

Civil Fraud

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Fraud is *intentional wrongdoing* designed to evade tax. The existence of fraud is a question of fact to be resolved upon consideration of the facts and proven by independent evidence.

Section 6663(a) imposes a penalty equal to 75% of a taxpayer's underpayment of Federal income tax that is due to fraud. The section 6663 fraud penalty consists of two elements: (1) the existence of an underpayment, and (2) fraudulent intent with respect to some portion of the underpayment. Civil fraud may be determined if the IRS proves clearly and convincingly that a person 1) underpaid his tax and 2) at least some part of each underpayment was due to fraud. The IRS has the burden of proof of both elements by clear and convincing evidence for each taxable year at issue; and that at least some portion of the underpayment for each year was due to fraud.

Because direct proof of a taxpayer's intent is rarely available, fraudulent intent may be established by circumstantial evidence. The IRS satisfies its burden of proof by showing that "the taxpayer intended to evade taxes known to be owing by conduct intended to conceal, mislead or otherwise prevent the collection of taxes. Taxpayer's entire course of conduct may be examined to establish the requisite intent, and an intent to mislead may be inferred from a pattern of conduct.

The courts focus on key **badges** of fraud in determining whether there was an "intent to evade" tax. The **badges of fraud** represents the circumstantial evidence that the IRS and the courts consider to determine if there is any civil fraud. The following facts will be considered:

- Whether income is understated
- Whether there are fictitious or improper deductions (e.g., overstatement of deductions, personal items deducted as business expenses)
- Accounting irregularities (e.g., two sets of books, false entries on documents)
- Obstructive actions of the taxpayer (e.g., false statements, destruction of records, transfer of assets, failure to cooperate with the examiner, concealment of assets)
- A pattern of underreporting taxable income
- Implausible or inconsistent explanations of behavior
- Illegal activities (e.g., drug dealing)
- Inadequate records
- Dealing in cash
- Failure to file returns

- Education and experience
- Fictitious or improper deductions
- Accounting irregularities (e.g. two sets of books)
- False entries in records or on tax returns
- Taxpayer obstructions

The "badges of fraud" are a two-way sword. If income is not understated, if the books and records are good, etc. Those "badges" can be viewed as "badges of compliance."

Mistake of law or the complexity of the law may be viewed as defenses to the civil fraud penalty.