

When Failure to File a Return Becomes Criminal

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Offenses

Willful Failure to File – 26 USC § 7203

Elements of the crime:

- A person required to pay any estimated tax or tax, or to make a return, keep any records, or supply any information
- Who willfully fails to do any of the above at the time required to do so
- Shall be guilty of a misdemeanor
- Each failure is a separate offense

Penalty:

- Fined no more than \$25,000 (\$100,000 for corporations) and/or
- Imprisoned for no more than 1 year
- Costs of prosecution

Special Exceptions:

- If no estimated tax penalty applies under 26 USC § § 6654 or 6665, section 7203 does not apply.
- If the willful failure relates to reporting cash received in a trade or business under 26 USC § 60501, the violation is a felony punishable by up to 5 years in prison

Offenses (continued)

Attempt to Evade or Defeat Tax

Elements of the crime:

- Willfully attempting in any manner to evade or defeat any tax or payment thereof
- A tax imposed by Title 26 is due and owing
- Shall be guilty of a felony

Penalty

- Fined no more than \$100,000 (\$500,000 for corporations) and/or
- Imprisoned for no more than 5 years
- Costs of prosecution

Offenses (continued)

Spies v. United States, 317 U.S. 492 (1943)

Elements of “Spies” evasion:

- Failure to file return **and**
- Affirmative acts of evasion, i.e., acts showing an intent to conceal or mislead.

Examples of Affirmative acts of evasion per *Spies* include:

- Keeping a double set of books
- Making false or altered entries
- Making false invoices
- Destroying records
- Concealing sources of income
- Handling transactions to avoid usual records
- Any other conduct likely to conceal or mislead

Filing false Forms W-4 claiming exemption for federal taxation with failure to file tax returns each year can be affirmative acts of evasion. See *U.S. v. Brooks* 174 F 3d 950, 954-956 (8th Cir. 1999).

Omission to act will not satisfy the affirmative act requirement. *Spies* at 499. *U.S. v. Hoskins*, 645 F 3d 1086, 1091 (10th Cir. 2011)(“To be liable under § 7201, a defendant must do more than passively fail to file a tax return”).

Offenses (continued)

Other affirmative acts include:

- False statements to agents. *U.S. v. Goodyear*, 649 F.2d 226, 227-28 (4th Cir. 1981).
- Proof of a false statement on an extension of time to file a tax return that no tax is owed for the year. *U.S. v. Klausner*, 80 F. 3d 55, 62 (2d Cir. 1996).

False statements may be made before, simultaneously with, or after the taxpayer's failure to file a return (see, *U.S. v. Copeland*, 786 F. 2d 768, 769-70 (7th Cir. 1985)), but must be made with the intent to evade tax for the year charged. See, *U.S. v. Voigt*, 89 F. 3d 1050, 1089-91 (3d Cir. 1996).

Penalties:

- Punishable as a 26 USC § 7201 tax evasion

Offenses (continued)

Evasion of Payment

- Requires establishing an ability to pay to satisfy the willfulness requirement. *Spies* at 498.
- Claims that the taxpayer lacks liquid assets to pay the tax does not prevent a showing of willfulness where the taxpayer was living high and spending freely. *U.S. v. Tucker*, 686 F 2d 230, 233-34 (5th Cir.), *cert. denied*, 459 U.S. 1071 (1982).
- Willful failure to pay is a lesser included offense of a willful attempt to evade payment of tax. *U.S. v. McGill*, 964 F 2d 222, 239-40 (3d Cir. 1992); *U.S. v. DeJar*, 823 F. 2d 1110, 1113-14 (9th Cir. 1987).

Willfulness

- Willfulness means the voluntary, intentional, violation of a known legal duty. *Cheek v. United States, 498 US 192 (1991)* , citing *United States v. Pomponio, 429 US 10, 13 (1976)*.
- Willfulness is a subjective, state-of-mind issue.
- In *Cheek*, the Supreme Court held that a defendant on trial for evasion of federal income taxes must be acquitted if the jury finds that he sincerely believed he was not violating the law, regardless of whether the defendant's belief was "objectively reasonable".
- Willfulness does not exist if the defendant acted in good faith with a belief that the law did not impose the legal obligation she is alleged to have violated.

Statute of Limitations

- Under 26 USC §6531(4), the statute of limitations for willful failure to file returns (other than information returns) or to pay tax is 6 years.
- Under 26 USC §6531(2), the statute of limitations for willfully attempting to evade or defeat tax or payment thereof is 6 years.
- A 3-year statute of limitations applies to willful failure to file information returns, such as partnership returns, and to willful failure to keep records or supply information.
- A 3-year statute of limitations applies to willful failure to file a Form 8300.

CI Investigations of Failure to File Cases

- How do the investigations get started?
 - Civil fraud referrals from within IRS
 - Whistleblowers and informants
 - Cooperating witnesses
 - Grand jury investigations
 - Other government agencies' investigations or information
 - FinCen

CI Investigations (continued)

- What can you expect the CI investigation to entail?
 - IRS database showing no return filing
 - Proof of prior return filing from IRS records (to prove knowledge of requirement to file)
 - Investigation of income producing activities
 - Evidence gathering to establish willfulness from:
 - Taxpayer interview/misrepresentations
 - Tracing income into nominee names or foreign accounts
 - Shell companies established to hide income/ownership
 - Multiple LLCs or partnerships used to hide income/ownership
 - Dealing in cash
 - Depositing cash in banks in increments under \$10,000 (smurfing)

What Prosecutors Look for in Charging Failure to File Cases

- SOME FACTORS to be considered:
 - Pattern of activity/Multiple years of non-filing
 - With sufficient income to trigger filing requirements
 - Evidence of willfulness
 - Defiant submissions to IRS (tax defier-type materials)
 - Taxes owed and unpaid
 - Choice made not to file (i.e., preparer prepped the returns, TP did not) file/authorize e-filing
 - Other financial affairs in order (mortgage up to date, car insurance paid, etc.)
 - Prior filing compliance
 - Spotty filing history/non-compliance
 - History with IRS collection efforts
 - Status of state tax compliance
 - Unfiled returns submitted as part of loan application, in court proceedings, etc.

Considerations in Developing a Defense

- Know your client
 - Age
 - Experience
 - Education
 - Personal/family circumstances
 - Medical history
 - Financial circumstances
 - Tax knowledge and filing history

Possible Defenses—What Works and What Doesn't

- Inadvertence and negligence
- Taxpayer was not required to file
- Lack of knowledge of duty to file
- Reliance on others—accountants, lawyers, etc. (See, *United States v. Boyle*, 469 U.S. 241 (1985) (The failure to make a timely filing of a tax return is not excused by the taxpayer's reliance on an agent.)
- Case should be civil only
- Non-filer syndrome
- Filing returns and/or paying tax during investigation or after indictment
- Statute of limitations