First Friday Fraud Facts+

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The Idaho State Controller's Office distributes this newsletter as a cost-effective method of increasing awareness about ways to detect and prevent fraud, waste, and abuse in government.

Welcome to First Friday Fraud Facts+ (F4+). This edition will discuss tax fraud.

Tax fraud takes place when a taxpayer deliberately evades a tax owed or believed to be owed to the government. Tax fraud involves both:

- An underpayment; and
- A fraudulent intent[1]

Federal law requires employment tax withholding and payment by employers. Failure to do so by falsifying or withholding information is against the law and constitutes tax fraud, and violators may face both civil and criminal penalties. Employment taxes may consist of:

- Federal income tax withholding
- Social Security taxes
- Medicare taxes
- Unemployment taxes
- Workers' Compensation[2]

Tax fraud is a serious violation, typically discovered and reported through an IRS audit and investigation. The IRS has the burden of proof that fraud was deliberately committed. Taxpayers who intentionally commit tax fraud are subject to penalties and accumulated interest.

The IRS code book describes two forms of tax fraud; civil tax fraud and failure to file tax returns.

General Civil Tax Fraud

Civil tax fraud occurs when a taxpayer willfully under-reports or leaves out their income entirely in order to pay fewer or no taxes. If a taxpayer is found guilty of civil tax fraud, the penalties can be severe (i.e., the underpayment amount originally filed and consciously reported incorrectly in addition to a 75% penalty).

Some examples of civil tax fraud include:

- Avoiding reporting requirements by concealing income (e.g., using only cash to make payments or deliberately not reporting assets)

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Inside this issue:

Welcome	1
General Civil Tax Fraud	1
Failure to File	2
Red Flags	2
Fraud Case	2

- Obscuring income by using separate bookkeeping methods to secretly track income and expenses
- Concealing income in off shore accounts
- Keeping inadequate records (if at all)
- Purging evidence during an audit (e.g., records, receipts, logs, etc.)
- Lying during an audit
- Using a fake social security number

Failure to File

After an investigation, the IRS may determine tax fraud has been committed by a taxpayer if taxes were filed late or evaded altogether. The amount of the penalty is 5% per month of the total amount owed. If the IRS considers the failure to file as fraudulent, the amount of the monthly penalty increases to 15% (with a 75% maximum penalty).

Some examples of fraudulent failure to file include:

- Not complying with known tax filing requirements
- Routinely filing tax returns late or failing to file at all
- Taxpayer declining to provide an explanation of why they failed to file
- Refusing to cooperate with the IRS during an audit[3]

Red Flags

There are several potential red flags that are often found in cases involving tax fraud. Some of these include:

- False exemptions or deductions
- Kickbacks
- Fabricated documents
- Unreported income

If you suspect or know of an individual or entity that is not complying with tax laws, IRS Form 3949-A can be submitted to the IRS, which requests a description of the alleged violation, the dollar amount involved, the name and address of the individual or entity, etc.[4]

Fraud Case

This case involves a Brooklyn man who deceitfully altered the amounts in his business accounting system to conceal a tax evasion scheme.

The man was the owner and president of a New Jersey wholesale distributor of sportswear and t-shirts. Between 2006 and 2008, he manipulated the company's accounting records by deleting cash sales from the general ledger accounts in the company's accounting software program. He also filed false corporate tax returns with the IRS, underreporting his company's gross receipts by at least $1.5 million.

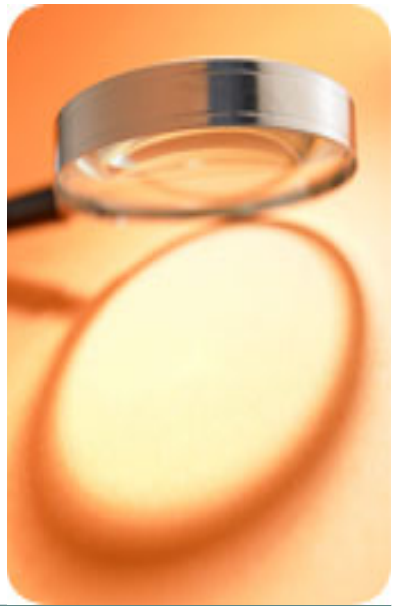
According to the IRS-Criminal Investigation unit, he not only "cooked" the company books, but also his personal income tax returns as well.

The former business owner was sentenced to serve one year and a day in prison for tax evasion. Once he gets out of prison he will also be required to serve three years supervised release.[5]

[1] Tax Fraud. http://www.irstaxattorney.com/tax-fraud/tax_fraud.html Accessed 1/14/2014.

[2] All the Types of Employment Taxes. http://biztaxlaw.about.com/od/employmenttaxes/tp/Types-Of-Employment-Taxes.htm Accessed 1/14/2014.

[3] IRS Tax Fraud: Types & Penalties for Income Tax Fraud. http://www.backtaxeshelp.com/tax-fraud.html Accessed 1/14/2014.

[4] How Do You Report Suspected Tax Fraud Activity? http://www.irs.gov/Individuals/How-Do-You-Report-Suspected-Tax-Fraud-Activity%3F Accessed 3/6/2014.

[5] No One Likes a Manipulator. http://www.fraudoftheday.com/2013/12/27/one-likes-manipulator/ Accessed 1/14/2014.