent to do so even though technically not required.

1. Note: A number of States impose an estate tax, an inheritance tax, or both. Those States are summarized in the following table, though the filing requirements for the various states are not:

State	Type of Transfer Tax Potentially Imposed
Connecticut	Estate Tax
Hawaii	Estate Tax
Illinois	Estate Tax
Iowa	Inheritance Tax
Kentucky	Inheritance Tax
Maine	Estate Tax
Maryland	Estate and Inheritance Taxes
Massachusetts	Estate Tax
Minnesota	Estate Tax
Nebraska	Inheritance Tax
New Jersey	Inheritance Taxe
New York	Estate Tax
Oregon	Estate Tax
Pennsylvania	Inheritance Tax

Rhode Island	Estate Tax
Vermont	Estate Tax
Washington	Estate Tax

A. Filing the Federal Estate Tax Return

1. When Required or Otherwise Advisable to File:

a. When Required: The personal representative of an estate generally must file Form 706, United States (and Generation-Skipping Transfer) Tax Return, in all cases where the gross estate on the date of death exceeds the basic exclusion amount in effect under I.R.C. § 2010(c) ($11.18 million for 2018 and $11.4 million for 2019). As a general rule, the Form 706 must be filed any time within nine months after the decedent's date of death. See I.R.C. § 6075(a).

b. When Otherwise Advisable to File: With the permanency of portability in 2012, it is generally advisable to file a Federal estate tax return even though one might not otherwise be required. Portability can only be elected on a *timely-filed, complete, and properly prepared estate tax return* of the predeceased spouse whose exemption is intended to be used, regardless of whether the estate of the predeceased spouse is otherwise required to file a tax return. In other words, to claim the predeceased spouse's exclusion amount for the surviving spouse, the personal representative of the predeceased spouse will need to file an estate tax return even if the predeceased spouse's estate is not taxable. For surviving spouse's who could conceivably have a taxable estate, it is therefore a best practice to file a Federal estate tax return to preserve the availability of the deceased spouse's unused exclusion (i.e., his or her DSUE). See I.R.C. § 2010(c)(5).

2. Extension of Time to File Estate Tax Return: I.R.C. § 6081 provides for the extension of time to file an estate tax return. See I.R.C. § 6081(a).

B. Planning: Plan With the End In Sight

1. Anticipate Your Audience: All estate planners should anticipate their audience from the planning stage forward. "Begin with the end in sight" is good advice to follow.

2. Practice Tip 1: Always Use Reputable Appraisal Firms: Use reputable and independent appraisal firms whenever valuing property for purposes of estate planning, whether it be in connection with lifetime gifts or preparing an estate tax return.

3. Practice Tip 2: Ensure Adequate Documentation for the Audit: Ensure that all necessary documentation is completed during the planning process and stored in a safe place so you can attach it to the estate tax return when necessary.

4. Practice Tip 3: Assume That All Relevant Evidence Will Be Reviewed By An Agent and a Judge: Planning with an expectation that all relevant evidence will be reviewed by an estate and gift tax examiner and/or Judge.

5. Practice Tip 4: Rely on Reference Books for Appraisal: Be sure to double check appraisals against standard references materials (e.g., David Laro & Shannon P. Pratt, Business Valuation and Taxes: Procedure, Law, and Perspective (2^{nd} Edition 2011)) and case law dealing with similar issues (e.g., fractional interest discounts, discounts for lack of marketability and lack of control). You may not be an appraiser but you are an intelligent person.

C. Estate Tax Return Preparation: Prepare With the End in Sight

1. Overview: As detailed below, it is a virtual certainty that the estate tax return will be reviewed by the Service. Like the planning process, estate tax returns should be prepared with the audit in sight.

2. Be Sure to Perfect the Return: An estate tax return, signed under penalties of perjury, certifies that the return is “true, correct, and complete.” This means, in addition to making reasoned judgment calls as to how to present a return for examination, that the estate tax return includes all required information and attachments. A common reason for audit is that the estate tax return does not include all required information and attachments. Preparers often overlook (or ignore) the following items that should be included with the return:

   a. Certified copy of will, if decedent died testate;

   b. Certified copy of death certificate;

   c. Form 712, Life Insurance Statement, for all life insurance policies listed on return (i.e., on the life of the decedent);

   d. If alternate valuation is elected, evidence of sale or distribution of assets made during the alternate period;

e. If transfer is by trust, a copy of the instrument;

f. Power of appointment instruments;

g. Appraisals on included real estate;

h. Appraisals on art objects, including paintings, sculptures, tapestries, silverware, or other artifacts, *which are required for art objects with an artistic or intrinsic value of more than $3,000*;

i. Financial data on non-public enterprises;

j. State certification of payment of state death taxes;

k. Copies of Form 709, United States Gift (and Generation-Skipping Transfer) Tax Return, filed by and for decedent;

l. Form 706-CE, Certificate of Payment of Foreign Death Tax;

m. For non-resident citizens, copies of inventory and other documents filed in a foreign probate court; and

n. For non-resident, possibly a former citizen, documents relating to possible expatriation.

3. <u>Secure Powers of Attorney Early:</u>

a. <u>Protection Against Unauthorized Disclosure:</u> I.R.C. § 7213 makes it unlawful for any Federal employee to willfully disclose any return or return information to an unauthorized person. Therefore, the Service has taken significant steps to prevent unauthorized disclosure of returns and return information.

b. <u>Properly Execute Part 4 in the Form 706 Will Authorize Disclosure:</u> A properly executed authorization in Part 4 of the Form 706 grants third party authorization. Be sure to complete this information (some return preparers do not). I.R.M., pt. 4.25.1.5.5.1(1) (Jul. 20, 2018). If Part 4 of the Form 706 is incomplete, a Form 2848, Power of Attorney and Declaration of Representative, should be obtained. <u>Id.</u>

c. <u>Request a Form 2848 in Any Event:</u> Practitioners representing the estate should, after letters of administration have been issued and upon the signing of an engagement letter, have the personal representative or personal representative sign a Form 2848 and/or State-equivalent power of attorney, so that the representative is authorized to discuss the return with the Service, request gift tax returns, etc.

4. Know What the Service Knows When the Return is Prepared: Before preparing the Form 706, arm yourself with the information the Service knows. Doing so will eliminate the potential for allegations of fraud on the part of the personal representative. Specifically, request or perform the following:

   a. Account Transcripts: Request Service account transcripts, including (i) wage and income, (ii) account, (3) gift, and (4) related entity transcripts. Transcripts can be requested by telephone at (800) 908-9946 or online at http://www.irs.gov/Individuals/Get-Transcript;

   b. Prior Years' Gift Tax Returns: Order prior years' gift tax returns from the Service by filing Form 4506, Request for Copy of Tax Return. Note the $50 fee for each return requested, which is nonrefundable if no return is found;

   c. Copies of Predeceased Spouse's Estate Tax Return: If you were not the practitioner who prepared the predeceased spouse's estate tax return, request a copy of this return from the personal representative, or if necessary, the Service, by preparing Form 4506. The Service will request a copy of this return and you should have similar information available to you. Make sure that all assets reported on the predeceased spouse's return are accounted for (or their disposition explainable by you) in connection with the preparation of the estate tax return before you;

   d. Stock Books: To the extent there were closely held business, it is important to obtain copies of stock books (or other books and records of the business showing transfers of equity in the company). The Service is increasingly looking to these stock books to determine if there were transfers of the business to younger generations and then cross-checking those books and records to determine whether all required gift tax returns were filed;

   e. Deed Searches: It is advisable to perform deed searches of the decedent's real estate holdings to determine whether all transfers of real estate (for Medicaid planning or otherwise) were reported for gift tax purposes;

   f. Last Three Years of Income Tax Returns: Request the last three years of the decedent's federal and state income tax returns to understand sources of income and assets held (the estate tax return preparer will need to provide the last full year's return for some states (e.g., New Jersey));

g. <u>Last Three Years of Bank Statements:</u> Request the last three years of the decedent's bank statements to understand sources of income, potential liabilities, and claims against the estate;

h. <u>FOIA Requests:</u> Practitioners should submit to the Service Disclosure Office a Freedom of Information Request Act, 5 U.S.C. § 552, et seq. ("FOIA") with respect to the six years prior to the decedent's date of death. If the estate tax return is selected for audit, practitioners should make regular FOIA requests to the Service and request third parties to whom summonses have been issued to provide a copy of all records produced to the Service. This will allow the practitioner to monitor the case and ensures that he or she has all information in the Government's possession;

i. <u>Credit Checks:</u> Perform a credit check on the decedent to learn of liabilities and expenses of the estate;

j. <u>Westlaw's Adverse Judgment Search:</u> Use Westlaw to conduct an adverse judgment search to learn of liabilities and expenses of the estate;

k. <u>Accurint:</u> Use LexisNexis to conduct an Accurint search, which provides detailed information available on businesses and individuals, as well as their assets (including real estate), relatives, and associates;

l. <u>TLO:</u> Use Transunion TLOxp ("TLO"), to search personal information, bankruptcies, foreclosures, liens, judgments, assets, and professional licenses, in addition to other items; and

m. <u>Google Searches:</u> Use Google to understand the decedent and obtain any information about the decedent disseminated on the Internet.

5. <u>Address Common Audit Issues in Preparing the Estate Tax Return:</u> Make no mistake, much of your function as a lawyer is to protect your clients from themselves. Trust what your client tell you, but verify it. Be sure to anticipate the most commonly audited issues when preparing the estate tax return and, topic-by-topic, ask yourself if you have addressed the following to minimize the allegations of fraud:

a. <u>Adjusted taxable gifts</u>

(1) Have all lifetime gifts been reported on Form 709 and line 4 of Form 706?

(2) Have you reported any gift tax the decedent paid with respect to lifetime gifts on line 7 of Form 706?

(3) If annual exclusions were claimed, did the donee receive a present interest in the transferred property?

b. Schedule A - Real Estate

(1) If the property was not sold, is the fair market value determined on the basis of a reliable appraiser with a copy of the appraisal attached to the return?

(2) If the property was sold in an arm's length transaction, is the sales price reflected?

(3) Are you improperly reporting real estate held jointly (that property should be reported on Schedule E) or real property held by a revocable trust (thot property should be reported on Schedule G)?

c. Schedule A-1 - Alternate Use Valuation

(1) Was alternate use valuation property elected and applied on the tax return?

(2) Did you include a copy of the lien to the estate tax return?

(3) Did the estate have a qualified use, did it meet the material participation tests before and after death, and are the liquidity requirements met?

d. Schedule B - Stocks and Bonds

(1) Did you properly identify the securities held (e.g., did you include the number of shares, the CUSIP number or ticker symbols, the exchange on which the stock is traded, and the type of security)?

(2) Did you properly account for accrued interests and dividends?

(3) Did you check the stocks and bonds reported against the dividends and interest reported on the decedent's Form 1040?

(4) Are you improperly reporting stocks and bonds held by a revocable trust on Schedule B (those items should be reported on Schedule G)?

e. Schedule F - Closely Held Businesses[1]

(1) Does the governing entity instrument contain requirements for determining the sales price of the

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[1] Some states, such as New Jersey, require the submission of additional information in the context of valuing a closely held business. The instructions to the New Jersey Inheritance Tax Return provides as follows:

> If the decedent had any interest in a closely held corporation, submit (in addition to the general information required above):
>
> 1. For the five year period preceding the decedent's date of death:
>   A. A listing of salaries paid to officers.
>   B. A listing of dividends paid, together with the name(s) of the payees.
>
> 2. Copy/copies of any stock purchase or option agreement to which the decedent was a party as of the date of death.
>
> 3. Copy/copies of any insurance policy/policies on the decedent's life payable to the corporation as beneficiary together with a statement of the benefits payable thereunder.
>
> 4. The number of shares of stock of all classes issued and outstanding and the par value thereof.
>
> 5. List of stockholders setting forth the number of shares held by each.

Partnerships and joint ventures must provide a copy of the partnership agreement, any mutual purchase agreements the decedent was a party to, and any insurance policies on the decedent's life payable to the surviving partners. Sole proprietorships are required to identify any of the sole proprietorship's assets that are listed elsewhere on the return.

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closely held business interest? If so, did you adhere to those standards?

(2) Does the closely held business have an established practice for determining the fair market value of the closely held business interest if not disclosed in the agreements? If so, were you consistent in following that approach on the estate tax return?

(3) Are there rights of first refusal which might result in a reduction of the fair market value?

(4) Is the value determines on the basis of a reliable appraisal? Review the entity's tax returns and financial statements to determine the fair market value of the shares.

(5) Have you reviewed for appropriate discounts (e.g., lack of marketability, lack of control, built in gains, key person, etc.)? Is the discount reasonable in the light of existing case law?

f. <u>Schedule C - Mortgages, Notes, and Cash</u>

(1) Did you report self-canceling installment notes, forgiveness of indebtedness, installment sales, promissory notes that are not at arm's length, and below market loans? If so, did you comply with all requirements to take the treatment you are taking?

(2) Are you improperly reporting cash held by a revocable trust on Schedule C (those items should be reported on Schedule G)?

(3) Are you improperly reporting joint checking accounts on Schedule C (those items should be reported on Schedule E)?

g. <u>Schedule D - Life Insurance</u>

(1) Did you attach a Form 712 for each life insurance policy on the life of the decedent?

(2) To the extent the life insurance is excludible under a life insurance trust, have proper Crummey notices and powers been given?

(3) Did you attach copies of all trust agreements excluding the life insurance?

h. Schedule E - Joint Owned Property

(1) If you are reporting only a fraction of a property's fair market value because of joint ownership, do you have proof of contribution by another party (either by check or affidavit, if necessary)?

(2) Is the payment of expenses and mortgage indebtedness consistent with fractional ownership?

(3) If fractional interests are claimed,

(a) is the fractional interest warranted (i.e., was the property held as tenants in common), and

(b) is the amount of the fractional interest reasonable in the light of existing case law?

i. Schedule F - Misc. Property

(1) Did you report jewelry, antique cars, club memberships, collectibles, etc? Are these items reported on an insurance rider that the Service may request?

(2) If dealing with family limited partnerships, consider the following:

(a) Did the formation and funding of the partnership result in an indirect gift?

(b) Have you examined whether the interest is includible under I.R.C. § 2036 (retained life estate), I.R.C. § 2037 (transfers taking effect at death), or I.R.C. § 2038 (revocable interests)?

(c) If discounts are claimed, were the discounts reasonable in the light of existing case law?

j. Schedule G - Transfers During the Decedent's Life

(1) Did you report as taxable gifts within three years of death?

(2) Are there revocable trusts? If so, include a copy of the revocable trust agreement with the estate tax return.

(3) Has the value of all transfers to revocable trusts been reported on Schedule G?

(4) Did the decedent have a general power of appointment over a revocable trust that should be reported on Schedule H?

k. Schedule H - Powers of Appointment

(1) Did the decedent have a general power of appointment in a trust created during life?

(2) Did you include copies of the instrument granting the decedent the power of appointment?

l. Schedule I - Annuities

(1) Did you report annuities or a retirement benefit (e.g., IRA, 401(k), etc.) the decedent owned that are payable to a beneficiary at his or her death?

(2) Is the value of the annuity properly calculated?

(3) Did you check income tax returns to determine the annuities the decedent was receiving at death?

m. Schedule J - Expenses Incurred During Administration

(1) Are the expenses claimed as deductions necessarily and reasonably incurred by the estate for the collection of assets, payment of debts, or the distribution of property to the persons entitled to it;

(2) Are executors’ commissions properly calculated in accordance with local law, the governing instrument, or otherwise?

(3) Is it better to claim attorneys' fees and accountants' fees on the estate's income tax return (i.e., in which top marginal bracket will your beneficiaries be)?

(4) Were the expenses actually paid and reported on the personal representative's personal income tax return?

(5) Should you file a protective claim for refund in the event additional attorneys' fees or incurred in connection with the audit of the return?

n. Schedule K - Debts of the Decedent

(1) Were the debts actually paid?

(2) Do you have proof of the indebtedness?

o. Schedule M - Marital Deduction

(1) Were disclaimers filed? If so, attach a copy of the disclaimer to the estate tax return?

(2) Have you reduced the deductions on Schedule J, K, and L for any marital deduction claimed with respect to the asset?

p. Schedule O - Charitable, Public, and Similar Gifts and Bequests

(1) Have you complied with the substantiation requirements for charitable gifts and bequests?

q. Schedules R and R-1 - Generation Skipping Transfer Tax Return

(1) Have generation-skipping transfers been made at death or during life? Has the GST applicable exclusion amount been allocated correctly?

r. Portability

(1) Was portability properly elected by filing a Form 706 for the predeceased spouse?

(2) Have you examined the predeceased spouse's return for potential adjustments to the deceased spouse unused exclusion amount carrying forward to the decedent's estate tax return)?

D. Examinations of Estate Tax Returns - An Overview

1. Returns Will Be Examined: All estate tax returns are processed in Cincinnati, Ohio. Unlike other returns, which are subject to a "lottery", all estate tax returns are individually reviewed during "classification" to determine audit potential and identify the key issues for examination. During classification, classifiers (as compared with examiners) are required to review all schedules on returns to identify any significant issues. IRM, pt. 4.25.3.4.1(1) (Jul. 23, 2018).

a. The Normal Scope of an Examination: As a general rule, all significant issues are to be identified during classification and detailed on a classification sheet. Normally, all issues addressed on the classification sheet should be addressed during the examination and documented in the examiner's workpapers.

b. Exceptions to the Normal Scope of an Examination: The exceptions to the normal scope of an examination are as follows:

(1) Limited Scope Examinations (i.e., those where only one or two issues are selected for examination, typically conducive to a correspondence examination), I.R.M., pt. 4.25.1.2.1 (Aug. 6, 2015), and

(2) Project Cases (i.e., areas where the Service has identified a potential for abuse and a heightened interest). I.R.M., pt. 4.25.1.2.2 (Aug. 6, 2015).

c. Assignment of the Estate Tax Return and the Auditor: Depending upon the audit issue(s) classified, each case will be given a grade of complexity. Returns with more complex issues will be assigned to a more senior estate and gift tax examiner (usually an attorney); returns with less complex issues will be assigned to a less senior estate and gift tax examiner (sometimes an attorney).

2. Timing of Classification and Examination: Estate tax return audits are usually initiated within nine months after filing. Absent special circumstances (e.g., someone filing a reward application two years after the estate tax return is filed), estate tax return audits are usually concluded no later than 18 months after filing. See I.R.M., pt. 4.25.1.5.1 (Jul. 20, 2018).

3. Using Transcripts to Understand the Events Following Classification:

    a. In General: As a general proposition, the following events can happen post-classification: (a) the case is not selected for field consideration (i.e., the return will be accepted as filed); or (b) the case is selected for field consideration (i.e., the return is being audited).

    b. Cases Not Selected for Field Consideration: After it has been determined that a return will be accepted as filed, the Campus Center will take the following steps:

        (1) Close the Audit Information Management System (AIMS) using disposal code 20 (Accepted as Filed or disposal code 35 (Surveyed Excess Inventory);

        (2) Assure the return has a stamp to indicate "Accepted as Filed" by classification; and

        (3) Issue Letter 627, Estate Tax Closing Letter. See I.R.M., pt. 4.25.3.5.1 (Jul. 23, 2018).

    c. Cases Selected for Field Consideration: For selected estate tax returns, the Campus Center will send the return to a field office for review, completing necessary forms along the way (e.g., Form 3210, Document Transmittal). See I.R.M., pt. 4.25.3.5.2 (Jul. 23, 2018).

4. Statute of Limitations Applicable to Estate Tax Returns:

    a. General Rule: When a taxpayer files a return, the Service is legally empowered to assess the reported tax. I.R.C. § 6201. As a general rule, the Service must assess the estate tax within three years from the later of (1) the due date of the return, or (2) three years of the date the return is filed. See I.R.C. § 6501(a).

(1) Common Exception # 1: False or Fraudulent Return: When a false or fraudulent return has been filed with the intent to evade tax, the tax may be assessed at any time. See I.R.C. § 6501(c).

(2) Common Exception #2: Omitted Income: The Internal Revenue Code ("Code" or "IRC") allows for an extended six-year statute of limitations on assessment where omitted items includible in a gross estate exceed 25% of the total gross estate reported on the estate tax return IRC 6501(e)(2).

b. Period of Limitations for Assessment of Estate Tax May Not Be Extended by Agreement: Although the Service and the taxpayer can agree to extend the statute of limitations, the statute of limitations on assessment of the estate tax cannot be extended. See I.R.C. § 6501(c)(4). This means that a deficiency must either be assessed or a statutory notice of deficiency mailed to the taxpayer, prior to the expiration of the statute of limitations.

c. DSUE Not Subject to Statute of Limitations on the First to Die: Review of the DSUE is not subject to the statute of limitations on the first to die, which means that the Service can examine a predeceased spouse's DSUE on audit of the surviving spouse's death. See I.R.C. § 2010(c)(5)(B).

d. Calculating the Statute of Limitations: The following chart may be helpful to calculate the period of limitations for assessment:

Returns Without Filing Extensions	Statute Runs From:
Return mailed and received on or before due date	Due date of return
Return mailed and received after due date	Date return received
Return mailed on or before due date but received after due date	Due date of return
Returns With Filing Extensions:	Statute Runs From:

Return mailed and received on or before extension date	Date return received
Return mailed and received after extension date	Date return received
Return mailed on or before extension date but received after extension date	Postmark date of return

1. <u>Characters in the Cast:</u> The typical case of character in an estate tax audit include the following:

   a. *Personal Representative, Executor, or Administrator:* The personal representative, executor, or administrator is a court-appointed fiduciary of the estate charged with, among other fiduciary responsibilities, filing an estate tax return and representing the estate during the audit and any ensuing litigation;

   b. *Estate and Gift Tax Examiner:* The estate and gift tax examiner is an Internal Revenue Service ("Service") employee who is charged with auditing the estate tax return for compliance with the Federal estate and gift tax laws;

   c. *Appeals*: The Service's Office of Appeals ("Appeals") is an independent organization within the Service whose mission is to help taxpayers and the Service resolve tax disagreements without litigation;

   d. *CI*: The Service's Criminal Investigation Division ("CI") is the law enforcement division of the Service;

   e. *TAS*: The Taxpayer Advocate Service, which is an independent organization within the Service whose mission is to ensure that all taxpayers are treated fairly and that the taxpayers' rights are understood and respected; and

   f. *Chief Counsel* and *Division Counsel*: The Service's Chief Counsel (based in Washington, D.C.) and its Division Counsel (based locally) are the Commissioner's attorneys who litigate cases and advise with respect to, among other things, estate tax audits.

2. The 80/20 Rule: Examination activity should be commensurate with the time charged to the case. I.R.M., pt. 4.25.1.5.3 (Jan. 9, 2014). Estate and gift tax examiners adhere to the mantra that 80% of the tax determined to be due will come from 20% of the issues identified for audit. Thus, estate tax return audits tend to be highly focused.

3. Key Revenue Raiser: Transfer taxes generated only a small percentage of the total Federal tax collected. However, estate and gift tax auditors return for the tax authorities more tax dollars per capita than any other subdivision of tax. Therefore, the Service emphasizes audits in this area.

4. Auditors are Specially Trained: Examining agents in estate and gift tax audits are specially trained in estate tax, gift tax, and fraud.

III. Fraud by the Decedent and Fraud by the Personal Representative

A. Overview

1. Mistake, Coincidence, or Pattern? Executors work with incomplete and imperfect information. Thus, errors sometimes arise in the preparation and filing of the estate tax return. Your job is to eliminate (or at least minimize) the potential for these "errors" to the greatest extent possible. As the number of "errors" increase, the view that fraud is being committed also arises. A good mantra to adhere to as you figure out if these errors rise to the level of fraud is once is a mistake, twice is a coincidence, and three times is a pattern.

2. Civil Tax Fraud:

a. Defined: "'Fraud' … means intentional wrongdoing on the part of a taxpayer motivated by a specific purpose to evade a tax known or believed to be owing." Stoltzfus v. United States, 398 F.2d 1002, 1004 (3d Cir. 1968); Gagliardi v. United States, 81 Fed. Cl. 772, 777 (Fed. Cl. 2008) ("The term 'fraud,' as used in the statutory provisions authorizing the assessment of civil fraud penalties against taxpayers, means intentional wrongdoing on the part of a taxpayer motivated by a specific purpose to evade a tax known or believed to be owing." [Internal citations omitted.]

b. Elements: Tax fraud is often defined as an intentional wrongdoing on the part of a taxpayer, with the specific purpose of evading a tax known or believed to be owed. Tax fraud requires each of the following:

(1) A tax due and owing; and

(2) Fraudulent intent.

c. Relevant Statutes:

(1) Fraud Penalty:

IRC § 6663. Imposition of fraud penalty.

(a) Imposition of penalty. If any part of any underpayment of tax required to be shown on a return is due to fraud, there shall be added to the tax an amount equal to 75 percent of the portion of the underpayment which is attributable to fraud.

(b) Determination of portion attributable to fraud. If the Secretary establishes that any portion of an underpayment is attributable to fraud, the entire underpayment shall be treated as attributable to fraud, except with respect to any portion of the underpayment which the taxpayer establishes (by a preponderance of the evidence) is not attributable to fraud.

(2) Fraudulent Failure to File:

IRC § 6651. Failure to file tax return or to pay tax.

(a) Addition to the tax. In case of failure -

(1) to file any return required under authority of subchapter A of chapter 61 (other than part III thereof), subchapter A of chapter 51 (relating to distilled spirits, wines, and beer), or of subchapter A of chapter 52 (relating to tobacco, cigars, cigarettes, and cigarette papers and tubes), or of subchapter A of chapter 53 (relating to machine guns and certain other firearms), on the date prescribed therefore (determined with regard to any extension of time for filing), unless it is shown that such failure is due to reasonable cause and not due to willful neglect, there shall be added to the amount required to be shown as tax on such return 5 percent of the amount of such tax if the failure is for not more than 1 month, with an additional 5 percent for each additional month or fraction thereof during which such failure continues, not exceeding 25 percent in the aggregate;

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(f) Increase in penalty for fraudulent failure to file. If any failure to file any return is fraudulent, paragraph (1) of subsection (a) shall be applied -

(1) by substituting “15 percent” for “5 percent” each place it appears, and

(2) by substituting “75 percent” for “25 percent”.

d. The IRS Fraud Program: The IRS has adopted a National Fraud Program. The primary purpose of the IRS fraud program is to foster voluntary compliance through the recommendation of criminal prosecutions and/or civil penalties against taxpayers who evade the assessment and/or payment of taxes known to be due and owing. IRM, pt. 25.1.1.1(3) (Jan. 23, 2014).

3. Criminal Tax Evasion: The Code makes criminal at least 15 offenses for violating the internal revenue laws.

a. <u>Tax Evasion:</u> Tax evasion, the most basic crime under the Code, is defined in IRC § 7201 as the willful attempt to evade or defeat any tax imposed by the Code.

(1) <u>Beginning Date:</u> General rule is the statute of limitations begins to run from the latter of the due date of the return or the last affirmative act of evasion. If the delinquent filing of a false return is the method of attempting to evade, the statue will being to run on the date the return if filed. <u>United States v. Habig</u>, 390 U.S. 222, 225 (1968).

(2) <u>Continuing Offense Doctrine:</u> The date of filing a fraudulent return, while normally the date from which to measure the start of the statute of limitations for criminal prosecution for evasion, is not necessarily the last act in furtherance of the evasion. Any subsequent act -- such as making false statements to an agent in an audit in order to further hide the evasion in the return -- can refresh the statute of limitations on the original evasion (as well as constitute a separate crime under 18 USC § 1001). <u>United States v. Beacon Brass Co., Inc.</u>, 344 U.S. 43 (1952).

b. <u>Statute of Limitations:</u> IRC § 6531(2) provides that the statutes of limitations for the offense of willfully attempting in any manner to evade or defeat any tax or the payment thereof is six years.

c. <u>Elements of Tax Evasion:</u> "The elements of an § 7201 offense are willfulness, the existence of a tax deficiency, and an affirmative act constituting an evasion or attempted evasion of the tax." <u>United States v. Kim</u>, 884 F.2d 189, 192 n. 1 (5th Cir. 1989) (citing <u>Sansone v. United States</u>, 380 U.S. 343, 351 (1965).

(1) <u>Willfulness Defined:</u> Willfulness is the "voluntary, intentional violation of a known legal duty." <u>Cheek v. United States</u>, 498 U.S. 192, 201 (1991); <u>United States v. Pomponio</u>, 429 U.S. 10, 13 (1976).

(a) <u>Examples of Willfulness:</u>

i) Evidence of a consistent pattern of under-reporting large amounts of income. <u>United States v. Bishop</u>, 264 F.3d 535, 550 (5th Cir. 2001).

ii) Providing accountant or return preparer with inaccurate or incomplete information. Id. at 552.

iii) False statements to agents; false exculpatory statements, whether made by a defendant or instigated by him. Id.

iv) Keeping a double set of books. Id.

v) Hiding, destroying, throwing away, or losing books and records. Id.

vi) Making or using false documents, false entries in books and records, false invoices. Id.

vii) Destruction of invoices to customers. United States v. Garavaglia, 566 F.2d 1056, 1059 (6th Cir. 1977).

viii) Use of nominees. Bishop at 550; United States v. Daniel, 956 F.2d 540, 542-43 (6th Cir. 1992).

ix) Extensive use of currency or cashier's checks. Id.

x) Spending large amounts of cash which could not be reconciled with the amount of income reported. Bishop at 550.

(2) Awareness Required: The government must establish that the defendant was aware of their legal obligations under the tax laws. United States v. Bishop, 412 U.S. 346, 358-59 (1973).

(a) Subjective Test: A defendant's good faith belief that he or she is not violating the tax laws, no matter how objectively unreasonable the belief may be, is a defense in a tax prosecution. Cheek v. United States, 498 U.S. 192, 199-201 (1991).

(b) Application to Unclear Law: A defendant generally will not be found guilty if the law he or she is charged with violating is unclear.

i) If two co-ordinate branches of government come to two opposite conclusions as to the applicability of the law, then the defendant cannot willfully break it. United States v. Critzer, 498 F.2d 1160, 1162 (4th Cir. 1974).

ii) "A criminal proceeding [under the IRC] is an inappropriate vehicle for pioneering interpretations of tax law". United States v. Garber, 607 F.2d92, 100 (5th Cir. 1979).

iii) If the law is unknowable in an objective legal sense, there can be no intent to violate the duty that would permit conviction, regardless of a defendant's actual intent. James v. United States, 366 U.S. 213 (1961).

iv) "When ambiguity of the law is raised in a tax evasion case, the question presented is whether by virtue of the statutes, regulations or their construction or by force of common sense, the defendant had fair warning that his alleged conduct constituted tax evasion." United States v. Brodnik, 710 F.Supp.2d 526, 553 (D. W.V. 2010).

(3) Deficiency Required: A defendant cannot be convicted of tax evasion unless there is a deficiency of tax proven beyond a reasonable doubt. Boulware v. United States, 552 U.S. 421, 424 (2008).

(a) Deficiency Defined: A deficiency is the amount by which the tax imposed by statute exceeds the sum of (1) the amount of tax shown on the return; (2) plus the amount of any previously assessed deficiency; (3) minus any rebate previously received. United States v. Bishop, 264 F.3d 535, 550 (5th Cir. 2001).

i) Deficiency of Another Satisfies: The tax deficiency does not need to be for taxes due and owing from the defendant. Attempt to evade the assessment or payment of taxes of another satisfy the deficiency requirement. United States v. Wilson, 118 F.3d 228, 236 (4th Cir. 1997).

(b) No Need for Assessment or Demand: The Service does not need to make an assessment of tax or demand for payment in order to bring tax evasion charges. The government does not need to civilly or administratively determine a tax liability prior to bringing a tax evasion charge. United States v. Ellett, 527 F.3d 38, 40 (2d Cir. 2008).

i) A tax deficiency arises by operation of law on the date the return was due if the taxpayer fails to file and the government can show a tax liability. United States v. Voorhies, 658 F.2d 710, 714 (9th Cir. 1981).

(4) Affirmative Act Required:

(a) In General: Failing to file a return coupled with an affirmative act of evasion is commonly referred to as a "Spies evasion". Spies sets forth the following examples of conduct which can constitute affirmative acts of evasion:

i) Keeping a double set of books;

ii) Making false or altered entries;

iii) Concealing sources of income;

iv) Destruction of records;

v) Handling transactions to avoid usual records; and

vi) Any other conduct likely to conceal or mislead. United States v. Spies, 317 US 492, 499 (1943).

(b) Legal Acts as Affirmative Acts: Even an activity that would otherwise be legal can constitute an affirmative act supporting a conviction under IRC § 7201 as long as the defendant commits the act with the intent to evade tax.

i) Taxpayer's entry into an independent contractor agreement, although a legal activity in and of itself, satisfied the affirmative act element of IRC § 7201. United States v. Jungles, 903 F.2d 468, 474 (7th Cir. 1990); see also United States v. Conley, 826 F.2d 551, 557-59 (7th Cir. 1987) (use of nominees and cash with intent to evade payment of taxes constituted affirmative act).

(c) False Statements Made to Agents: Spies evasion can extend to false statements made to IRS agents. United States v. Klausner, 80 F.3d 55, 62 (2d Cir. 1996).

i) Proof of false statements on an application for an extension of time to file a tax return that no tax is owed for the year is sufficient to meet the affirmative act requirement. United States v. Hogan, 861 F.2d 312, 315 (1st Cir. 1988).

(d) No Signature Required:

i) A false return does not need to be signed to be treated as an affirmative act of evasion, as long as it is identified as the defendant's return. United States v. Robinson, 974 F.2d 575, 578 (5th Cir. 1992).

ii) The fact that a return was signed by someone other than the defendant does not preclude a finding that the defendant knew of its falsity and had it filed in an attempt to evade. United States v. Fawaz, 881 F.2d 259, 265 (6th Cir. 1989).

4. Fine Line Between Tax Avoidance and Tax Evasion:

a. <u>Tax Avoidance Not Criminal:</u> Tax avoidance is not a crime. <u>Gregory v. Helvering</u>, 293 U.S. 465, 469 (1935) ("The legal right of a taxpayer to decrease the amount of what otherwise would be his taxes, or altogether avoid them, by means which the law permits, cannot be doubted."); <u>see also</u> IRM, pt. 25.1.1.2.4(1) (Jan. 23, 2014).

b. <u>Tax Evasion Criminal:</u> Tax evasion is a crime. Evasion involves some affirmative acts to evade or defeat tax or payment of tax. Examples of affirmative acts are deceit, subterfuge, camouflage, concealment, attempts to color or obscure events, or make things seem other than they are. IRM, pt. 25.1.1.2.4(2) (Jan. 23, 2014).

(1) Common evasion schemes include:

(a) Intentional understatement or omission of income;

(b) Claiming fictitious or improper deductions;

(c) False allocation of income;

(d) Improper claims, credits or exemptions; and/or

(e) Concealment of assets. IRM, pt. 25.1.1.2.4(3) (Jan. 23, 2014).

5. <u>Criminal Fraud v. Civil Fraud:</u>

a. <u>Results:</u>

(1) <u>Civil Tax Fraud:</u> Civil tax fraud results in a remedial action taken by the Government such as assessing the correct tax and imposing civil penalties as an addition to tax, as well as retrieving transferred assets. IRM, pt. 25.1.1.2.3(1) (Jan. 23, 2014). Civil penalties are assessed and collected administratively as a part of the tax.

(2) <u>Criminal Tax Fraud:</u> Criminal fraud results in a punitive action with penalties consisting of fines and/or imprisonment. Criminal penalties (1) are enforced only by prosecution, (2) are provided to punish the taxpayer's wrongdoing, and (3) serve as a deterrent to other taxpayers. IRM, pt. 25.1.1.2.3(2) (Jan. 23, 2014).

(a) Willfulness Required: Willfulness is a common element of tax crimes. Willfulness is defined as a voluntary, intentional violation of a known legal duty. Cheek v. United States, 498 U.S. 192, 201 (1991).

(b) Good Faith May Negate Willfulness: A good faith misunderstanding of the law or a good faith belief that one is not violating the law negates the willfulness element. Id. at 203.

(3) Duality of Civil and Criminal Tax Frauds: A tax fraud offense may result in both civil and criminal penalties.

b. Imposition:

(1) Civil Tax Fraud: Civil penalties are assessed and collected administratively as a part of the tax. Thus, if the IRS determines a tax fraud liability is due from a taxpayer, the IRS must issue a notice of deficiency. See IRC § 6212(a).

(a) Restriction on Assessment: Except in the case of certain jeopardy or termination assessments, the IRS may not assess a deficiency until (i) a notice of deficiency has been mailed to the taxpayer, and (ii) the time for filing a petition with the Tax Court has expired (i.e., 90 days generally or 150 days if addressed to a person outside the United States). If a petition with the Tax Court is filed, then the IRS may not assess the deficiency until 60 days after the Tax Court decision has become final. (i.e., for 150 days if no appeal has been filed).

(b) Forums for Litigation: The taxpayer facing a civil fraud tax penalty can:

i) Petition the United States Tax Court within 90 days (or 150 days if addressed to a taxpayer outside the United States) without paying the penalty. See IRC § 6213; or

ii) Pay the penalty and sue for a refund in the U.S. Court of Federal Claims, see 28 U.S.C. § 1491, or the U.S. district courts, see 28 U.S.C. § 1346.

(2) Criminal Tax Fraud: Again, criminal penalties (1) are enforced only by prosecution, (2) are provided to punish the taxpayer's wrongdoing, and (3) serve as a deterrent to other taxpayers. IRM, pt. 25.1.1.2.3(2) (Jan. 23, 2014).

c. Burden of Proof:

(1) Overview: The Government bears the burden of proving fraud in civil and criminal tax cases.

(2) Criminal Tax Fraud:

(a) Beyond a Reasonable Doubt: In criminal cases the government must prove tax evasion beyond a reasonable doubt.

(b) "The Fifth Amendment Due Process Clause and the Sixth Amendment jury trial right together require 'criminal convictions to rest upon a jury determination that the defendant is guilty of every element of the crime with which he is charged, beyond a reasonable doubt.'" United States v. Jinwright, 683 F.3d 471, 479 (4th Cir. 2012) (quoting United States v. Gaudin, 515 U.S. 506, 510 (1995)).

(3) Civil Tax Fraud:

(a) Clear and Convincing Evidence: In civil cases the government must prove fraud with intent to evade taxes by "clear and convincing evidence." IRC § 7454(a); Tax Court Rule 142(b); Morse v. Comm'r, 419 F.3d 829, 832 (8th Cir. 2005) ("The Commissioner has the burden to prove fraud by clear and convincing evidence.").

i) Clear and convincing evidence is "that measure or degree of proof which will produce in the mind of the trier of facts a firm believe or conviction as to the allegations sought to be established. It is intermediate, being more than a mere preponderance, but not the extent of such certainty as is required beyond a reasonable doubt as in criminal cases. It does not mean clear and unequivocal." Ohio v. Akron Ctr. for Reprod. Health, 497 U.S. 502, 516 (1990) (quoting Cross v. Ledford, 120 N.E.2d 118, 123 (Ohio 1954)).

(b) Circumstantial Evidence Typical: Fraud is rarely admitted, and as such, courts may infer fraud from "any conduct, the likely effect of which would be to mislead or conceal." United States v. Walton, 909 F.2d 915, 926 (6th Cir. 1990).

(c) Badges of Fraud: Because fraud is rarely admitted, courts typically rely upon certain badges of fraud as to whether a taxpayer had the requisite fraudulent intent to support a civil fraud penalty. These badges of fraud include: (1) understating income, (2) maintaining inadequate records or destroying records, (3) implausible or inconsistent explanations of behavior, (4) concealment of income or assets, (5) failing to cooperate with tax authorities, (6) engaging in illegal activities, (7) intent to mislead which may be inferred from a pattern of conduct, (8) lack of credibility of the taxpayer's testimony, (9) filing false documents, (10) failing to file tax returns, and (11) dealing in cash. Aston v. Commissioner, T.C. Memo. 2003-128 (citing Spies at 499).

d. Privileges: Eggshell audits, especially those where estate and gift taxes are at issue, require heightened sensitivity.

(1) Attorney Client Privilege Generally Extends to Federally Authorized Practitioners in Civil Cases: With certain exceptions, in civil cases the common law attorney client privilege extends to federally authorized tax practitioners. See IRC § 7525. IRC § 7525 does not apply in criminal cases. See IRC § 7525(a)(2) (privilege "may only be asserted in * * * (A) any noncriminal tax matters before the Internal Revenue Service, and (B) any noncriminal tax proceeding in Federal court brought by or against the United States."

(a) Thus, where a potentially civil estate and gift tax audit turns criminal, there may be no privilege between the personal representative and the accountant.

(2) State Accountant-Client Privileges: Most states do not recognize an accountant-client privilege. Information created by state-created accountant-client privileges generally will not withstand an IRS summons. See, e.g., Couch v. United States, 409 U.S. 322, 335 (1973) ("no state-created [accountant-client] privilege has been recognized in federal cases.").

e. Double Jeopardy:

(1) Double jeopardy does not apply to civil fraud penalties.

(a) Taxpayers can be prosecuted criminally and later have civil tax fraud penalties assessed against them.

(b) "We believe § 6663 is remedial, rather than punitive, in nature and therefore should not be regarded as a criminal penalty for double jeopardy purposes." Morse v. Comm'r, 419 F.3d 829, 835 (8th Cir. 2005).

(c) "Congress may impose both a criminal and a civil sanction in respect to the same act or omission; for the double jeopardy clause prohibits merely punishing twice, or attempting a second time to punish criminally, for the same offense." Helvering v. Mitchell, 303 U.S. 391, 399 (1938).

B. Investigations of Fraud:

1. Frontline Fraud Detection: The IRS Fraud Program:

a. Purpose: The IRS Fraud Program is designed to encourage voluntary compliance through the imposition of civil penalties and, as appropriate, criminal prosecution of taxpayers who willfully and intentionally evade tax reporting and/or payment obligations. IRM, pt. 25.1.1.1(3) (Jan. 23, 2014).

b. Specific Training in Fraud: The IRS specifically trains its revenue officers, agents, and other employees in fraud detection. These employees are trained to identify signs or badges of fraud.

c. Fraud Detection Begins During the Audit: Many of the criminal prosecutions start as IRS examinations (aka audits) and IRS collections.

(1) When affirmative acts (firm indications) of fraud/willfulness exist and criminal criteria are met, the compliance employee will refer the case through the Fraud Technical Advisor (FTA) to Criminal Investigation (CI) via Form 2797, Referral Report of Potential Criminal Fraud Cases. IRM, pt. 25.1.3.1(2) (Aug. 5, 2015).

2. Badges of Fraud:

a. Categories of Badges of Fraud: As noted above, the IRS typically looks for fraud in the context of certain badges of fraud. The IRS has categorized the badges of fraud into five categories.

(1) Affirmative Acts of Fraud:

(a) Defined: Affirmative acts of fraud are those actions taken by the taxpayer, return preparer and/or promoter that establish that a particular action was deliberately done for the purpose of deceit, subterfuge, camouflage, concealment, some attempt to color or obscure events, or make things seem other than what they are. IRM, pt. 25.1.1.3(2) (Jan. 23, 2014).

(b) Required for Showing of Fraud: Fraud cannot be established without affirmative acts of fraud. IRM, pt. 25.1.1.3(2) (Jan. 23, 2014).

(c) Examples. Examples of affirmative acts of fraud include omissions of specific items where similar items are included; concealment of bank accounts or other assets; failure to deposit receipts to business accounts; and covering up sources of receipts. IRM, pt. 25.1.1.3(2) (Jan. 23, 2014).

(2) Indicators of Fraud - Overview:

(a) Indicators Common: Taxpayers who knowingly understate their tax liability often leave evidence in the form of identifying earmarks (or indicators) of fraud. Indicators of fraud serve as a sign or symptom, or signify that actions may have been done for the purpose of deceit, concealment or to make things seem other than what they are. IRM, pt. 25.1.1.3(1) (Jan. 23, 2014).

(b) Indicators Not Conclusive: Indications, in and of themselves, do not establish that a particular action was done. IRM, pt. 25.1.1.3(1) (Jan. 23, 2014).

(c) Examples: Examples of indicators include substantial unexplained increases in net worth, substantial excess of personal expenditures over available resources, bank deposits from unexplained sources substantially exceeding reported income, and documents that appear to be altered or false. IRM, pt. 25.1.1.3(1) (Jan. 23, 2014).

(3) Indicators of Fraud - Method of Concealment: Per IRM, pt. 25.1.2.3(7) (Jun. 9, 2015), the indicators of fraud with respect to methods of concealment are as follows:

(a) Inadequacy of consideration.

(b) Insolvency of transferor.

(c) Asset ownership placed in other names.

(d) Transfer of all or nearly all of debtor's property.

(e) Close relationship between parties to the transfer.

(f) Transfer made in anticipation of a tax assessment or while the investigation of a deficiency is pending.

(g) Reservation of any interest in the property transferred.

(h) Transaction not in the usual course of business.

(i) Retention of possession or continued use of asset.

(j) Transactions surrounded by secrecy.

(k) False entries in books of transferor or transferee.

(l) Unusual disposition of the consideration received for the property.

(m) Use of secret bank accounts for income.

(n) Deposits into bank accounts under nominee names.

(o) Conduct of business transactions in false names.

(4) Indicators of Fraud - Income: Per IRM, pt. 25.1.2.3(2) (Jun. 9, 2015), the indicators of fraud with respect to income are as follows:

(a) Omitting specific items where similar items are included.

(b) Omitting entire sources of income.

(c) Failing to report or explain substantial amounts of income identified as received.

(d) Inability to explain substantial increases in net worth, especially over a period of years.

(e) Substantial personal expenditures exceeding reported available resources.

(f) Inability to explain sources of bank deposits substantially exceeding reported income.

(g) Concealing bank accounts, brokerage accounts, and other property.

(h) Inadequately explaining dealings in large sums of currency, or the unexplained expenditure of currency.

(i) Consistent concealment of unexplained currency, especially in a business not routinely requiring large cash transactions.

(j) Failing to deposit receipts in a business account, contrary to established practices.

(k) Failing to file a tax return, especially for a period of several years, despite evidence of substantial amounts of taxable income.

(l) Cashing checks, representing income, at check cashing services and at banks where the taxpayer does not maintain an account.

(m) Concealing sources of receipts by false description of the source(s) of disclosed income, and/or nontaxable receipts.

(5) Indicators of Fraud - Expenses or Deductions: Per IRM, pt. 25.1.2.3(3) (Jun. 9, 2015), the indicators of fraud with respect to expenses or deductions are as follows:

(a) Claiming fictitious or substantially overstated deductions.

(b) Claiming substantial business expense deductions for personal expenditures.

(c) Claiming dependency exemptions for nonexistent, deceased, or self-supporting persons. Providing false or altered documents, such as birth certificates, lease documents, school/medical records, for the purpose of claiming the educational credit, additional child tax credit, earned income tax credit (EITC), or other refundable credits.

(d) Disguising trust fund loans as expenses or deductions.

(6) Indicators of Fraud - Books and Records: Per IRM, pt. 25.1.2.3(4) (Jun. 9, 2015), the indicators of fraud with respect to books and records are as follows:

(a) Multiple sets of books or no records.

(b) Failure to keep adequate records, concealment of records, or refusal to make records available.

(c) False entries, or alterations made on the books and records; back-dated or post-dated documents; false invoices, false applications, false statement, or other false documents or applications.

(d) Invoices are irregularly numbered, unnumbered or altered.

(e) Checks made payable to third parties that are endorsed back to the taxpayer. Checks made payable to vendors and other business payees that are cashed by the taxpayer.

(f) Variances between treatment of questionable items as reflected on the tax return, and representations within the books.

(g) Intentional under- or over-footing of columns in journal or ledger.

(h) Amounts on tax return not in agreement with amounts in books.

(i) Amounts posted to ledger accounts not in agreement with source books or records.

(j) Journalizing of questionable items out of correct account.

(k) Recording income items in suspense or asset accounts.

(l) False receipts to donors by exempt organizations.

(7) <u>Indicators of Fraud - Allocations of Income:</u> Per IRM, pt. 25.1.2.3(5) (Jun. 9, 2015), the indicators of fraud with respect to allocations of income are as follows:

(a) Distribution of profits to fictitious partners.

(b) Inclusion of income or deductions in the tax return of a related taxpayer, when tax rate differences are a factor.

(8) <u>Indicators of Fraud - Conduct of Taxpayer:</u> Per IRM, pt. 25.1.2.3(6) (Jun. 9, 2015), the indicators of fraud with respect to the conduct of the taxpayer are as follows:

(a) False statement about a material fact pertaining to the examination.

(b) Attempts to hinder or obstruct the examination. For example, failure to answer questions; repeated cancelled or rescheduled appointments; refusal to provide records; threatening potential witnesses, including the examiner; or assaulting the examiner.

(c) Failure to follow the advice of accountant, attorney, or return preparer.

(d) Failure to make full disclosure of relevant facts to the accountant, attorney, or return preparer.

(e) The taxpayer's knowledge of taxes and business practices where numerous questionable items appear on the tax returns.

(f) Testimony of employees concerning irregular business practices by the taxpayer.

(g) Destruction of books and records, especially if just after examination was started.

(h) Transfer of assets for purposes of concealment, or diversion of funds and/or assets by officials or trustees.

(i) Pattern of consistent failure over several years to report income fully.

(j) Proof that the tax return was incorrect to such an extent and in respect to items of such magnitude and character as to compel the conclusion that the falsity was known and deliberate.

(k) Payment of improper expenses by or for officials or trustees.

(l) Willful and intentional failure to execute pension plan amendments.

(m) Backdating applications and related documents.

(n) False statements on Tax Exempt/Government Entity (TE/GE) determination letter applications.

(o) Use of false social security numbers.

(p) Submission of false Form W-4.

(q) Submitting a false affidavit.

(r) Attempt to bribe the examiner.

(s) Submission of tax returns with false claims of withholding (Form 1099-OID, Form W-2) or refundable credits (Form 4136, Form 2439) resulting in a substantial refund.

(t) Intentional submission of a bad check resulting in erroneous refunds and releases of liens.

(u) Submission of false Form W-7 information to secure Individual Taxpayer Identification Number (ITIN) for self and dependants.

b. Internal Processes for Determining Fraud: When indicators (badges) of fraud are uncovered, the compliance employee must clearly document the potential fraud indicators and initiate a discussion with the compliance employee's group manager. If the compliance employee's group manager concurs there are indicators of fraud warranting fraud development, the compliance employee must contact the fraud technical advisor (FTA) assigned to that area.

c. Considerations to Prosecute Criminally or Civilly: Among the issues considered in determining whether to make a criminal referral are the following factors:

(1) Amount of tax;

(2) Targeted areas/industries (e.g., tax shelters, international issues);

(3) The flagrancy of the conduct; and

(4) Publicity.

d. What the IRM Directs Compliance To Do:

(1) Referral of Potential Criminal Fraud Cases: IRM, pt. 25.1.3.2(1) (Aug. 5, 2015) provides as follows:

(a) If after consultation with the FTA, it is determined that a potential fraud case has firm indications of fraud or willfulness and meets criminal criteria, the compliance employee will suspend the examination/collection activity without disclosing to the taxpayer or representative the reason for the suspension. When the taxpayer asks if a fraud referral is being considered or whether CI is involved, the examiner or revenue officer must not give a false or deceitful response. Guidance from the courts provides that compliance employees:

i) May decline to answer questions about criminal potential;

ii) May not deceive taxpayers when asked specifically about the character or nature of an investigation;

iii) Are not required to initiate disclosure about developing indicators of fraud or a potential referral to CI; or

iv) May simply advise that when firm indicators of fraud are present, a referral to CI is required.

(2) Form 2797:

(a) The compliance employee will complete Form 2797, Referral Report of Potential Criminal Fraud Cases. IRM, pt. 25.1.3.2(2) (Aug. 5, 2015).

(3) Referral Evaluation:

(a) The Initial Referral: Within 10 workdays of receipt of the referral, the evaluating special agent assigned to evaluate the referral will identify the subject (individual or entity under criminal investigation consideration) as the primary investigation, assign a case investigation number, and set up an initial conference. At that conference, the referring compliance employee, his/her group manager, the evaluating special agent, his/her supervisory special agent, and the fraud technical advisor will meet to discuss the referral, review tax returns and evidence gathered to support the alleged offense, and criminal tax computations, among other things. IRM, pt. 25.1.3.3(1) (Aug. 5, 2015).

(b) Items Discussed at the Initial Conference: IRM, pt. 25.1.3.3(1) (Aug. 5, 2015) instructs that the following issues should be discussed at the initial conference:

i) Income is verified;

ii) Explanations offered by the taxpayer, the taxpayer's representative, and/or the return preparer concerning the alleged offense are considered;

iii) Whether returns were solicited and attempts were made to resolve the civil issues;

iv) The IRS's prior actions involving similar alleged offenses; and

v) Observations about the age, health (physical and mental), education, and occupation of the taxpayer.

3. How Do Criminal Investigations Begin at the IRS:

a. CI's Compliance Strategies and Activities: The IRS's Criminal Investigations Division ("CI") generally categorizes its compliance strategies and activities into three components:

(1) Legal source investigations;

(2) Illegal source investigations, and

(3) Narcotics related.

b. Statistics for 2012 Through 2014: The IRS reports the following statistics concerning its criminal investigations for 2012 through 2014:

	FY 2016	FY 2015	FY 2014
Investigations initiated	3,395	3,853	4,297
Prosecution recommendations	2,744	3,289	3,478
Informations/indictments	2,761	3,208	3,272
Convictions	2,672	2,879	3,110
Sentenced	2,699	3,092	3,268
Percent to prison	79.9%	80.8%	79.6%

IRS, Statistics Data for Three Fiscal Years – Criminal Investigations (CI) available at https://www.irs.gov/compliance/criminal-investigation/statistical-data-for-three-fiscal-years-criminal-investigation-ci

a. Agency Referrals: Law enforcement agencies, federal or state agencies, or other divisions of the IRS provide information to CI that lead to criminal tax investigations.

b. Financial Reporting Forms: The filing or the failure to file financial forms such as currency transaction reports ("CTR"); suspicious activity reports ("SARs"); Forms 8300, which report receipt of more than $10,000.00 received in a trade or business, or FinCEN Report 114, Report of Foreign Bank and Financial Accounts, and other foreign financial transaction forms have triggered many criminal investigations.

2. Approaches to Monitor Civil Cases That May Turn Criminal:

a. Statute of Limitations: During the criminal investigation, the revenue agent should closely monitor the statute of limitations and request extensions. It is a rare case in which it is a good approach to agree to the statute of limitations in a potentially criminal case.

b. <u>FOIA Requests May Allow the Taxpayer to Monitor Case Development:</u> The attorney should make regular FOIA requests to the United States and request that third parties to whom summonses have been issued to provide a copy of all records produced to the IRS. This will allow the attorney to monitor the case and ensures that the attorney has all information in the possession of the United States.

3. <u>Summons Authority:</u>

a. <u>Summons Authority:</u> Congress has empowered the IRS to examine any books, records, or other data relevant to the investigation of a taxpayer's civil or criminal tax liability. IRC § 7602(a)(1).

b. <u>The Statute:</u> IRC § 7602(a) provides as follows:

For the purpose of ascertaining the correctness of any return, making a return where none has been made, determining the liability of any person for any internal revenue tax or the liability at law or in equity of any transferee or fiduciary of any person in respect of any internal revenue tax, or collecting any such liability, the Secretary is authorized-

(1) To examine any books, papers, records, or other data which may be relevant or material to such inquiry;

(2) To summon the person liable for tax or required to perform the act, or any officer or employee of such person, or any person having possession, custody, or care of books of account containing entries relating to the business of the person liable for tax or required to perform the act, or any other person the Secretary may deem proper, to appear before the Secretary at a time and place named in the summons and to produce such books, papers, records, or other data, and to give such testimony, under oath, as may be relevant or material to such inquiry; and

(3) To take such testimony of the person concerned, under oath, as may be relevant or material to such inquiry.

c. <u>The Fifth Amendment and the Required Records Exception:</u>

(1) <u>Background:</u> The Fifth Amendment provides, in relevant part, that “[n]o person … shall be compelled in any criminal case to be a witness against himself.” The Fifth Amendment protects testimonial communications that are

incriminating but not necessarily the incriminating content of documents. In Shapiro v. United States, 335 U.S. 1 (1948) and Grosso v. United States, 390 U.S. 62 (1968), the Supreme Court articulated the required records exception to the Fifth Amendment's prohibition on self incrimination.

(2) Relevance to Bank Secrecy Act: In connection with the DOJ's enforcement of undisclosed foreign financial accounts, the Department has issued numerous subpoenas requiring taxpayers to produce the records required under the Bank Secrecy Act. There has been much litigation as to whether these documents must be produced. The appellate courts deciding the issue have uniformly agreed that the required records exception applied to require taxpayers to produce foreign financial account information under the Bank Secrecy Act and related regulations. E.g., In re Grand Jury Subpoena, 696 F.3d 428 (5th Cir. 2012); In re Special February 2011-11 Grand Jury Subpoena Dated September 12, 2011, 691 F.3d 903, 908 (7th Cir. 2012); In re M.H., 648 F.3d 1067, 1069 (9th Cir. 2011).

d. Summons Can be Challenged Via *Powell* and *Clarke*:

(1) *Powell* Challenges: The IRS may obtain this information by serving a summons on the subject of the investigation or on any third party who may possess relevant information. An individual who has a summons served on him or her may challenge its legality in a court if the Government petitions the court to enforce the summons. After the Government establishes that certain threshold requirements have been met, the taxpayer bears a heavy burden of proving that enforcement of the summons is an unenforceable abuse of process.

(a) Burden on Government: Before a summons will be enforced, the Government must prove that:

i) The investigation is conducted for a legitimate purpose;

ii) The information sought is relevant to the purpose of the investigation;

iii) The IRS must not already possess the information sought; and

iv) All required administrative steps have been taken. United States v. Powell, 379 U.S. 48, 57-58 (1964).

(2) *Clarke* Challenges: In United States v. Clarke, 573 U.S. 248, 249 (2014), a unanimous Supreme Court held that the taxpayers were entitled to an evidentiary hearing about the motives of the IRS officials in issuing the summons where they "point to specific facts or circumstances plausibly raising an inference of bad faith." Thus, Clarke stands for the proposition that taxpayers have a right to challenge an IRS summons enforcement action in court when they can show that the agency issued the summons in bad faith.

4. Criminal Investigations May Not Be Cloaked in Civil Audit:

a. Parallel Investigations Permissible: The Supreme Court has held that the government may conduct parallel civil and criminal investigations without violating the due process clause, so long as it does not act in bad faith. United States v. Kordel, 397 U.S. 1, 11-12 (1970).

b. Civil Action Not to be Used Solely to Obtain Evidence for Criminal Prosecution: The Government may not use a civil action solely for the purpose of obtaining evidence for a criminal prosecution. See, e.g., id. at 12-13; United States v. Rand, 308 F.Supp. 1231 (D.C. Ohio 1970).

5. Will a Civil Case Turn Criminal?:

a. The USAM: The U.S. Attorneys' Manual ("USAM") instructs as follows with respect to prosecutions:

The attorney for the government should commence or recommend federal prosecution if he/she believes that the person's conduct constitutes a federal offense and that the admissible evidence will probably be sufficient to obtain and sustain a conviction, unless, in his/her judgment, prosecution should be declined because:

1. No substantial federal interest would be served by prosecution;

2. The person is subject to effective prosecution in another jurisdiction; or

3. There exists an adequate non-criminal alternative to prosecution.

USAM 9-27.220 (updated Feb. 2018).

b. Commonly Asked Questions: The following questions are routinely asked in deciding whether to make a criminal referral:

(1) Can the Government prove willfulness (a common element of tax crimes)?

(2) Is there a reasonable probability of conviction?

(3) Does the case have jury appeal (e.g., the presence of aggravating factors)?

B. Fraud by the Decedent or the Estate and Resolving That Fraud

1. Overview: Fraud may have occurred during the decedent's lifetime with respect to income taxes, gift taxes, employment taxes, etc. Fraud may also have occurred after the decedent's death by the personal representative with respect to income taxes, the estate tax, and the gift tax. This outline discusses each point below.

2. Unreported Domestic Income by the Decedent During Life: To the extent it is determined that a decedent had unreported domestic income during his or her lifetime, the estate may use the voluntary disclosure process (discussed immediately below) to report the decedent's income and bring the decedent (and the estate) into compliance.

3. Unreported Foreign Accounts and Unreported Foreign Income by the Decedent During Life:

a. Overview: An area increasingly being reviewed by the Service for fraud, whether on the part of the decedent or the personal representative, is in the context of unreported foreign financial accounts.

(1) Inquire Into Foreign Bank Assets: Where a decedent's gross estate includes foreign assets, it essential that the personal representative and representatives of the estate determine that the decedent has properly reported all foreign source income.

(2) Pursue Voluntary Disclosure: If it is discovered that the decedent was not fully tax compliant, a voluntary disclosure should be pursued. Although we discuss voluntary disclosures below, this outline is not intended to be a complete discussion of voluntary disclosures. Rather, it is intended to let readers know about available options.

(3) FBAR Requirement Applies to Estates: Persons and estates with offshore accounts are required to file FinCEN Report 114, Report of Foreign Bank and Financial Accounts ("FBAR"), and report all income from these accounts and assets on their federal and state income tax returns annually. Due to the criminal sanctions that may be imposed as a result of failure to properly report foreign accounts, the Service's offshore voluntary disclosure program allows taxpayers to avoid criminal sanctions and higher penalties by voluntarily coming forward to the Service.

(4) Additional Filing Requirements That May Apply:

(a) Form 926: Return by a U.S. Transferor of Property: reports a transfer of property (even if such property is not appreciated property) to a foreign corporation described in IRC § 6038B(a)(1)(A), 367(d), or 367(e);

(b) Form 3520: Annual Return to Report Transactions with Foreign Trusts and Receipt of Certain Foreign Gifts;

(c) Form 3520-A: Annual Information Return of Foreign Trust with a U.S. Owner;

(d) Form 5471: Information Return of U.S. Persons with Respect to Certain Foreign Corporations;

(e) Form 5472: Information Return of 25% Foreign-Owned U.S. Corporation or a Foreign Corporation Engaged in a U.S. Trade or Business;

(f) Form 8865: Return of U.S. Persons with Respect to Certain Foreign Partnerships;

(g) Form 8938: Statement of Specified Foreign Financial Assets;

(h) Form 8621: Information Return by a Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund;

(i) Form 8621-A: Return by a Shareholder Making Certain Late Elections to End Treatment as Passive Foreign Investment Company;

(j) Form 8858: Information Return of U.S. Persons with Respect to Foreign Disregarded Entities and Foreign Branches;

(k) Form 706-CE: Certificate of Payment of Foreign Death Tax [must be filed for foreign death tax credit to be permitted on Form 706];

(l) Form 1116: Foreign Tax Credit (Individual, Estate or Trust) [must be filed to obtain foreign tax credit].

b. <u>Options With Respect to Voluntary Disclosures:</u>

(1) <u>Types of Disclosures Generally:</u> Generally speaking, there are three types of disclosures available with respect to the offshore voluntary disclosure program:

(a) <u>Quiet Disclosure</u>: A quiet disclosure is a process through which a taxpayer files amended tax returns together with FBARs and other unfiled information returns without first contacting the Service. The taxpayer who proceeds with a quiet disclosure does not receive immunity from potential criminal prosecution or from the civil and criminal monetary penalties that may be assessed.

(b) Noisy Disclosure: A noisy disclosure is a truthful, timely and complete disclosure to the Service where the taxpayer demonstrates a willingness to cooperate in order to determine and pay the correct tax, interest and penalty liabilities. If completed through one of the Offshore Voluntary Disclosure Programs, other than the Streamlined Program discussed in this outline, the taxpayer receives immunity from criminal prosecution and is subject to a revised civil penalty regime.

(c) Semi-Quiet Disclosure: The taxpayer's attorney submits a letter to the Service to make a voluntary disclosure of unreported income and unfiled informational returns. The letter is submitted together with amended income tax returns, unfiled informational returns and offers to pay the taxes, interest and penalties determined by the Service to be due and owing. The amended income tax returns are submitted in compliance with qualified amended return procedures (discussed below) to protect the taxpayer from certain penalty assessments.

(2) Offshore Voluntary Disclosure Program:

(a) In General: The Service provides a separate voluntary disclosure practice of which many practitioners are likely aware. Taxpayers are not guaranteed immunity from criminal prosecution and are warned that they should not rely on the results of other cases when assessing whether their cases will result in criminal prosecution. However, if the taxpayer follows the applicable procedures and makes a truthful, timely and complete disclosure, the IRS may recommend that the case not be submitted for criminal prosecution. Therefore the taxpayer should show a willingness to cooperate with the IRS to determine the correct tax liability and must make a good faith arrangement to ensure that all taxes, interest and penalties are paid in full.

If the error was non-willful, the potential for criminal prosecution is almost non-existent.

(3) Qualified Amended Returns:

(a) In General: A qualified amended return is designed to address civil violations of the Internal Revenue Code in a manner that protects the taxpayer from certain accuracy-related penalties.

(b) What is a Qualified Amended Return? A qualified amended return is an amended return filed after the original properly extended due date of the return but before any of the following events:

i) The date the taxpayer is first contacted by the IRS for any examination, including a criminal investigation;

ii) The date any person is contacted for a tax shelter promoter examination under Section 6700 with respect to any tax benefit claimed on the return;

iii) The date the IRS issues a John Doe summons under Section 7609(f) relating to the tax liability of a person, group, or class that includes the taxpayer;

iv) The date the Commissioner announces a settlement initiative to compromise or waive penalties with respect to a listed transaction; and/or

v) With respect to a pass-through item, the date the pass-through entity is first contacted by the IRS for any examination with respect to the entity's return.

(c) Accuracy-Related Penalty May Not Apply: The qualified amended return procedure allows a taxpayer to treat the amount of tax reported as the tax reported on the original return so that the accuracy-related penalty will not apply. Treas. Reg. § 1.6664-2(c)(2). However, if the Service determines that the failure to report is due to fraud, the taxpayer is potentially liable for criminal prosecution or, at the least, a fraud penalty equal to 75% of the underpayment of tax. In addition, the qualified amended return procedure does not protect the taxpayer from other civil penalties.[2] Taxpayers faced with potential assessments of these penalties will have to challenge the assessments based on reasonable cause arguments, when such exceptions are available.

(d) Ownership of a Foreign Bank Account as a Reportable Transaction But Not a Listed Transaction: Qualified amended returns can be filed for reportable transaction, but not for listed transactions. Ownership of a foreign bank account is a reportable transaction but not a listed transaction.[3] Furthermore, non-prosecution

[2] Taxpayers who fail to file informational returns related to foreign investments, including FBARs, face a penalty of $10,000 for each unfiled form for each year that there was no filing and the taxpayer is determined non-willful. If the failure to file is determined willful, the monetary penalty can be as high as 50% of the value of the unreported foreign accounts. The statute of limitations for civil investigations is six years and five years for criminal. These penalties increase if the taxpayer does not timely-respond to an IRS notification for failure to file. In addition, a taxpayer who fails to file the proper forms related to foreign business investments risks sustaining a reduction in foreign tax credits that can be claimed. Finally, a taxpayer who receives certain foreign gifts but fails to file Forms 3520 or 3520-A is liable for a penalty of 5% of the value of the gift. This penalty can be increased up to 25% of the value of the gift if the taxpayer does not timely-file the necessary form after IRS notification is received.

[3] Listed transactions are reportable transactions but reportable transactions are not necessarily listed transactions. Compare Treas. Reg. § 1.6011-4(b) (defining reportable transactions to include listed transactions), with Notice 2009-59, 2009-31 I.R.B. 170 (setting forth listed transactions identified by the IRS). A listed transaction is defined as a transaction that is the same as or substantially similar to one of the types of transactions that the IRS has determined to be a tax avoidance transaction and identified by notice, regulation, or other form of published guidance as a listed transaction. Treas. Reg. § 1.6011-4(b)(2). A reportable transaction is defined as, among

agreements between the Department of Justice and certain foreign financial institutions that facilitated U.S. taxpayer efforts to conceal foreign investments were not made pursuant to I.R.C. § 6700 and do not involve listed transactions. Thus, taxpayers may be able to come into compliance through the submission of qualified amended returns; PROVIDED, that they are submitted prior to the occurrence of one of the enumerated preclusion events.

c. Miscellaneous Issues With Foreign Bank Accounts:

(1) Deductibility of Penalty: A penalty for offshore accounts is deductible.

(2) Ensuring Compliance With Offshore Reporting Requirements: Where a decedent's foreign bank statements are not available, either to ensure that the decedent has properly reported his or her foreign source income or to be utilized for the preparation of amended tax returns and to provide to the Service in a voluntary disclosure, such documents may be requested from decedent's banking institution.

(a) Obtain Documents With Court Documents: Typically, provision of estate documents such as Letters Testamentary or Letters of Administration showing who has been designated as the Executor or Administrator of an estate along with notarized signature are sufficient to gain authority to communicate with a decedent's bank and obtain necessary documents.

(b) Obtain Documents With Blanket Authorization: An Administrator or Executor of an estate may also authorize the decedent's foreign bank to provide

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other transactions, a listed transaction, a section 165 loss transaction, and transactions of interest. Treas. Reg. § 1.6011-4(b).

documents and communicate with the estate's counsel and accountants.

(3) FBAR Requirements Continue Until Safe Deposit Boxes Closed: As the responsibility to file an FBAR applies to an estate, estate representatives must continue to file FBARs until all foreign accounts including safety deposit boxes are closed.

(4) Foreign Inheritances: If a foreign gift is received, the donee or beneficiary should file Form 3520, Annual Return to Report Transactions with Foreign Trusts and Receipt of Certain Foreign Gifts.

4. Decedent's Fraud on the Spouse: How to Handle the Paramour

a. The Issue: How do you handle cash, jewelry, and other gifts given to the decedent's paramour? Should these items be pulled back into the estate as deathbed gifts if made within three years of death? Most likely yes. Because, as discussed below, the paramour may face income tax liability, he or she is unlikely to help the estate. Should the paramour report these items on Form 1040?

b. Income Inclusion? The United States has tried to criminally prosecute paramours for failing to file income tax returns on the amount received. See United States v. Harris, 942 F.2d 1125 (7th Cir. 1991). In Harris, an elderly widower, Kritzik, gave Lynnette Harris and Ann Conley each over a half million dollars. Id. at 1127. The court held that when determining whether an item is income or a gift "the donor's intent is the 'crucial consideration'". Id. (citing Commissioner v. Duberstein, 363 U.S. 278, 285 (1960)). A transfer of property is a gift if the transferor acted out of a "detached and disinterested generosity, ... out of affection, respect, admiration, charity, or like impulses." By contrast, a transfer of property is income if it is the result of "the constraining force of any moral or legal duty, constitutes a reward for services rendered, or proceeds from the incentive of anticipated benefit of an economic nature." Harris at 1128 (citations omitted).

c. <u>Criminal Prosecution of Paramours:</u> The <u>Harris</u> court hinted at the problem with criminal income tax prosecutions of a decedent's paramour. On this issue, the court stated as follows:

> the United States tried to present direct evidence of Kritzik's intent in the form of an affidavit that he provided IRS investigators before his death. In the affidavit, Kritzik stated that he regarded both Harris and Conley as prostitutes. But Kritzik had an obvious motive to lie to the investigators-he could have been subject to civil or criminal penalties for failure to pay gift taxes if he failed to shift the tax burden to the sisters. The District Court was correct to exclude this affidavit under the hearsay rule and under the confrontation clause. In general, evidentiary difficulties such as this will often be insurmountable in trying to prove a willful tax violation that hinges on the intent of a dead person. The civil remedies available to the IRS will almost always lead to surer justice in such cases than criminal prosecution. [<u>Id.</u> at 1129.]

If the obligation to pay a tax is sufficiently in doubt, willfulness is impossible as a matter of law, and the "defendant's actual intent is irrelevant." [<u>Id.</u> at 1132 (citations omitted); <u>but see</u> <u>United States v. Trupin</u>, 119 Fed Appx. 323 (2d Cir. 2005).]

d. <u>Practical Dealings With the Paramour:</u> The paramour is unlikely to be helpful to the estate in characterizing the payments as money for services as this could lead to income tax issues to the paramour. Thus, it is best to look for details on lifetime gifts to a paramour within three years of death by reviewing the decedent's bank records.

e. <u>Cases Holding That Transfers to Paramours Are Gifts:</u>

(1) In <u>Reynolds v. Commissioner</u>, T. C. Memo. 1999-62, <u>superseded by statute as recognized in Polone v. Commissioner</u>, 505 F.3d 966 (9th Cir. 2007), the IRS had asserted that the petitioner-paramour had received taxable income in settlement of a lawsuit against the man. The Service argued that the money was for past homemaking services. The Tax Court (J. Laro) found that the settlement was for relinquishment of her interest in property acquired during the 24 year cohabitation. The Court found the

petitioner's basis in the property was determined as if the property was a gift.

(2) In Starks v. Commissioner, T.C. Memo. 1966-134, the Service wanted to assess income taxes against the paramour. The court held that the money and property from the 55 year old married man to the 24 year old woman for the years 1954 through 1958 were gifts and therefore not subject to income taxes.

(3) In Pascarelli v. Commissioner, 55 T.C. 1082 (1971), aff'd, 485 F.2d 681 (3d Cir. 1973), the Service issued the petitioner-paramour notices of deficiency for both income taxes and gift tax transferee liability. During the period at issue the petitioner-paramour and the decedent lived together "as husband and wife in all respects, except for the facts that they were not legally married and did not occupy the same bedroom at the petitioner's house." Id. at 1090. The decedent transferred various sums of money to the petitioner. The court held that except for some amounts that were given to petitioner to be used specifically for the benefit of the gentlemen that the remainder were gifts and the petitioner was liable for the gift tax as transferee.

(4) However, see Toms v. Commissioner, T.C. Memo. 1992-125, where the court held that the payments were income to the petitioner, a woman who ran a prostitution and escort service.

5. Limit Allegations of Fraud By Filing Gift Tax Returns:

a. Overview: Posthumous allegations of fraud with respect to transfers of assets can be limited by having the decedent file gift tax returns during his or her lifetime with respect to inter vivos gifts.

b. Filing Requirements:

(1) When Required: Generally, I.R.C. § 6019 requires a U.S. federal gift tax return to be filed by any individual who, subject to certain exceptions, makes a transfer by gift which (i) does not qualify for the marital deduction, (ii) does not

qualify for the charitable deduction, (iii) is greater than the I.R.C. § 2503(b) annual exclusion amount of $10,000 as adjusted for inflation, or (iv) is not a qualifying medical or educational expense.

(2) When Due:

(a) In General: As a general rule, gift tax return must be filed on or before April 15th of the close of the taxable year. I.R.C. § 6075(b).

(b) Extensions Allowed: I.R.C. § 6081(a) authorizes the Service to extend the filing of a gift tax return by up to six months. Any extension of time granted to a taxpayer for filing his or her Federal income tax return is deemed to be also an extension of time to file a gift tax return under I.R.C. § 6019.

(3) Filing of Gift Tax Return May Be Defense to Allegations of Fraud: To the extent there is a transfer of property for which a gift tax return is filed and the transfer is adequately disclosed, it becomes much more difficult for the Service to allege that there was fraud on the part of the decedent with respect to the transfer.

c. The Period of Limitations on Assessment

(1) In General: I.R.C. § 6501 requires the Service to assess a gift tax liability by the later of (1) three years after the due date of the gift tax return, or (2) three years after the gift tax return was actually filed.

(2) May Be Extended by Agreement: I.R.C. § 6501(c)(4) provides that the general three-year period of limitations on assessment may be extended if the Service and the taxpayer agree to do so in writing.

(3) Situation in Which Gift Tax May Be Assessed at Any Time:

(a) General Rule: I.R.C. § 6501(c)(9) provides that if a gift is not shown on a gift tax return in a manner adequate to apprise the Service of the nature of the gift, then the gift tax may be assessed at any time with respect to that gift. Most typically, this additional assessment occurs in connection with the filing of the estate tax return.

(b) Adequate Disclosure Especially Important in Gift Tax Cases: Because the failure to adequately disclose a gift on a gift tax return means that the related gift tax can be assessed at any time, it is especially important for practitioners to adequately disclose the gift on the return.

(c) When Is a Gift Not Adequately Disclosed: I.R.M., pt. 4.25.1.11.2(3) (Oct. 30, 2017) instructs that a gift may be inadequately disclosed if it is:

i) Omitted completely from the return; or

ii) Shown on the return, but the manner in which it is shown is not adequate to apprise the Service as to the nature of the gift.

(d) Protective Returns: In situations in which the taxpayer contends that a gift was not made (i.e., in a bona fide sale for adequate consideration such as a promissory note), it is usually advisable to file a gift tax return reporting a zero tax liability with respect to the "sale". The protective return should disclose all facts and supporting documentation surrounding the "sale". The purpose of filing this protective return is to have the statute of limitations with respect to that "sale" expire from a gift tax perspective.

6. Recent Cases Involving Fraud of a Decedent:

a. Estate of Fortunato: In Fortunato v. Commissioner, T.C. Memo. 2010-105, the Tax Court held that an estate was not liable for a $11,662,737 estate tax deficiency or fraud penalty. The IRS argued that the decedent owned an interest (and fraudulently failed to include in the decedent’s gross estate) various warehouse companies. The Court found that the decedent did not own an interest in the warehouse companies, that there was no deficiency in estate tax, and accordingly, that the fraud penalty did not apply.

b. Estate of Trompeter: In Estate of Trompeter v. Commissioner, T.C. Memo. 1998-35, vacated and remanded, 279 F.3d 767 (9th Cir. 2002), the Tax Court held that the estate was liable for a deficiency and the fraud penalty. As to the Court's conclusion that the estate was liable for the fraud penalty, the Court relied upon the following facts:

(1) The estate failed to report certain assets, undervalued other assets, and omitted and concealed the assets with the specific intent of evading tax;

(2) The personal representatives offered implausible and inconsistent explanations of her behavior, including that the decedent did not actually give the personal representative jewelry which she claims to have received as a gift before the decedent's death;

(3) The personal representatives failed to cooperate with the IRS by failing to disclose all of the decedent's records revealing purchases of jewelry, gems, art, and other artifacts; and

(4) The personal representatives were college-educated and had extensive work experience.

c. Estate of Monroe: In Estate of Monroe v. Commissioner, 104 T.C. 352, rev'd in part and remanded in part, 124 F.3d 699 (9th Cir. 1997), the Tax Court sustained the IRS's disallowance of the marital deduction claimed on the decedent's estate tax return on the ground that the disclaimers were invalid. The IRS asserted the fraud penalty, but subsequently conceded it. On appeal, the U.S. Court of Appeals for the Ninth Circuit held that most of the disclaimers were in fact "qualified" and that the estate was not liable for the negligence penalty.

d. Estate of Fox: In Estate of Fox v. Commissioner, T.C. Memo. 1995-30, the Tax Court held that the personal representative was not liable for the fraud penalty because any underpayment of tax was excused on the ground of reliance on the estate's accountant.

IV. <u>Limiting the Liability of the Personal Representative and Transferees in Potentially Fraudulent Situations</u>

A. <u>Overview</u>

1. Fiduciaries such as trustees and executors commonly take over assets, including business interests, for settlors or decedents in many different situations, either because of death, incompetency, designation by the grantor or other reasons. When a fiduciary initially takes over an estate or trust, one of the issues that must be addressed involves potential income tax liabilities for the estate or trust, and in some cases even for a business owned by the estate or trust. Estate and gift taxes of the grantor/decedent may also be a consideration for a fiduciary, especially where the granting instrument requires the fiduciary to pay any estate or gift taxes owed by the decedent. There is no doubt under the Code that a fiduciary must file tax returns and pay taxes on income generated during the time of their administration of the estate, and also pay estate taxes if necessary. Regarding past tax obligations of a decedent, however, the answer becomes murky. Fiduciaries typically take the "see no evil, hear no evil" approach regarding past tax debts. That approach can be correct, where there is no reason to question the prior tax years. But in other cases, that choice can be an enormous mistake, which could cause personal liability for the fiduciary himself if the assets of the estate or trust are insufficient to cover the taxes.

2. <u>Personal Liability for a Personal Representative:</u> A personal representative can become personally liable for unpaid Federal estate tax of the estate <u>or</u> for unpaid Federal income tax of the decedent. <u>See</u> 31 U.S.C. § 3713(a), (b). A personal representative can also become personally liable for unpaid State estate and inheritance taxes. <u>See, e.g.</u>, N.J.S.A. 54:36-7. This section discusses Federal liability only.

3. <u>The Relevant Statutes:</u> 31 U.S.C. § 3713, entitled Priority of Government Claims, provides that a personal representative can be held personally liable to the United States is a personal representative pays a "debt" of the estate before satisfying the Government's claims.

a.

(1) A claim of the United States Government shall be paid first when-

(a) a person indebted to the Government is insolvent and-

i) the debtor without enough property to pay all debts makes a voluntary assignment of property;

ii) property of the debtor, if absent, is attached; or

iii) an act of bankruptcy is committed; or

(b) the estate of a deceased debtor, in the custody of the executor or administrator, is not enough to pay all debts of the debtor.

(2) This subsection does not apply to a case under title 11.

b. A representative of a person or an estate (except a trustee acting under title 11) paying any part of a debt of the person or estate before paying a claim of the Government is liable to the extent of the payment for unpaid claims of the Government.

4. <u>Liability Can Extend to Certain Trustees:</u> A trustee of a trust which was revocable until the decedent's death can, in certain circumstances, also be personally liable for the decedent's and the estate's taxes. <u>See, e.g.</u>, Fla. Stat. §§ 737.707(3) and 733.607(2).

5. <u>United States Need Not Perfect Its Claim:</u> The United States is not subject to State law requirements of filing proofs of claim.

6. <u>United States May Assert a Claim After Discharge:</u> The United States may make its claim long after the estate has been probated and the personal representative discharged by the probate court.

B. <u>The King's Debtors Dying, the King Shall First Be Paid</u>

1. <u>The King Shall Be Paid First:</u> A personal representative of an estate without enough property to pay all claims of the estate <u>must</u> pay the Federal tax claims before all other claims. 31 U.S.C. § 3713.

2. <u>Creation of Liability:</u> I.R.C. § 3713(b) creates the underlying liability for the personal representative and I.R.C. § 6901(a)(1)(B) provides the

Service to use their standard assessment and collection methods for the liability which, as discussed below, is the issuance of a notice of liability.

3. The Notice of Liability: When proceeding pursuant to I.R.C. § 6901(a)(1)(B) the Service issues a notice of liability.

4. The Periods to Assess and Collect a Liability Under I.R.C. § 6901: The period of limitations on assessment with respect to a liability under I.R.C. § 6901 expires on the date that is the later of one year after (1) the liability arises, or (2) the expiration of the period of collection of the tax in respect of which the liability arises (i.e., generally ten years). Thus, as a general rule, the Service can assess liability on the fiduciary under I.R.C. § 6901 up to ten years after assessment of the tax in respect of which such liability arises.

5. Means of Enforcing the Liability: The United States asserts this claim by filing suit against the personal representative in the appropriate federal district court pursuant to I.R.C. § 7402(a).

C. Federal Personal Liability for the Personal Representative

1. Overview: If the personal representative pays other creditors prior to paying the United States, the fiduciary may be held personally liable to the extent of the payments that he or she turned over to non-governmental creditors. 31 U.S.C. § 3713(b); United States v. Coppola, 85 F.3d 1015, 1020 (2d Cir. 1996); I.R.M., pt. 5.5.3.9 (Mar. 26, 2010).

2. Requirements for Liability: Pursuant to 31 U.S.C. § 3713(b), the following requirements must be met for there to be personal liability imposed upon the personal representative:

   a. The United States must have a claim;

   b. The personal representative must have knowledge of the United States' claim or be placed on inquiry notice of the claim;

   c. The personal representative must have paid a "debt", which term is generally defined to include the payment of a beneficiary's distributive share;

   d. The debt must have been paid at a time when the estate is insolvent or the debt must have created the insolvency; and

e. The Service must have filed a timely assessment against the personal representative.

4. Elements of Liability

a. Under 31 U.S.C § 3713 and the cases which have interpreted this statute, a fiduciary may be held liable by the government for past estate, gift and/or income tax obligations of a decedent, which are given priority over most other claims against an Estate and against distributions to heirs. Case law has interpreted this statute to require a showing of three elements to find a fiduciary liable under the statute:

(1) the personal representative distributed assets of the estate;

(2) the distribution rendered the estate insolvent; and

(3) the distribution took place after the personal representative had notice of the Government's claim.

Allen v. Commissioner, T.C. Memo 1999-385.

b. The burden of proof regarding the elements under the Federal Priority Statute falls on the fiduciary, who has to show that the elements are not met. United States v. Reitano, 2014 WL 4384486, at *3 (D. Mass. 2014) (citing Bramwell v. U.S. Fid. & Guar. Co., 269 U.S. 483 (1926)).

5. Concept of Knowledge/Notice

a. Although the statute is silent on the issue of whether an executor must have notice of the government's claim, case law has interpreted the statute to require that the fiduciary have knowledge of the claim in order to be held personally liable for the debt. See Reitano, Id. At *3, FN 7. However, the type of knowledge that is required to allow the Government to establish its claims under this statute has been broadly construed.

b. Unfortunately, it appears that inquiry notice, as opposed to actual notice, is the kind of notice required under the priority statute. Inquiry notice is defined as follows:

"The knowledge requirement of 31 U.S.C. sec. 192 [now 31 U.S.C. sec. 3713] may be satisfied by either actual knowledge of the liability or notice of such facts as would put a reasonably prudent person on inquiry as to the existence of the unpaid claim of the United States." Leigh v. Commissioner, 72 T.C. 1105, 1110 (1979) (citing Irving Trust Co. v. Commissioner, 36 B.T.A. 146 (1937); Livingston v. Becker, 40 F.2d 673 [8 AFTR 10790] (E.D. Mo. 1929)). To be chargeable with knowledge of such a debt, the executor must be in possession of such facts as to "put him on inquiry." New v. Commissioner, 48 T.C. 671, 676 (1967). "It is this knowing disregard of the debts due to the United States that imposes liability on the fiduciary". Leigh v. Commissioner, supra at 1109-1110 (citing United States v. Crocker, 313 F.2d 946 [11 AFTR 2d 941] (9th Cir. 1963)).

Little v. Commissioner, 113 TC 474 (1999).

c. Under this notice concept, the unpaid taxes do not have to be formally assessed in order for the fiduciary to become liable under the statute. Viles v. Commissioner, 233 F.2d 276 (6th Cir. 1956). So long as the fiduciary knows of facts that, if true, would give a reasonable person notice that such tax debts could exist, then the fiduciary could be held liable for the debt even if not assessed. New v. Commissioner, 48 T.C. 671 (1967). See also Rev. Rul. 79-310 (Citations omitted).

d. There is some authority stating that a fiduciary can be absolved from liability under 31 U.S.C. § 3713 where he or she presents credible evidence that he or she does not have actual knowledge of a tax debt, but the burden would be on the fiduciary to provide such proof. See, e.g., O'Sullivan v. CIR, T.C. Memo 1994-17 (U.S. Tax Ct. 1994) (holding fiduciary met burden of showing no inquiry notice, where she possessed a signed copy of a prior return of the decedent for the year in question, even where that return was not filed by the decedent, and no other evidence was presented to show that the fiduciary had knowledge that the taxes were not paid).

e. However, although unsupported by any case law or statutory authority, the regulations would seem to indicate that a "due diligence" standard applies for fiduciaries in determining unpaid tax liability. Specifically, Treas. Reg. § 1.641(b)(2), states as follows:

"The fiduciary is required to make and file the return and pay the tax on the taxable income of an estate or of a trust. Liability for the payment of the tax on the taxable income of an estate attaches to the person of the executor or administrator up to and after his discharge if, prior to distribution and discharge, he had notice of his tax obligations or failed to exercise due diligence in ascertaining whether or not such obligations existed. For the extent of such liability, see section 3467 of the Revised Statutes, as amended by section 518 of the Revenue Act of 1934 (31 U. S. C. 192)."

Although this regulation pertains to current estate or trust income taxes (assessed by IRC § 641), rather than past tax liability, the application of a "due diligence" standard in the area of personal fiduciary liability is somewhat novel in this area, and could be used by the IRS to assert a heightened duty on the part of a fiduciary to ascertain tax obligations of the decedent or grantor than what currently appears to be required by case law.

f. It is also possible for some fiduciaries to assert good faith reliance upon a CPA or attorney for not paying taxes as a defense to personal liability under Section 3713. See Little v. Commissioner, 113 TC 474, 482 (1999). However, a fiduciary relies upon such a defense at his or her peril, as there are many other cases holding that such good faith reliance on advisors is not sufficient to negate a finding of personal liability. As stated in New v. Commissioner,

"If a fiduciary is put on inquiry, the fact that he inquires wrongly or haphazardly is not enough and is no defense. To absolve petitioner because his inquiry turned out to be inadequate would be to reward the careless fiduciary and to put a premium on rapid cursory investigations. Once a fiduciary is put on notice sufficient to put a reasonably prudent person on inquiry, he thereafter pursues a unilateral inquiry at his peril. Any other conclusion would make the fiduciary the final arbiter of what the estate owed in tax, a result entirely nullifying all effect of 31 U.S.C. sec. 192." New v. Commissioner, 48 T.C. 671, 679 (1967).

6. Potential Criminal Liability of the Personal Representative and Attorney:

a. In General: In rare circumstances, the United States has prosecuted the personal representative of an estate criminally.

b. Tales from the Crypt:

(1) Personal Representative Guilty of Making False Return: September 9, 2004 - Press Release: ROSEMARIE D. BRIA, "sentenced…. for subscribing a false estate tax return," "one-count Information charging her with filing a false estate tax return," "omitted estate assets from the estate tax return resulting in a tax loss to the Government."

(2) Attorney Guilty of Obstruction of Justice: May 2, 2012 – Press Release: SUZANNE LAND, "a Cincinnati attorney, pleaded guilty today to obstructing and impeding the Internal Revenue Service (IRS) while representing the estates of two deceased clients."

(3) Attorney Guilty of Making False Statements to the Service: December 28, 2012 – Press Release: William A. Hirst, "attorney pleaded guilty yesterday to one count of making a false statement to the Internal Revenue Service," "Hirst told the IRS he found the three lost deeds in a file and recorded them, which was false since Hirst knew he signed the client's signature to the three deeds recorded on April 4, 2005".

D. Federal Personal Liability for the Transferees of Estates and Gifts

1. General Lien Attached to Property: The United States has a lien on all property of the taxpayer for assessed and unpaid taxes. See I.R.C. § 6321 and 6322. The lien does not arise until the tax is assessed. Id.

2. Estate Tax a Lien on the Gross Estate: The United States has a special tax lien on the gross estate of an estate equal to the estate tax due. I.R.C. § 6324. This lien attached at the time of the decedent's death (i.e., the tax need not be assessed before the lien attaches). See Treas. Reg. § 301.6324-1(a)(1). Thus, the Service can also attach the property of the gross estate to a special lien.

3. Transferee Liability Imposed: I.R.C. § 6901(a)(1)(A) also imposed transferee liability on any heir, legatee, devisee of an estate or a donee of any gift. See also Treas. Reg. § 301.6901-1(a)(1).

E. Protect the Personal Representative From Personal Liability

1. <u>In General:</u> As discussed above, the personal representative faces potential exposure for the estate's tax liability. In addition to indemnity contracts, which are discussed below and may be appropriate for certain personal representatives, a personal representative should file the following three forms, each of which is discussed more fully below, to protect the personal representative from exposure to tax liability:

    a. Form 56, Notice Concerning Fiduciary Relationship;

    b. Form 4810, Request for Prompt Assessment Under Internal Revenue Code Section 6501(d); and

    c. Form 5495, Request for Discharge From Personal Liability Under Internal Revenue Code Section 2204 or 6905.

2. <u>Form 56, Notice Concerning Fiduciary Relationship:</u>

    a. <u>When to File:</u> File Form 56 two times: first, when the personal representative is appointed to let the Service know who the personal representative is and where to send all tax notices; and second, when the personal representative completes his or her job and dies, resigns, or is discharged.

    b. <u>Relevant Regulatory Requirement to File Up-Front:</u> Treas. Reg. § 301.6903-1(a) provides as follows:

    > Every person acting for another person in a fiduciary capacity shall give notice thereof to the district director in writing. As soon as such notice is filed with the district director such fiduciary must, except as otherwise specifically provided, assume the powers, rights, duties, and privileges of the taxpayer with respect to the taxes imposed by the Code. If the person is acting as a fiduciary for a transferee or other person subject to the liability specified in I.R.C. § 6901, such fiduciary is required to assume the powers, rights, duties, and privileges of the transferee or other person under that section. The amount of the tax or liability is ordinarily not collectible from the personal estate of the fiduciary but is collectible from the estate of the taxpayer or from the estate of the transferee or other person subject to the liability specified in I.R.C. § 6901.

c. <u>Forward Mail:</u> Have the decedent's mail forwarded to the personal representative or attorney to ensure that all proper financial and tax mailings are obtained.

d. <u>Ensure Liquidity for the Estate:</u> Promptly estimate the amount of cash required to discharge all liabilities and take early steps to ensure sufficient liquidity to prevent the assessment of penalties and interest.

e. <u>Be Sure to File Following Discharge:</u> If the personal representative dies, resigns, or is discharged from his or her fiduciary duty, file a second Form 56. In <u>Estate of Hull v. Commissioner</u>, T.C. Memo. 1990-579, where a wife filed Form 56 with the Service, administered the estate, but did not file a second Form 56 providing notice that the fiduciary relationship had terminated, the Tax Court held that a notice of deficiency was validly issued.

3. <u>Form 4810, Request for Prompt Assessment Under Internal Revenue Code Section 6501(d):</u>

a. <u>Determine Tax Exposure Through Form 4810:</u> Determine whether the Decedent owed any back taxes by filing with the Service a Form 4810, through which a request is made for prompt assessment of income and gift taxes.

b. <u>Relevant Statutory Provision:</u> Normally, the period for limitations on assessment is limited to three years. I.R.C. § 6501(a). The period of limitations on assessment may be extended by written agreement. I.R.C. § 6501(c)(4). Under I.R.C. § 6501(d), the personal representative of an estate may make a request for prompt assessment that will shorten the period of limitations on assessment to 18 months from the date of the written request therefor. For an estate, the prompt assessment procedures apply to any tax (other than estate tax) for which a return is required and for which the decedent or the estate may be liable. As an aside, this provision also applies to a liquidating corporation,

c. <u>Limit Distributions:</u> A cautious personal representative will wait for the Service to respond to their assessment request prior to making any distributions to the beneficiaries of the estate. The benefit of filing the Form 4810 is that a personal representative can distribute assets to the estate's beneficiaries more quickly while limiting the representative's risk.

d. Cases and Administrative Guidance Involving Attempts to Reduce a Personal Representative's Exposure to Personal Liability:

(1) The Request for Prompt Assessment Does Not Extend the Three-Year Period of Limitations on Assessment in the Second Circuit: In Estate of Callaway v. Commissioner, 231 F.3d 106 (2d Cir. 2000), the Court of Appeals for the Second Circuit held that the 18-month period for making a prompt assessment does not extend the period of limitations on assessment beyond the normal three-year period. Under the facts of the case, taxpayers, husband (H) and wife (W), timely filed their income tax return for 1988 on April 15, 1988. In 1990, H died. On Dec. 23, 1991, W, acting as personal representative of H's estate, filed a prompt assessment request with respect to taxpayers' 1988 return. The Court held that the time for making an assessment expired on April 15, 1992, three years after the filing of the 1988 return, not on June 23, 1993, 18 months after the filing of the prompt assessment request. This was because, the Court held, the 18-month period for assessment (here ending on June 23, 1993) does not extend the period for making the assessment beyond the date three years after the filing of the return (here, April 15, 1992).

(2) The Request for Prompt Assessment Does Not Limit a Statute Extension: In Greenfield v. Commissioner, T.C. Memo. 2008-16, the Tax Court held that a request for prompt assessment does not limit an agreement to extent the statute of limitations entered into by the taxpayer.

(3) Transferee Liability is Not Affected by a Request for Prompt Assessment: In Gen. Couns. Mem. 32904 (Aug. 27, 1964), the Service addressed whether transferee liability statutes are affected by a request for prompt assessment. The Service held that I.R.C. §§ 6501(d) and 6901(e), when read together, reveal that for purposes of computing the period of limitations on assessment against a transferee, the

period of assessment against a deceased person, or dissolved corporation as a transferor, regardless of the fact that a request for prompt assessment has been made, is the period that would be in effect had death or termination not occurred (i.e., the normal 3-year period from the date the return was filed rather than the 18-month period prescribed in I.R.C. § 6501(d)).

4. Form 5495, Request for Discharge From Personal Liability Under Internal Revenue Code Section 2204 or 6905:

a. General Rule for Liability:

(1) Regulatory Liability: Treas. Reg. § 20.2002-1 provides that a personal representative is generally personally liable for the tax debts of a decedent or estate. That section provides as follows:

(a) Every executor, administrator, or assignee, or other person, who pays, in whole or in part, any debt due by the person or estate for whom or for which he acts before he satisfies and pays the debts due to the United States from such person or estate, shall become answerable in his own person and estate to the extent of such payments for the debts so due to the United States, or for so much thereof as may remain due and unpaid.

(2) Liability Imposed: In Estate of Sivyer v. Commissioner, 64 T.C. 581 (1975), the Court held a personal representative fully liable for a deficiency to the extent of the remaining estate assets in the personal representative's control or in the control of the transferees.

b. Overview of Mechanisms to Discharge a Personal Representative From Liability: There are various provisions by which a personal representative can limit his or her personal liability. Generally, the personal representative invokes the benefits of these statutory provisions by filing with the Service Form 5495, Request for Discharge From Personal Liability Under Internal Revenue Code Section 2204 or 6905. As the name of the Form suggests, the types of requests that can be made (and the statutory predicates) are as follows:

(1) Discharge From Personal Liability for Estate Tax: I.R.C. § 2204 provides that a fiduciary other than a personal representative (e.g., a trustee of a revocable trust) may apply for discharge of personal liability for estate tax.

(2) Discharge From Personal Liability for Income and Gift Taxes: I.R.C. § 6905(a) provides, that after a decedent's individual (but not fiduciary) income or gift tax return has been filed, a personal representative may make written application to the Service office where the estate tax return is filed for release of the PR's personal liability for such income or gift tax.

c. Effect of Filing Form 5495: If, in response to the filing of a Form 5495, the personal representative pays the additional tax or if no notice is received from the Service within nine months from the date of filing Form 5495, then the personal representative is discharged from personal liability.

d. When to File: Practitioners or personal representatives should file Form 5495, Request for Discharge From Personal Liability Under Internal Revenue Code Section 2204 or 6905 separately but at the same time as Form 4810.

e. Relevant Statutory and Regulatory Provisions:

(1) General Rule for Relief From Liability: I.R.C. § 2204(a) provides as follows:

> If the executor makes written application to the Secretary for determination of the amount of the tax and discharge from personal liability thereof, the Secretary (as soon as possible, and in any event within 9 months after the making of such application, or, if the application is made before the return is filed, then within 9 months after the return is filed, but not after the expiration of the period prescribed for the assessment of the tax in I.R.C. § 6501) shall notify the executor of the amount of the

tax. The executor, on payment of the amount of which he is notified (other than any amount the time for payment of which is extended under I.R.C. § § 6161, 6163, or 6166), and on furnishing any bond which may be required for any amount for which the time for payment is extended, shall be discharged from personal liability for any deficiency in tax thereafter found to be due and shall be entitled to a receipt or writing showing such discharge.

(2) Good Faith Reliance on Gift Tax Returns: I.R.C. § 2204(d) provides as follows:

> If the executor in good faith relies on gift tax returns furnished under section 6103 (e)(3) for determining the decedent's adjusted taxable gifts, the executor shall be discharged from personal liability with respect to any deficiency of the tax imposed by this chapter which is attributable to adjusted taxable gifts which–
>
> i) are made more than 3 years before the date of the decedent's death, and
>
> ii) are not shown on such returns.

f. Time for Service to Respond: If Form 5495 is properly filed, the Service has nine months to notify the personal representative of any deficiency for decedent’s applicable income or gift tax returns.

5. Indemnity Agreements and Refunding Bonds and Releases: Additionally, the personal representative can enter into contractual agreements with distributees in which the distributees agree to (1) indemnify the personal representative from any personal liability arising from the distribution, and/or (2) refund such amounts distributed as are necessary to satisfy the estate’s debts, including tax debts, and release the personal representative from personal liability for such distribution.

a. Indemnity Agreements: The personal representative can enter into contractual agreements with distributees in which the distributees agree to indemnify the personal representative from any personal liability arising from the distribution.

b. Refunding Bond and Releases: The personal representative (or any other fiduciary, such as a trustee) can condition a distribution upon the distributee signing a refunding bond and release, which is a contractual arrangement through which the distributee agrees to refund such amounts distributed as are necessary to satisfy the estate's debts, including tax debts, and release the personal representative from personal liability for such distribution

6. State court orders provide no defense: One common misconception by attorneys and other professionals in this area is that an order of a probate court, or the running of a probate court statute of limitation for the filing of claims, is sufficient to negate as claim by the IRS for unpaid taxes. This position has been uniformly rejected by the courts. See, e.g., Viles v. Commissioner, 233 F.2d 376, 380 (6th Cir. 1956) (holding "it was not necessary for the Government to appear in or become a party to the probate court proceedings and its priority was not affected by the state court's judgment.") See also Northwestern Jobbers Credit Bureau, 1 TC 863 (1943) (holding orders of state courts, such as a writ of execution or an order of a court requiring distributions to be made to the exclusion of the United States, do not absolve a fiduciary from liability under the priority statute).

Thus, a probate court's order of distribution which discharges a fiduciary in an estate has no effect on the IRS's ability to assert personal liability for unpaid tax debts of a decedent against a fiduciary.

F. Application to Other Fiduciaries

1. The language of Section 3713 seems to apply only to "a representative of a person or an estate" who pays other claims before paying the government for back taxes, and indeed most cases focus on the liability of executors of estates, rather than trustees. However, there are cases extending this liability to persons who exert possession and control over a decedent's assets, including trustees.

2. For example, the U.S. Supreme Court held in King v. United States, 379 U.S. 329 (1964), that a court appointed receiver could fall within the category of fiduciaries covered by the Federal Priority Statute. There, the receiver argued that he was excluded from coverage by the statute because

he was acting as an officer of the court, rather than as a representative of the taxpayer. The Court held this argument was misplaced, in that whether he fell within the category of fiduciaries covered by the statute depended not on his title or manner of appointment, but "upon the degree of control he is in a position to assert over the allocation among creditors of the debtor's assets in his possession."

3. The Federal Priority statute was later amended to exclude trustees appointed in federal bankruptcy, and accordingly the specific holding in King has been abrogated by statute. However, the rationale of King is still valid, and should be considered when faced with non-bankruptcy fiduciaries (such as state court receivers).

4. Allen case—possession of assets by son was held to be enough to incur liability as a representative of the estate, even without filing a probate proceeding and being appointed as the executor. The Court here used the definition of "executor" under IRC Code § 2203 to justify this holding. This definition defines an executor as either an appointed executor, or if none then any person in actual ore constructive property of the decedent.

5. <u>U.S. v. McIntyre</u>, 110 AFTR 2d 2012-5151 (S.D. TX 2012). In a relatively complicated fact pattern, the Court held that both a personal representative and a trustee who had received assets of an estate could be held liable under Section 3713. The Court found that "a trustee is a paradigmatic example of a fiduciary," and that because the decedent's Will provided that the trust would be responsible for any debts due on his death, the trustee could be a fiduciary under Section 3713. Because the trust made distributions without paying gift taxes owed by the decedent, and because the Court held that the trustee had knowledge that the IRS "might" make a claim against the decedent for those gift taxes, the trustee had sufficient notice under the statute to make it personally liable for the taxes.

G. <u>Transferee Liability – A Danger to Trustees</u>

1. <u>General legal principles:</u> Another possible avenue of liability for a fiduciary lies in the concept of "transferee liability," which allows the IRS to force persons who receive assets of an Estate or Trust to return those assets for payment of tax debts. Specifically, those provisions in the Code are found in Section 6324(a)(2), which imposes tax liability for estate taxes against

transferees holding assets included within the decedent's gross estate under IRC Sections 2034 and 2042, and 6324(b), which imposes tax liability for delinquent gift taxes against transferees who received assets of a decedent. Even if the Code does not specifically contain a statute providing for legal liability to transferees, the IRS and courts have allowed such a claim to be made in equity. See, e.g., Berliant v. Commissioner, 53 AFTR 2d 84-1619, 729 F2d 496 (7th Cir. 1964).

2. Who is the transferee of a trust? In many situations, the fiduciary has already made distributions of assets to a beneficiary of a trust. A question arises, for liability purposes, as to who is the "transferee" upon whom liability can be imposed: the trustee, or the beneficiary?

   a. Englert v. Commissioner: In the case of Englert v. Commissioner, 32 T.C. 1008 (1959), the tax court answered this question by finding that the trustee should be considered the transferee under the Code provisions imposing liability. The Tax Court determined from the plain language of the statutes that a trustee, **and not a beneficiary**, was included in the class of persons against whom transferee for revocable transfers could be imposed. The appellate court, on appeal, ultimately determined from the equities of the case that it would be patently unfair to impose personal liability against this particular trustee, and accordingly that the IRS was estopped due to its own conduct from imposing personal liability on the trustee. See Schuster v. Commissioner, 312 F.2d 311 (9th Cir. 1962). However, the appellate court agreed with the substantive analysis provided by the tax court on the issue of who should be considered the transferee.

   b. U.S. v. Johnson: The holding in *Englert* was reinforced in the case of U.S. v. Johnson, 109 AFTR 2d 2012-2253 (D. Ut. 2012). This case involved the estate of Anna Smith, in which she created a family trust which received all of the assets of the estate, including stock in a corporation. The trustee then distributed all of the assets to the beneficiaries, and in exchange the beneficiaries agreed to pay all the remaining estate taxes. Ultimately, the corporation went bankrupt, and the estate defaulted on the remaining taxes. The IRS attempted to collect the taxes from both the trustees and the beneficiaries. Citing *Englert*, the Court held that the beneficiaries did not fall within the definition of "transferees" under Section 6324(a)(2), because they did not receive or hold the property immediately upon the death of the decedent. *Id*. at 2257-58.

      The Johnson case provides an excellent summation of the law in this area, and also of the various forms of statutory construction that apply to tax cases. Suffice it to say, the IRS attempted every conceivable argument to extend transferee liability to the beneficiaries, and the Court rejected every one.

The trustees, however, were held to be personally liable for the remaining taxes under the transferee provisions. The trustees attempted to escape liability by arguing that because the IRS had not made a timely assessment of taxes against them (within 3 years of the estate tax return filing), it was barred from its action against them. *Id*. at 2260. The Court agreed that were the IRS to choose to bring an action for transferee liability under the methods proscribed by Section 6901 of the IRC, then the IRS would be subject to such deadlines and procedures, including assessment. However, the Court held that Section 6901 was only one method of collection by the IRS for transferee liability, and that where the IRS chooses to bring an action under Section 6324(a)(2), it is not subject to such deadlines, and is only subject to the general limitation periods for collection. *Id*. at 2261. In other words, through this holding the IRS can avoid assessment entirely for a transferee claim under Section 6324(a)(2), and move straight toward enforcement of the tax debt.

c. Conclusion: While these cases may be favorable to beneficiaries, they provide dangerous precedent for trustees, since it is now virtually undisputed that trustees will incur transferee liability exclusively for many types of transfers. The danger from these cases and the code sections to the trustees is something that cannot be ignored, where there is reason to suspect any kind of taxes are owed by the decedent. The liability is personal to the trustee, and consequently a trustee distributes assets at his peril where known tax liabilities of the decedent exist.

H. Payment of Estate Administrative Expenses

1. Section 3713 does not provide the IRS with priority over all expenses, but only over the debts of the decedent himself. Typical administrative expenses incurred by the estate which would be defined under state law, such as funeral expenses, payment of professionals, statutory allowances for widows and children, etc., are not considered debts of the decedent, and accordingly take priority over the federal tax debts. Rev. Rul. 80-112. See also U.S. v. Weisburn, 48 F. Supp. 393 (E.D. Pa. 1943) (holding that payment of administrative expenses and funeral expenses took priority over federal tax debts).

2. The question of how far this priority for administrative expenses extends is an open question, and is subject to review by the IRS, especially where the

expenses move outside of standard administrative expenses and into the broader category of expenses incurred to maintain or preserve assets. For example, in U.S. v. McIntyre, *supra*, the district court refused to hold that accounting and legal services were incurred "in the preservation, safekeeping and management of the estate," as would have qualified them as administrative expenses under the Texas Probate Code, and accordingly held that the Trustee was personally liable for payment of these expenses before the federal tax debt.

3. Case law in this area is sparse and somewhat contradictory, but is something a fiduciary should consider as he or she takes over trust or estate assets, especially regarding payment of expenses for maintaining the assets. Improper payments prior to payment of tax debts can result in the added imposition of personal liability under the Federal Priority Statute, where the debts are not paid and the estate and trust have fully distributed the assets.

G. Business Taxes

1. Because the fiduciary who takes over management of a decedent's business steps into his or her shoes for that purpose, the fiduciary can incur liability for current business taxes in the same manner as the decedent. It is self-evident that once the trust is funded, the trustee becomes responsible for calculation of any taxes owed by the trust. For estates, where the decedent owned a controlling interest in a company, the fiduciary will then take over as a director or officer of the company, which will bring about duties as it relates to preparation and payment of business taxes, for federal, state and local taxes, which accrue for the business.

Importantly, payroll taxes are a significant risk for fiduciaries when taking over a business, and can arise both from taxes owed after the decedent's death during the ongoing administration of the business, and also for taxes not properly withheld by the company prior to the decedent's death. There can be many warning signs that a fiduciary can see for this problem, especially where employees of the business claim to be independent contractors, or where they assert that they have always been paid in cash. Those facts can give rise to inquiry notice under the Federal Priority statute, since they are indicative that prior trust fund taxes have not been paid.

The Federal Priority statute has been applied to corporate officers and directors in many situations. See, e.g., U.S. v. Renda, 709 F.3d 472 (5th Cir. 2013) (holding president of insolvent corporation personally liable under the priority statute for payment of government claims). Thus, where a trustee or executor takes on an active role with a closely held business, he or she may incur personal liability for failure to pay federal debts in a situation where the company has become insolvent.

I. <u>Conflicts of Interest</u>

1. When a fiduciary takes over a business as part of its duties, there are many conflicts which can arise in the fulfilling of its duties. These conflicts can arise between the fiduciary's duties to the beneficiaries, and the fiduciary's duties as the manager or director of the company. They can also arise from the fiduciary's own concern for its personal liability, versus its duties as a director or as fiduciary.

As it regards the issues of tax liability in particular, a common question arises over the fiduciary's duties in determining past tax liability. As a general rule, a fiduciary is under no obligation, by statute or otherwise, to review prior tax returns for deficiencies. The fiduciary is also under no obligation to file an amended return, even if he or she is aware of a deficiency.

However, where the fiduciary has knowledge that would put a reasonable person under a duty of inquiry, the issue becomes muddled, in that the fiduciary's concern for his or her own personal liability may conflict directly with the interests of the business or the beneficiaries, both of which may want to 'let the sleeping dog lie" with regards to prior tax issues not being actively audited or investigated by the IRS. While this conflict may not pose such a problem where the tax liability is easily ascertainable, in many situations the records of the company or taxpayer are so muddled or incomplete that it is not reasonably possible to determine the taxes owed, although it may be clear that some taxes should be paid.

Unfortunately, there is no simple solution to this issue, and no significant case law addressing the issues. As noted in the next section, there are ways for a fiduciary to attempt to avoid or discharge this personal liability, but care must be used to navigate the issues surrounding these methods, especially where the stockholders or beneficiaries do not want to address the issue.

V. FOIA Requests

A. Background

1. Enactment of the Law: The Freedom of Information Act ("FOIA"), 5 U.S.C. § 552, is a federal freedom of information law that allows for the full or partial disclosure of previously unreleased documents within the control of the federal Government, including the Service.

2. Learn What the Government Knows: Practitioners should submit a FOIA request to the Service at various stages during the audit, Appeals, and post-audit or post-Appeals stages of a tax controversy.

3. Reason for Making the Request: Often, but not always, the FOIA will give the practitioner insight into the reasons that the Service determined a certain adjustment in the taxpayers' income, estate, or gift tax for a particular year. Additionally, FOIA might help certain taxpayers show that procedural due process requirements were not met (e.g., I.R.C. § 6751's written supervisory approval of a penalty determination.[4] In this regard, a FOIA response can be of considerable value when taking an issue before Appeals or before a federal court.

B. Making FOIA Requests

1. Format of the FOIA Request: There is no required form for making a FOIA request. We advise that such request be made in writing to the Service's Disclosure Office.

2. How to Make: FOIA requests can be sent by fax or by mail as follows:

a. By Fax: FOIA requests can be faxed to (877) 891-6035.

b. By Mail: FOIA requests can be sent by mail to the following address:

(1) Internal Revenue Service,
IRS FOIA Request,

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[4] As noted, I.R.C. § 6751(b)(1) generally requires that the initial determination that a penalty applies be approved in writing by the immediate supervisor of the person making the determination, the taxpayer may argue that the penalty may not be assessed. This issue is pending before the United States Tax Court and should be resolved in 2016. See Graev v. Commissioner, docket No. 30638-08.

Stop 93A,
Post Office Box 621506
Atlanta, GA 30362-3006

3. Cost: There is generally no charge for the first 100 pages and $0.20 per page thereafter. As a practical matter, the Service tends to issue its FOIA response for voluminous materials on a CD.

4. Limitations on the FOIA Request: There are, of course, limits to the FOIA request. Two of the more noteworthy limitations are as follows:

   a. The Service is only required to look for an existing record or document in response to a FOIA request. FOIA does not require the Service to collect information it does not have or to research or analyze data for a person making a FOIA request; and

   b. The Service is not obligated to create a new record to comply with a FOIA request. However, when records are maintained by a computer, the Service may be required to retrieve information in response to a FOIA request.

C. The FOIA Response

1. Time to Respond: Under FOIA, the Service must determine within 20 business days after the date a FOIA request is received whether and to what extent to comply with the FOIA request. 5 U.S.C. § 552. The Service can extend the 20-day period by an additional 10 days in unusual circumstances. See, e.g., 5 U.S.C. § 552 (a)(6)(B)(i)-(iii). Such unusual circumstances include, but are not limited to, the need to collect information from field offices, the need to review large numbers of documents, and the need to consult with other agencies. 5 U.S.C. § 552 (a)(6)(B)(i).

2. Denials in Whole or In Part: The Service tends to respond to the FOIA request and will generally produce some but not all documents. If a FOIA request is denied in whole or in part, the Service must state the reasons for the denial. The request may be exempt from disclosure under FOIA because:

a. It concerns classified documents pertaining to national defense and foreign policy;

b. It is prohibited by internal personnel rules and policies;

c. The information is exempt under other laws, the most common of which cited in the tax contest is the prohibition on disclosure of other taxpayer information under I.R.C. § 6103;

d. It concerns trade secrets and confidential commerce or financial information;

e. It concerns interagency or intragency memorandums or letters;

f. It is exempt for personal privacy reasons, such as personnel, medical, and similar files, the disclosure of which would amount to an invasion of privacy;

g. It concerns information compiled for law enforcement reasons;

h. It concerns information that is contained in or related to examination, operating, or conditions reports prepared by, on behalf of, or for the use of an agency responsible for the regulation of a financial institution;

i. It covers geological and geophysical information, data, and maps concerning wells. See Posting of FOIA Requests: A Look Into the IRS Examination File to Tax Controversy (Civil and Criminal Report) blog, http://taxlitigator.me/2012/01/11/ foia-requests-a-look-into-the-irs-examination-file/ (discussing the FOIA requirements and exemptions more fully).

D. FOIA Appeal Rights and Judicial Actions

1. Right to Appeal: Taxpayers can appeal a denial of a FOIA request, either in whole or in part, administratively to the Service. The appeal should include reasons why the Service response to the FOIA request was inadequate and must be postmarked within 35 days after the date of the denial letter or other adverse determinations.

2. Means of Appeal: An appeal is filed by sending a letter to Internal Revenue Service Office of Appeals, Attn: FOIA Appeals, 5045 E. Butler Avenue, M/Stop 55201, Fresno, California 93727-5136.

3. Contents of Appeal: The appeal should include copies of the FOIA request and the initial Service decision responding to the request. The envelope containing the appeal should be marked in the lower lefthand corner with the words "Freedom of Information Act Appeal."

4. Time for Appeal: The Service is required to make a decision on an appeal within 20 business days after the date of receipt of the appeal unless extended. Treas. Reg. § 601.702(c)(10)(iii).

5. Judicial FOIA Actions: If an administrative FOIA appeal before the Service is denied, a complaint against the Service seeking disclosure of the requested information may be filed to the appropriate federal District Court. 5 U.S.C. 552(a)(4)(B); Treas. Reg. § 601.702(c)(13). A copy of the complaint must be served upon the Commissioner of Internal Revenue, Attention: CC:PA, 1111 Constitution Avenue, N.W., Washington, D.C. 20224.

6. Right to Attorneys' Fees: Reasonable attorneys' fees and litigation costs may be awarded if the taxpayer substantially prevails in the FOIA litigation.

Appendix A: Summary of Criminal Violations (Adapted From IRM, pt. 25.1 (Ex. 25.1.1-1)

Statutory Authority and Offense	Classification of Offense	Elements for Prosecution
26 U.S.C. § 7201 (Evasion)	Felony	(1) Willfulness; (2) Attempt to evade or defeat (usually involves concealment or deception) tax or payment thereof; and (3) Tax deficiency.
26 U.S.C. § 7202 (Trust Fund Violation – Failure to Collect or Park Over Tax)	Felony	(1) Willfulness; (2) Requirement to collect, truthfully account for, and pay over employment taxes; and (3) Either failure to collect any tax or failure to truthfully account for and pay over any tax or both.
26 U.S.C. § 7203 (Failure to File or Failure to Pay)	Misdemeanor	(1) Willfulness; (2) Requirement to file a return, pay an estimated tax or tax, maintain records, or supply information; and (3) Failure to file a return, pay an estimated tax or tax, maintain records, or supply information.
26 U.S.C. § 6050I (Trade or Business Required to File a Form 8300 for Receiving More Than $10,000 Cash)	Felony	(1) Willfulness; (2) Subject to reporting requirement relating to cash of more than $10,000 received in trade or business; and (3) Evasion of reporting requirement by: a. Causing a trade or business to fail to file report, or b. Causing a trade or business to file false report, or c. Structuring transactions to avoid report.

26 U.S.C. § 7204 (Employee Wage Statements)	Misdemeanor	(1) Duty to deduct and withhold employment tax or income tax (IRC §§ 3102(a), 3402(a)); (2) Duty to timely furnish to the employee a written statement showing specified information concerning the deductions (IRC § 6051); (3) Furnishing a false or fraudulent statement to an employee, or the failure to furnish a statement to an employee at the required time and in the required manner; and (4) Willfulness.
26 U.S.C. § 7205 (False-W-4)	Misdemeanor	(1) Duty to supply information to employer regarding income tax withholding (IRC § 3402(f)(2)); (2) Furnishing false or fraudulent information or failure to supply information which would require an increase in tax to be withheld; and (3) Willfulness.
26 U.S.C. § 7206(1) (False Return)	Felony	(1) Making and subscribing a return, statement or other document under penalties of perjury; (2) Knowledge that it is not true and correct as to every material matter; and (3) Willfulness.
26 U.S.C. § 7206(2) (Assisting in Preparation of False Return)	Felony	(1) Aiding or assisting in, procuring, counseling, or advising the preparation or presentation of a document in connection with matters

		arising under the internal revenue laws; (2) Document was false as to a material matter; and (3) Willfulness.
26 U.S.C. § 7206(4) (Removal or Concealment With Intent to Defraud)	Felony	(1) Tax imposed on property; (2) Property on which tax is imposed or will be imposed or levy is authorized; (3) Removal or concealment; and (4) Intent to evade or defeat assessment or collection of tax.
26 U.S.C. § 7206(5) (Compromises and Closing Agreements)	Felony	(1) Willful concealment of property; or (2) Willful withholding, falsifying and destroying records; and (3) Receives, withholds, destroys, mutilates, or falsifies any book, document, or record, or makes any false statement.
26 U.S.C. § 7207 (Submission of False Documents)	Felony	(1) Willfulness; (2) Delivery or disclosure to any officer or employee of the IRS of any list, return, account, statement, or other document; (3) Return, statement, or other document is false or fraudulent as to a material matter; and (4) Knowledge of material falsity.
26 U.S.C. § 7212(a) (Omnibus Clause)	Felony	(1) Corrupt effort, endeavor, or attempt; (2) To impede, obstruct or interfere with; and

		(3) Due administration of the Code.
26 U.S.C. § 7212(a) (Corrupt or Forcible Interference)	Felony or Misdemeanor	(1) Use of force or threats; (2) To intimidate, impede or obstruct; and (3) An officer or employee of the U.S. acting in official capacity under the Code.
26 U.S.C. § 7212(b) (Forcible Rescue of Seized Property)	Felony	(1) Forcible rescue or attempt to forcibly rescue; (2) Seized property; and (3) Knowledge of seizure.
26 U.S.C. § 7215 (Collecting and Paying Tax)	Misdemeanor	(1) Taxpayer was a person required to collect, account for, and pay over income tax withholding on wages and FICA taxes; (2) Taxpayer was notified of the failure to collect, account for, and pay over; and (3) Taxpayer failed to collect, account for, and pay over the taxes, while not entertaining a reasonable doubt as to whether the law required the taxpayer to do so, and the failure was not due to circumstances beyond the taxpayer's control.
26 U.S.C. § 7232 (Failure to Register)	Felony	(1) Fails to register in connection with taxable purchase — diesel fuel and special motor fuels; or (2) Falsely represents that he is registered; or (3) Willfully makes false statement in an application for registration.
18 U.S.C. § 2 (Aiding and Abetting)	Felony or Misdemeanor	(1) Taxpayer associated with the criminal venture;

		(2) Taxpayer knowingly participated in the venture; and (3) Taxpayer sought by his or her actions to make the venture succeed.
18 U.S.C. § 152(1) (Concealment of Property)	Felony	(1) Bankruptcy proceeding was in existence; (2) Individual fraudulently concealed the property from the custodian; and (3) Property belonged to the bankruptcy estate.
18 U.S.C. § 152(2) (False Oath or Account)	Felony	(1) Existence of a bankruptcy proceeding; (2) Statement under oath; (3) Statement must be material; (4) Statement must be false; and (5) Statement was made knowingly and fraudulently.
18 U.S.C. § 152(3) (False Declarations)	Felony	(1) Existence of a bankruptcy proceeding; (2) Individual made a false declaration, certificate, verification, or other statement in relation to the bankruptcy proceeding; (3) Statement was material; and (4) Statement was known to be false.
18 U.S.C. § 152(4) (False Claims)	Felony	(1) Bankruptcy proceedings have commenced; (2) Individual presented or caused to be presented a proof of claim in the bankruptcy; (3) Proof of claim was false as to a material matter; and

		(4) Individual knew the proof of claim was false and acted knowingly and fraudulently.
18 U.S.C. § 152(5) (Fraudulent Receipt of Property)	Felony	(1) Individual receives a material amount of property from a debtor; (2) Such transfer occurred after the filing of a case under Title 11; and (3) Acts were done with the intent to defeat the provisions of Title 11.
18 U.S.C. § 152(6) (Extortion and Bribery)	Felony	(1) Individual gives, offers, receives, or attempts to obtain money or property, remuneration, compensation, reward, advantage, or promise for acting or forbearing to act in any case under Title 11; and (2) Action was made knowingly and fraudulently.
18 U.S.C. § 152(7) (Fraudulent Transfer or Concealment)	Felony	(1) Individual fraudulently transferred or concealed the defendant's property or the property of another; and (2) Such act of transfer or concealment was done with the intent to defeat the provisions of Title 11, or in contemplation of a case under Title 11.
18 U.S.C. § 152(8) (Destruction or Alteration of Recorded Information)	Felony	(1) Bankruptcy proceeding existed; (2) Individual concealed, destroyed, or mutilated the documents; (3) Such documents related to the property or financial affairs of the debtor; and

		(4) Individual acted knowingly and fraudulently.
18 U.S.C. § 152(9) (Withholding of Recorded Information)	Felony	(1) Bankruptcy proceeding existed; (2) Individual withheld from the trustee entitled to its possession; books, documents, records, or papers; (3) Such documents related to the property or financial affairs of the debtor; and (4) Individual withheld the documents knowingly and fraudulently.
18 U.S.C. § 157 (Bankruptcy Fraud)	Felony	(1) Defendant devised or intended to devise a scheme or artifice to defraud; and (2) For the purpose of executing or concealing such scheme or artifice or attempting to do so; (3) Files a petition under Title 11; or (4) Files a document in a proceeding under Title 11; or (5) Makes a false or fraudulent representation, claim, or promise concerning or in relation to a proceeding under Title 11.
18 U.S.C. § 286 (Conspiracy to Defraud the Government With Respect to Claims)	Felony	(1) An agreement, combination, or conspiracy to defraud the United States (2) By obtaining or aiding to obtain the payment of any false, fictitious or fraudulent claim.
18 U.S.C. § 287 (False Fictitious or Fraudulent Claims)	Felony	(1) Knowingly makes or presents (statute does not require that person providing

		false information to return discounter who filed return actually file return to be guilty under 18 U.S.C. § 287); (2) False, fictitious or fraudulent claim; and (3) Knowing that claim filed is false, fictitious or fraudulent.
18 U.S.C. § 371 (Conspiracy)	Felony	(1) The general conspiracy statute encompasses two distinct types of conspiracies; a. Conspiracy to commit any federal offense b. Conspiracy to defraud the United States or any agency thereof, which includes the Service (2) Essential elements of a 18 U.S.C. § 371 offense are: a. Agreement by two or more parties b. To commit an offense against the United States; or, to defraud the United States or one of its agencies c. Overt act by one or more of the parties in furtherance of the agreement; and (3) Requisite intent to defraud or to commit the substantive offense.
18 U.S.C. § 1001 (False Statements)	Felony	(1) Either: a. Falsifying, concealing or covering up any material fact by any trick, scheme, or device; or b. Making false, fictitious or fraudulent statements or representations; or c. Making or using any false writing or document.

		(2) Knowingly and willfully. (3) In a matter within the jurisdiction of a department or agency of the United States. (4) False matter was of a material nature
18 U.S.C. § 1956 (Laundering of Monetary Instruments)	Felony	(1) Whoever knowing that property involved is proceeds from a specified unlawful activity (“SUA”). (2) Person knew that proceeds was from some activity that constitutes a felony under state, federal or international law; a. Conducts or attempts to conduct a financial activity involving proceeds of a SUA b. With intent to promote the SUA or c. With intent to engage in conduct in violation of 7201 or 7206 or whoever knowing the transaction is i. Designed to conceal or disguise the nature, the location, the source, the ownership, or the control of the proceeds of the SUA or ii. To avoid a transaction reporting requirement under a State or Federal law