



The Wealth Counselor

A monthly newsletter for wealth planning professionals

The IRS' 2009 "Dirty Dozen"

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The Internal Revenue Service recently issued its 2009 "dirty dozen" list of consumer scams and tax evasion schemes that it warns the public to avoid and that it is targeting in audit and enforcement. This issue of The Wealth Counselor discusses this list and identifies resources to assist practitioners and clients in avoiding them.

Phishing

"Phishing" is a tactic used by Internet-based scam artists to trick unsuspecting victims into revealing personal or financial information. The criminals use the information to steal the victim's identity, access bank accounts, run up credit card charges or apply for loans in the victim's name.

Phishing scams often take the form of an e-mail that appears to come from a legitimate source, including the IRS. The IRS warns that it NEVER initiates unsolicited e-mail contact with taxpayers about their tax issues. Taxpayers who receive unsolicited e-mails that claim to be from the IRS should forward the message to phishing@irs.gov.

Many financial institutions have a "phishing" email address to which consumers can forward any suspected fraud attempt.

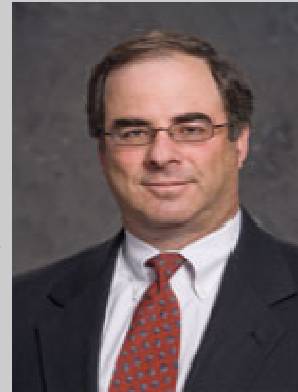
Planning Tip: More information about avoiding identity theft is available from the FTC at www.ftc.gov/bcp/edu/microsites/idtheft/consumers/about-identity-theft.html and on the IRS website at www.irs.gov/privacy/article/0,,id=186436,00.html.

Planning Tip: A good resource for identity theft victims is the FTC's *Take Charge: Fighting Back Against Identity Theft*, available online

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Probate, Trust Administration, Business
Succession Planning, Income Tax Planning
and Charitable Planning.

at www.ftc.gov/bcp/edu/pubs/consumer/idtheft/idt04.shtm.

Hiding Income Offshore

The IRS aggressively pursues taxpayers and promoters involved in certain abusive offshore transactions. These transactions attempt to hide income, and thus evade U.S. income tax, by using offshore banks or brokerage accounts or offshore entities. Recently, the IRS provided guidance to its auditors on how to deal with those hiding income offshore in undisclosed accounts. The IRS draws a clear line between taxpayers with offshore accounts who voluntarily come forward and those who fail to come forward and are discovered on audit.

Other targeted offshore tax abuses are using offshore debit cards, credit cards, wire transfers, foreign trusts, employee-leasing schemes, private annuities, life insurance plans, electronic funds transfer and payment systems, and offshore business merchant accounts and private banking relationships to hide income.

Planning Tip: A taxpayer who has a financial interest in or signature or other authority over one or more accounts in a foreign country must file a Form TD F 90-22.1, *Report of Foreign Bank and Financial Accounts (FBAR)* (available online at <http://www.irs.gov/pub/irs-pdf/f90221.pdf>) if the aggregate value of all such foreign financial accounts exceeds \$10,000 at any time during the calendar year. More information is available at www.irs.gov/businesses/article/0,,id=180946,00.html.

Filing False or Misleading Forms

The IRS is on the lookout for scam artists who file false or misleading returns to claim refunds to which they are not entitled. Frivolous information returns, such as Form 1099-Original Issue Discount (OID), claiming false withholding credits are used to legitimize erroneous refund claims. The new scam has evolved from an earlier phony argument that a "strawman" bank account has been created for each citizen. Under this scheme, taxpayers fabricated an information return, arguing they used their "strawman" account to pay for goods and services and falsely claimed the corresponding amount as withholding as a way to seek a tax refund.

Abuse of Charitable Organizations and Deductions

The IRS continues to observe the misuse of tax-exempt organizations. Abuses noted include arrangements to improperly shield income or assets from taxation and attempts by donors to maintain control over donated assets or income from donated property. The IRS also continues to investigate various schemes involving the donation of non-cash assets, including easements on property, closely-held corporate stock and real property. Often, the donations are highly overvalued or the organization receiving the donation promises that the donor can purchase the items back at a later date at a price the donor sets. The Pension Protection Act of 2006 imposed increased penalties for inaccurate appraisals and new definitions of qualified appraisals and qualified appraisers for taxpayers claiming charitable contributions.

Planning Tip: Notice 2006-96, *Guidance Regarding Appraisal Requirements for Noncash Charitable Contributions*, is available online at www.irs.gov/irb/2006-46_IRB/ar13.html. More detailed information is available in IRS Publication 561, available online at www.irs.gov/publications/p561/ix01.html.

Return Preparer Fraud

Dishonest return preparers can cause many headaches for taxpayers who use them. These preparers derive financial gain by skimming a portion of their clients' refunds and charging inflated fees for return preparation services and attract new clients by promising large refunds. Taxpayers should choose carefully when hiring a tax return preparer. As the saying goes, 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. Since 2002, the courts have issued injunctions ordering dozens of individuals to cease preparing returns, and the Department of Justice has filed complaints against dozens of others, which are pending in court.

Planning Tip: A significant benefit of clients working with a planning team is the increased likelihood that all team members are working in the client's best interest and within the bounds of the law.

Frivolous Arguments

Promoters of frivolous schemes encourage people to make unreasonable and unfounded claims to avoid paying the taxes they owe. The IRS has published a list of frivolous legal positions that it warns taxpayers to stay away from. Filing a tax return or making a submission based on any of the positions on the list will subject the taxpayer to a \$5,000 penalty.

Planning Tip: Notice 2008-14, which identifies these frivolous positions, is available online at www.irs.gov/pub/irs-drop/n-08-14.pdf.

Form 843 False Claims for Refund and Requests for Abatement

This scam involves using Form 843, *Claim for Refund and Request for Abatement* to request abatement of a falsely claimed previously assessed tax. Many taxpayers using this scheme have not previously filed tax returns. The tax they are trying to have abated has been assessed by the IRS through the Substitute for Return Program. These filers use Form 843 to list reasons for their request. Often, one of the reasons falsely given is "Failed to properly compute and/or calculate Section 83-Property Transferred in Connection with Performance of Service."

Abuse of Retirement Plans

The IRS continues to uncover abuses in retirement plan arrangements, including Roth Individual Retirement Arrangements (Roth IRAs). The IRS is looking for transactions that taxpayers are using to avoid the limitations on contributions to IRAs as well as transactions that are not properly reported as early distributions. Taxpayers should be wary of advisors who encourage them to shift appreciated assets into IRAs or companies

owned by their IRAs at less than fair market value to circumvent annual contribution limits. Other variations have included the use of limited liability companies to engage in prohibited activities.

Disguised Corporate Ownership

Some taxpayers form corporations and other entities in certain states for the primary purpose of disguising the ownership of a business or financial activity. Such entities can be used to facilitate underreporting of income, fictitious deductions, non-filing of tax returns, participating in listed transactions, money laundering, financial crimes, and even terrorist financing. The IRS is working with state authorities to identify these entities and to bring the owners of these entities into compliance.

Zero Wages

Filing a phony wage- or income-related information return to replace a legitimate information return has been used as an illegal method to lower the amount of taxes apparently owed. Typically, a Form 4852 (Substitute Form W-2) or a "corrected" Form 1099 is used improperly in the attempt to reduce reported taxable income - often to zero. The taxpayer also may submit a statement rebutting wages and taxes reported by a payer to the IRS. Sometimes fraudsters even include an explanation on their Form 4852 that cites statutory language on the definition of wages or may include some reference to a paying company that refuses to issue a corrected Form W-2 for fear of IRS retaliation. Taxpayers should resist any temptation to participate in any of the variations of this scheme.

Misuse of Trusts

For years, unscrupulous promoters have urged taxpayers to transfer assets into trusts, such as "constitutional trusts." While there are many legitimate, valid uses of trusts in tax and estate planning, these promoted transactions falsely promise reduction of income subject to tax, deductions for personal expenses, and reduced estate or gift taxes. Such trusts rarely deliver the promised tax benefits and are being used primarily as a means to avoid income tax liability and hide assets from creditors, including the IRS.

The IRS has recently seen an increase in the improper use of private annuity trusts and foreign trusts to divert income and deduct personal expenses. As with other arrangements, taxpayers should seek the advice of a trusted professional before entering into a trust arrangement.

Planning Tip: The IRS recognizes that there are many legitimate, valid uses for trusts, but like any strategy, trusts are subject to abuse. It is important that clients work with an attorney whose practice focuses in estate planning and who understands these issues.

Fuel Tax Credit Scams

The IRS is receiving claims for the fuel tax credit that are unreasonable. A taxpayer who uses fuel for off-highway business purposes is eligible for a tax credit for the federal highway tax included in the price of the fuel. The IRS has noticed that individuals are

claiming the tax credit for nontaxable uses of fuel when their occupation or income level makes the claim unreasonable. Fraud involving the fuel tax credit is considered a frivolous tax claim, potentially subjecting those who improperly claim the credit to a \$5,000 penalty.

How to Report Suspected Tax Fraud Activity

Suspected tax fraud can be reported to the IRS using Form 3949-A, *Information Referral*. Form 3949-A is available for download from the IRS website at <http://www.irs.gov/pub/irs-pdf/f3949a.pdf>. The completed form or a letter detailing the alleged fraudulent activity should be addressed to the Internal Revenue Service, Fresno, CA 93888. The mailing should include specific information about who is being reported, the activity being reported, how the activity became known, when the alleged violation took place, the amount of money involved and any other information that might be helpful in an investigation. The person filing the report is not required to self-identify, although it is helpful to do so. The identity of the person filing the report can be kept confidential.

Whistleblowers who provide allegations of fraud to the IRS that lead to successful collection of taxes may be eligible for a reward. The claim is made by filing Form 211, *Application for Award for Original Information* (available at <http://www.irs.gov/pub/irs-pdf/f211.pdf>) and following the procedures outlined in Notice 2008-4, *Claims Submitted to the IRS Whistleblower Office Under Section 7623*.

Conclusion

That the IRS publishes a "dirty dozen" list demonstrates the critical importance of taxpayers utilizing a planning team dedicated to working together to serve their best interests. Many of these scams involve abuses of otherwise legitimate planning strategies, so it is incumbent upon us - their planning team - to ensure that our clients avoid these traps as the IRS urges.

To comply with the U.S. Treasury regulations, we must inform you that (i) any U.S. federal tax advice contained in this newsletter was not intended or written to be used, and cannot be used, by any person for the purpose of avoiding U.S. federal tax penalties that may be imposed on such person and (ii) each taxpayer should seek advice from their tax adviser based on the taxpayer's particular circumstances.

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You have received this newsletter because I believe you will find its content valuable, and I hope that it will help you to provide better service to your clients. Please feel free to [contact me](#) if you have any questions about this or any matters relating to estate or wealth planning.

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