First Friday Fraud Facts+

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

Tax Fraud

Tax Fraud can be defined as the intentional falsification or misrepresentation of information on a tax return in order to limit the amount of an individual's or businesses' tax liability.[1] The federal government is defrauded of hundreds of billions of dollars in tax revenue each year.[2]

There are several ways to commit tax fraud. Each year, the Internal Revenue Service releases what it considers the "Dirty Dozen" of tax scams. For 2018, the list includes[3]:

1. Phishing: Using apparently legitimate emails and websites to trick victims into giving personal identifying information.

2. Phone Scams: When a criminal impersonates an IRS agent and threatens a taxpayer with arrest, license revocation, lawsuits, etc. if the taxpayer doesn't pay for false tax liabilities.

3. Identity Theft: Stealing taxpayers' identification such as names and social security numbers, and then using the information to file tax returns.

4. Return Preparer Fraud: Unscrupulous tax preparers who scam clients, perpetuating refund fraud, and steal and sell taxpayer's identity.

5. Fake Charities: Fraudulent groups claiming to be legal charitable organizations soliciting donations from donors.

6. Inflated Refund Claims: When a tax preparer promises extraordinary refunds, request that taxpayers sign a blank return before reviewing the taxpayer's records, or charge a fee based on a percentage of the refund.

7. Excessive Claims for Business Credits: Dishonestly claiming fuel tax credits, research credits, or other credits which are not available to most taxpayers.

8. Falsely Padding Deductions on Returns: Overstating deductions and expenses in order to pay less tax or receive a larger refund.

9. Falsifying Income to Claim Credits: Reporting more income than actually earned in order to qualify for credits such as the earned income tax credit.

10. Frivolous Tax Arguments: Schemes involving the misinterpretation of laws or the U.S. Constitution in such a way as to argue against filing a tax return or claiming income on a tax return, even though such arguments have been thrown out in court.

Inside This Issue:

11. Abusive Tax Shelters: Complex tax avoidance schemes, such as investment accounts, activities, and transactions that promote favorable tax treatments for taxpayers.

12. Offshore Tax Avoidance: Investing or depositing income and assets in another country in order to avoid paying U.S. taxes.

Employment Tax Fraud

Although there are several tax fraud schemes in addition to the “Dirty Dozen” provided by the IRS, this article will focus primarily on employment tax fraud.

Federal law requires employers to withhold and pay employment taxes (e.g., income, social security, Medicare, workers’ compensation, and unemployment). However, when an employer does not withhold and report employment taxes, the IRS audit and investigation team may come knocking.

Detecting and Reporting Tax Fraud

There are a variety of red flags found in cases involving employment tax fraud. Some of these include:

- Routinely late filing of tax returns.
- Tax returns are incomplete.
- No returns filed when there is a requirement to file a return.
- There is a high chance of kickbacks within the organization.
- Documents are fabricated.
- A large trend of inconsistent reported amounts between periods.

If someone suspects or knows of a person or an entity that is not complying with the employment tax laws, they can submit an IRS Form 3949-A, which is an information referral. The form requests:

- Information about the person or business being reported.
- A description of the alleged violation of income tax law (e.g., failure to withhold tax, kickbacks, etc.).
- Information about the reporting person (although not required for processing the report).

The Cost of Committing Tax Fraud

Participating in an illegal scheme to avoid taxes can result in imprisonment and fines, as well as the repayment of taxes owed along with penalties and interest. A penalty up to 75% of the underpayment of tax attributable to fraud, in addition to the taxes owed, can be assessed. Criminal convictions may also result in fines up to $250,000 for individuals ($500,000 for corporations), and up to five years in a federal prison, or both.[4]

Case Study[5,6]

Lucilious Ward from Denver Colorado owned and operated Global Access, a public and private transportation services company. Its largest client was the Regional Transportation District (RTD), which contracted with Global Access to provide bus transportation services. Global Access made more than $35 million from its contract with RTD during the period 2003 through 2012.

From January 2005 through the second quarter of 2011, Ward withheld employment taxes from Global Access's employees paychecks. Employment tax includes Federal Insurance Contribution Act taxes (FICA or social security and Medicare taxes) and income taxes. Ward hatched a scheme to keep the employment taxes instead of sending the funds to the IRS, and not filing IRS Forms 941 (employment tax forms) as required by law.

Global Access's office manager recommended that Ward contract with a payroll company to remit the company's employment taxes; however, Ward refused the advice. Furthermore, Global Access's CPA also warned Ward that the company needed to pay withholding taxes and discussed the consequences associated with not paying the taxes; however, Ward also ignored the CPA's council.

Additionally, In 2010 Ward filed an amended personal income tax return with the IRS for tax year 2007, falsely claiming that $76,479.44 had been withheld from his personal paychecks by Global Access and paid to the IRS, even though Ward had known that the company did not remit the employment taxes to the IRS.

Overall, Ward had stolen approximately $6 million, and was subsequently convicted and sentenced to 26 months in prison, three years of supervised release and ordered to pay $5,955,231 in restitution to the IRS.

References

[1]Investopedia. *Tax Fraud*. https://www.investopedia.com/terms/t/tax-fraud.asp. Accessed 9 April 2018

[2]Internal Revenue Service. *The Tax GAP*. https://www.irs.gov/newsroom/the-tax-gap. Accessed 11 April 2018

[3]Internal Revenue Service. *IRS wraps up 'Dirty Dozen' list of tax scams for 2018; Encourages taxpayers to remain vigilant*. https://www.irs.gov/newsroom/irs-wraps-up-dirty-dozen-list-of-tax-scams-for-2018-encourages-taxpayers-to-remain-vigilant. Accessed 11 April 2018.

[4]Internal Revenue Service. Related Statutes and Penalties - General Fraud. https://www.irs.gov/compliance/criminal-investigation/related-statutes-and-penalties-general-fraud. Accessed 11 April 2018

[5]Internal Revenue Service. *Examples of Employment Tax Fraud Investigations - Fiscal Year 2016*. https://www.irs.gov/compliance/criminal-

investigation/examples-of-employment-tax-fraud-investigations-fiscal-year-2016. Accessed 11 April 2018.

[6]United States Department of Justice, U.S. Attorney's Office District of Colorado. *Denver Man Pleads Guilty For Failure To Pay Over Million In Employment Taxes*. https://www.justice.gov/usao-co/pr/denver-man-pleads-guilty-failure-pay-over-million-employment-taxes. Accessed 11 April 2018.

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