Abusive Tax Schemes and Fraud

Office of Fraud Enforcement

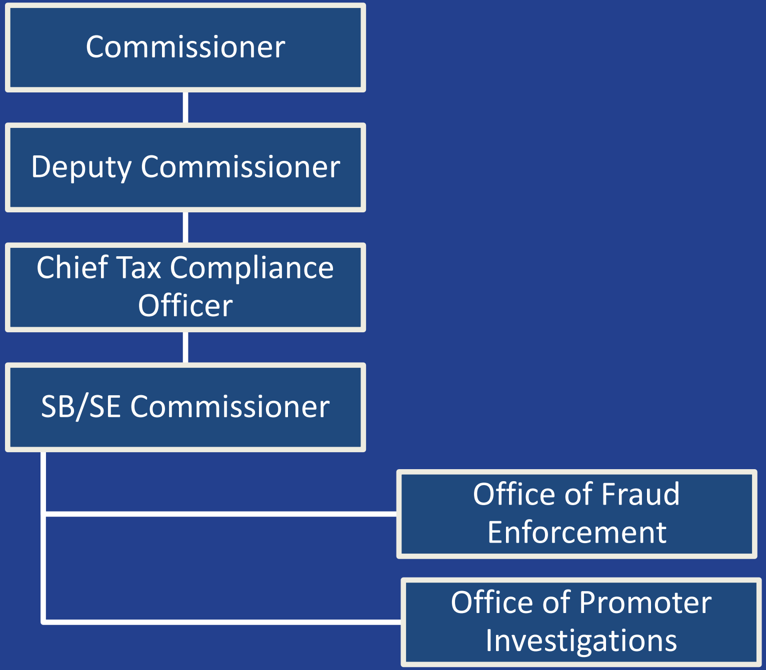
Office of Promoter Investigations

Objectives

Today our presentation will:

- Distinguish tax planning from fraud.
- Identify common characteristics of abusive tax promotions.
- Describe how to report to the IRS abusive schemes, abusive return preparers and fraudulent tax schemes.

Internal Revenue Service



Office of Fraud Enforcement Goals

- Educate taxpayers and provide them with tools and resources to help them recognize and avoid fraud.
- Prevent, identify and decrease tax fraud, refund/evasion schemes and emerging tax threats.
- Hold bad actors accountable.
- Implement agencywide policy and procedures.
- Partner with internal and external stakeholders.

Office of Promoter Investigation Goals

- Provide taxpayers and practitioners with the tools and resources to identify abusive tax schemes and abusive return preparers.
- Quickly detect and shutdown abusive tax schemes.
- Hold promoters, return preparers and enablers accountable.
- Implement agencywide policy and procedures.

Assisting Taxpayers Who Are Victims

- Assist victims of identify theft.
- Assist victims with tax compliance, such as:
  - Time-limited settlement offers for certain taxpayers under audit who participated in abusive micro-captive insurance transactions.
  - Voluntary disclosure program for the Employee Retention Credits.
  - On-going option to withdraw ERC claims.

Tax Fraud

Tax Planning versus Tax Fraud

- Tax Planning – legally avoiding income taxes using deductions, exclusions and tax credits.

- Tax Fraud – intentional wrongdoing with the specific purpose of evading a tax known or believed to be owed.

Tax Planning Examples

- Choosing a Health Savings Account or other tax-favored health plans.
- Choosing between a ROTH IRA and a traditional IRA.
- Electing to file a joint income tax return.
- Deducting student loan interest.
- Claiming the child and/or dependent care credit.

Abusive Transaction

- An entity, plan, arrangement, scheme or series of transactions that results in improper tax avoidance.
- The transaction intentionally interprets the Internal Revenue Code in a way that is different from its intended meaning.
- Also known as an abusive tax transaction or an abusive tax avoidance transaction.

Tax Fraud

- Any underpayment of any part of tax.
- Willful intention to conceal, mislead, or deceive to evade payment of tax:
  - Act of Omission
  - Act of Commission

Evasion of Assessment

- Concealing assets to omit income, such as:
  - Cash
  - Bank accounts
  - Brokerage accounts
  - Digital assets
- Creating fake invoices to claim false business expenses.
- Reporting inflated or false Federal tax withholdings from Form W-2.

Evasion of Payment

- Transferring assets specifically to shield them from IRS collection action.
- Omitting income and assets from Collection Information Statements.
- Willfully failing to deposit receipts into business accounts.

What Happens to Fraudsters?

May be subject to Criminal Prosecution

- Prison
- Fines & Penalties
- Restitution
- Forfeiture

Civil Penalties

- Civil Fraud Penalty (75% Penalty)
- Civil Fraudulent Failure-to-File Penalty (75% Penalty)

Case Review: The Chrisleys

- United States v. Chrisley, Case No. 1:19-CR-297-ELR-JSA (N.D. Ga.).
- Guilty: Tax Evasion /Bank Fraud – June 2022.
- Transferred loan out of company bank account to relative to evade payment.
- False Documents to banks to obtain loans.

Vessels for Tax Fraud

- ID Theft
  - Social Engineering – Phishing/Smishing
  - Dark Web Repository – Stolen Information
- Social Media Promotions of “Too Good To Be True” & “Get Rich QUICK!” Schemes

Hot Tax Issues on OFE’s Radar

- Fraudulent Returns / Evasion Activity
- COVID-19 Tax Credits
- Fuel Tax Credits
- Inflation Reduction Act projects involving Green Credits
- Refund Schemes - False Tax Withholding Amounts

Inflation Reduction Act Credits

Inflation Reduction Act (IRA)

- 10-year plan that includes a wide range of tax law changes
- "Green Credits" or "Clean Energy Tax Credits"
  - Home Energy Credits
  - Clean Vehicle Credits
  - Others IRA Credits

IRA Threat Mitigation

- Strategize to identify ID Thieves, then alert/protect victims.
- Warn the public about abusive tax return preparation/promotion by reporting false Clean Energy Credits.

Fuel Tax Credit (FTC)

Dirty Dozen 2024

"Promoters are pushing the accelerator on bad Fuel Tax Credit claims and driving honest taxpayers to a bad choice. These promoters frequently charge a large fee to the taxpayer to make these false claims. While the scammers drive away with the fees, the taxpayers are left behind with a bad claim and all the risk and responsibility to make it right."

- Danny Werfel, IRS Commissioner

What is the Fuel Tax Credit?

- Refund of federal excise taxes imposed on certain fuels when taxpayers use those fuels for nontaxable purposes.
- The excise tax is paid at the time the fuel is purchased.

Fuels Subject to Excise Tax

- Gasoline, including aviation gasoline.
- Diesel fuel, including dyed diesel fuel.
- Kerosene, including dyed kerosene and kerosene used in aviation.
- Alternative fuels like compressed natural gas and liquefied petroleum gas.

Nontaxable Fuel Uses

- Off-highway business use.
- For a boat engaged in commercial fishing.
- For commercial aviation (other than foreign trade).
- For machinery used for farming.

Claim Forms

- Form 4136, Credit for Federal Tax Paid on Fuels
- Form 8849, Claim for Refund of Excise Taxes, Schedule 1, Nontaxable Use of Fuels
- Form 720, Quarterly Federal Excise Tax Return, Schedule C, Claims

How to Claim the Credit

- Individuals: line 12 of Schedule 3, Additional Credits and Payments, attached to the Form 1040 series.
- Partnerships (other than electing large partnerships): allocate to each partner on Schedule K-1 (Form 1065).
- Other taxpayers: generally shown as a payment on the proper line of the income tax return.

Example of Fuel Tax Credit Claim

Form **4136**

Department of the Treasury
Internal Revenue Service

Credit for Federal Tax Paid on Fuels

Go to *www.irs.gov/Form4136* for instructions and the latest information.

OMB No. 1545-0162
2023
Attachment Sequence No. **79**

Name (as shown on your income tax return) | **Taxpayer identification number**

Caution: Claimant has the name and address of the person who sold the fuel to the claimant and the dates of purchase. For claims on lines 1c and 2b (type of use 13 or 14), 3d, 4c, and 5, claimant has not waived the right to make the claim. For claims on lines 1c and 2b (type of use 13 or 14), claimant certifies that a certificate has not been provided to the credit card issuer.

1 Nontaxable Use of Gasoline — **Note:** CRN is the credit reference number.

		(a) Type of use	(b) Rate	(c) Gallons	(d) Amount of credit	(e) CRN
a	Off-highway business use		$ .183	50,000		
b	Use on a farm for farming purposes		.183	0		362
c	Other nontaxable use (see **Caution** above line 1)		.183	0	$ 9,150 00	
d	Exported		.184	0		411

2 Nontaxable Use of Aviation Gasoline

		(a) Type of use	(b) Rate	(c) Gallons	(d) Amount of credit	(e) CRN
a	Use in commercial aviation (other than foreign trade)		$ .15		$	354
b	Other nontaxable use (see **Caution** above line 1)		.193			324
c	Exported		.194			412
d	LUST tax on aviation fuels used in foreign trade		.001			433

Employee Retention Credit (ERC)

ERC Criminal Investigations

- IRS Criminal Investigations initiated 460 criminal cases.
- These criminal cases relate to nearly $7 billion of potentially fraudulent claims
- Federal charges in 37 investigations, with 17 convictions and 9 sentencings
- Average sentence is 20 months

ERC – Where We Started

- Coronavirus Aid, Relief, and Economic Security (CARES) Act (3/2020); Notices 2021-20 and 2021-49, and Rev. Proc. 2021-33.
- Taxpayer Certainty and Disaster Tax Relief Act of 2020 (12/2020); Notices 2021-23 and Notice 2021-49, and Rev. Proc. 2021-33.
- American Rescue Plan Act of 2021 (3/2021); Notice 2021-49 and Rev. Proc. 2021-33.
- Infrastructure Investment and Jobs Act (11/2021); Notices 2021-49 and 2021-65.

Statement One, Truth or Myth?

The well-intentioned pandemic-era program was used by promoters for aggressive, misleading marketing campaigns that oversimplified or misrepresented eligibility rules.

Statement One: Truth

Promoters pushed more applicants into the program and frequently took a percentage of credit as compensation for services.

- Most fees paid to the promoters by the businesses claiming the ERC are contingent on the amount of the calculated credit.
- ERC Consultant/Advisor may not sign the Form 94X-X.
- ERC Consultant/Advisor may file a reversing Form 94X-X on behalf of the business for failure to pay the fee owed.

Statement Two, Truth or Myth?

You own a business and you have employees, you qualify for the ERC!

Statement Two: Myth

The eligibility rules are complicated and vary by year and by quarter. Eligibility for the ERC depends on your specific facts and circumstances.

Statement Three, Truth or Myth?

You can get $26,000 of free Government money for every employee!

Statement Three: Myth

- The employer must be an Eligible Employer who paid qualified wages to employees.
- Not all wages that you pay to employees may be qualified wages for purposes of the ERC.

Statement Four, Truth or Myth?

Any Government Order issued automatically qualifies you for the ERC.

Statement Four: Myth

Businesses need to have been subject to a qualifying government order related to COVID-19 that caused a full or partial suspension of your trade or business operations.

Statement Five, Truth or Myth?

You have nothing to lose by claiming the credit!

Statement Five: Myth

Businesses that incorrectly claim the ERC risk repayment requirements, penalties, interest, audit and potential expenses of hiring someone to help resolve the incorrect claim.

ERC – Where Are We Going?

- IRS compliance work continues:
  - Disallowing around 21,000 pending claims from businesses that did not exist during the time the credit was claimed or did not pay W-2 wages.
  - Using normal tax assessment and collection procedures to reclaim credits.
  - Educational visits.
  - Claim withdrawal process.

Art Donations

Improper Art Donation Deductions

- IR-2023-185, October 5, 2023: IRS warns taxpayers of improper art donation deduction promotions; highlights common red flags.
- IR-2024-104, April 10, 2024 (2024 IRS Dirty Dozen).
- Taxpayer claims a deduction based on inflated values or questionable appraisals.

How the Scheme Works

- Promoters convince taxpayers to buy "discounted" art.
- Promoter may provide other services, such as storage, shipping and appraisal of the art.
- Promoter promises art is worth significantly more than the purchase price.
- Taxpayer encouraged to wait at least one year to donate art.

Red Flags

- Artwork may have little market value outside what promoter advertises.
- Promoter may line up specific appraisers.
- Appraisals may not address value characteristics, such as rarity, age, quality, stature of artist and price paid.

Art Appraisal Services (AAS)

- https://www.irs.gov/appeals/art-appraisal-services
- Team of professionally trained appraisers.
- Assist IRS and taxpayers with valuation questions.
- AAS may be advised by the Commissioner’s Art Advisory Panel.
- Pub. 5392, The Art Advisory Panel of the Commissioner of Internal Revenue Annual Summary Report.

Micro-Captive Insurance

What is a "Micro-Captive" Insurance?

- Micro: small company
- Captive: company organized to insure the liabilities of its shareholders or their affiliates. See 3 Steven Plitt et al., *Couch on Insurance* § 39:2 (3d ed. 2021)

What is a Micro-Captive Transaction?

- Insurance agreement between a parent company and a captive insurer under its control.
- The Internal Revenue Code provides the parties with tax advantages.

Micro-Captive Tax Advantages

- Insured party may deduct premium payments as business expenses.
- The insurer may exclude up to $2.8 million (currently) from its taxable income.
- Insurer only taxed on its investment income.
- See Internal Revenue Code section 831(b).

Questions

1. Who has purchased insurance?
2. Who would pay a $12,000 yearly premium to insure property valued at $20,000?
3. Who has had insurance premiums returned, other than for cancelling the policy?

Abusive Micro-Captive Promotion

- The insured maximizes the insurance expense deduction to a related captive insurance company.
  - Pays unreasonable premiums.
  - Gross premiums paid linked to the section 831(b) exclusion amount.
- Substantial premiums returned to insured.

Micro-Captive Closing Statement

"No tax benefit should accrue if the money is not really for insurance—if the insurance contract is a sham, which the affiliated companies have entered into only to escape tax liability."

- CIC Servs., LLC v. IRS, 141 S. Ct. 1582, 209 L. Ed. 2d 615 (2021).

Reporting Abusive Schemes, Abusive Return Preparers and Fraud

Reporting Tax Fraud
Form 3949-A, Information Referral

- Purpose: To report individual or a business suspected of not complying with the tax laws.
- Online: www.irs.gov
- Internal Revenue Service

  PO Box 3801

  Ogden, UT 84409

Form 14242, Report Suspected Abusive Tax Promotions and Preparers

- Purpose: report suspected abusive tax avoidance scheme and/or preparers who promote such schemes.
- Online form: www.irs.gov
- Internal Revenue Service Lead Development Center

  Stop MS5040 24000 Avila Road

  Laguna Niguel, California 92677 3405
- Fax: 877-477-9135

IRS Whistleblower Office

- Form 211, Application for Award for Original Information
- Purpose: Claim for award for information leading to the detection of a violation of Internal Revenue laws.
- Internal Revenue Service

Whistleblower Office – ICE

1973 N Rulon White Blvd.

M/S 4110

Ogden, UT 84404

Summary

- Promoters perpetrate their schemes at the expense of taxpayers and tax practitioners.
- Unchecked fraud and promoted abusive tax schemes undermine the IRS mission.
- The Offices of Fraud Enforcement and Promoter Investigations work together to stop fraud and abuse.