

# Price & Farrington's Estate and Tax Planning FastFaxts

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Estate, Tax, Business and Wealth Planning for Advisors and Clients

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## The 2005 "Dirty Dozen": The IRS's Annual List of Tax Scams

Happy St. Patrick's Day!



**Advisor Alert:** Share this with your clients...

The Internal Revenue Service this week unveiled its annual listing of notorious tax scams, the "Dirty Dozen", reminding taxpayers and advisors to be wary of schemes that promise to eliminate taxes or otherwise sound too good to be true.

The list includes several new scams that: manipulate laws governing charities; abuse credit counseling services; rely on bogus arguments to claim tax exemptions; or exploit identity theft through e-mail, the internet or the phone. The Dirty Dozen is a reminder that tax scams take many forms while they take

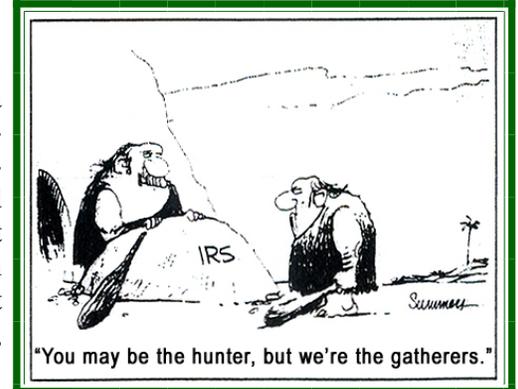
your money and leave you with a hefty tax bill. The IRS routinely pursues promoters and can impose imprisonment or fines. Advisors and their clients should remember that anyone pulled into these schemes can face repayment of taxes plus interest and penalties. If you suspect tax fraud, the number to call is 1-800-829-0433.

### The Dirty Dozen

**1. Trust Misuse.** This is a very common one. Promoters will falsely promise reduction of income subject to tax, deductions for personal expenses and reduced estate or gift taxes. Trusts, designed and implemented properly, are powerful, versatile estate and tax planning tools, but taxpayers should seek the advice of a trusted estate planning attorney before entering into *any* trust arrangement, especially if it's being aggressively marketed.

**2. Frivolous Arguments.** Promoters have been known to make outlandish claims, e.g.,: that the Sixteenth Amendment concerning congress' power to lay and collect income taxes was never ratified; that wages are not income; that filing a return and paying taxes are voluntary; and that being required to file Form 1040 violates the Fifth Amendment right against self-incrimination and the Fourth Amendment right to privacy. These arguments are false and have been repeatedly thrown out of court. Remember: A taxpayer's right to contest tax liability is different than the right to disobey the law.

**3. Return Preparer Fraud.** Dishonest return preparers cause headaches for their taxpayer-victims by charging inflated fees, skimming a portion of their clients' refunds and



attracting new clients by promising large refunds. You should choose carefully when hiring a tax preparer because if it sounds too good to be true, it probably is. No matter who prepares the return, the taxpayer is ultimately responsible for its accuracy. The Department of Justice (DOJ) has filed dozens of complaints against promoters and taxpayers in this area.

**4. Credit Counseling Agencies.** Beware of organizations that say they can fix credit ratings or that push debt payment agreements or that charge high fees, monthly service charges or mandatory "contributions" that end up adding to your debt. The IRS Tax Exempt and Government Entities Division has made it a priority to audit credit counseling organizations because some of these tax exempt organizations charge debtors large fees and provide little or no counseling.

**5. "Claim of Right" Doctrine.** In this scheme, a taxpayer files a return and claims a deduction equal to the entire amount of his or her wages. The promoter advises the taxpayer to label the deduction as "a necessary expense

### Local Businessmen Indicted on Tax-Fraud Charges.

A federal grand jury recently indicted two Tacoma businessmen on charges that they sold trust packages that they advised clients could be used to hide income and assets and evade taxes. The indictment alleges that from 1994 through 2000 they sold more than 400 trust packages that allowed clients to keep from paying more than \$7 million in taxes.

Several businesses they owned, including American Business, Estate and Tax Planning, sold the trusts in individual meetings and seminars. A trust package typically cost \$3000 to \$8,000 and up to \$1,000 in annual fees, according to the indictment, which charges the accused with defrauding the federal government by impeding tax collection. The defendants are also charged with failing to file tax returns and one is charged with criminal contempt for violating a permanent injunction against him.



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for the production of income” or “compensation for personal services actually rendered”. This “deduction” is based on a flagrant misinterpretation of the Internal Revenue Code and has no basis in law.

**6. “No Gain” Deduction.** Similar to “Claim of Right”, filers attempt to eliminate their entire adjusted gross income (AGI) by deducting it on Schedule A. The filer lists his or her AGI under the Schedule A section labeled “Other Miscellaneous Deductions” and attaches a statement to the return, referring to court documents and including the words “No Gain Realized”.

**7. Corporation Sole.** Since September, 2004, DOJ has obtained six injunctions against promoters of this scheme and filed complaints against 11 others. Scammers apply for incorporation under the pretext of being a “bishop” or “overseer” of a one-person phony religious organization looking for exemption from federal income taxes as a nonprofit, religious organization. When used legally, Corporation Sole statutes allow religious leaders to separate themselves from the control and ownership of church assets. But the rules have been twisted at seminars where taxpayers are charged fees of \$1000 or more and told that Corporation Sole laws provide a “legal” way to escape federal income taxes, child support obligations and other personal debts.

**8. Identity Theft.** It pays to be choosy when disclosing personal information about financial accounts, credit cards or in loan applications. The IRS is aware of several identity theft schemes involving taxes. In one case, fraudsters sent fictitious correspondence and IRS forms to trick bank customers into giving personal financial data. In another, abusive tax preparers used clients’ social security numbers to file false tax returns without the clients’ knowledge. Sometimes scammers pose as the IRS itself. Last year the IRS shut down a scheme in which e-mail was used to announce to unsuspecting taxpayers that they were “under audit” and could set matters right by divulging sensitive financial informa-

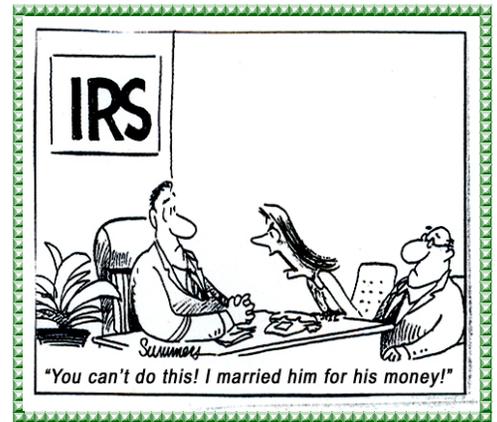
tion on an official-looking website. Taxpayers should be made aware that the *IRS does not use e-mail* to contact them about their accounts.

**9. Abuse of Charitable Organizations and Deductions.** The IRS has seen an increase in the use of tax-exempt organizations to improperly shield income or assets from taxation. Example: A taxpayer continued to maintain control over assets and income that had been moved to a donor-advised fund in order to try to get a tax deduction without transferring a commensurate benefit to charity. A “contribution” of an historic façade easement to a tax-exempt conservation organization is another example. Even if local laws allow the façade to be altered, the deduction claimed may far exceed the easement’s impact on the value of the property.

**10. Offshore Transactions.** Despite a crackdown, individuals continue to try to avoid U.S. taxes by illegally hiding income in offshore bank and brokerage accounts or by using offshore credit cards, wire transfers, foreign trusts, employee leasing schemes, private annuities or life insurance to do so. The IRS and tax agencies of U.S. states and possessions continue to aggressively pursue taxpayers and promoters who are involved in such abusive transactions.

**11. Zero Return.** Promotes instruct taxpayers to enter all zeros on their federal income tax filings. In a twist on this scheme, filers enter zero income, report their withholding, and then write “*nunc pro tunc*”, which is Latin for “now for then”, on the return. The IRS isn’t amused.

**12. Employment Tax Evasion.** The IRS has seen a number of illegal schemes that instruct employers not to withhold federal income tax or other employment taxes from wages paid to their employees. This advice is based on a faulty interpretation of the tax code and has been refuted in court. Recent cases have resulted in criminal convictions and injunctions for those promoting the scheme. Employer participants can also be held responsible



for back payment of employment taxes, plus penalties and interest. It is important to remember that employees who have nothing withheld from their wages are still responsible for payment of their personal taxes.

#### **Other Scams Still Linger.**

The IRS removed four scams from the Dirty Dozen this year: slavery reparations, improper home-based businesses, the Americans With Disabilities Act and Earned Income Tax Credit dependent-sharing. But taxpayers should remain wary as old scams routinely resurface or evolve. It is important to be vigilant about cons that may not be on the Dirty Dozen list since new scams or schemes pop up, especially around tax time. ■

**Working with a qualified team of professional advisors, including a tax and estate planning attorney, an accountant and an independent financial advisor are your best guarantee to avoid being victimized by tax scammers.**

**We're here to help!**



*Glen D. Pina*