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IRS Loses 'Lavish Spending Is Tax Evasion' Case, Big Spenders Rejoice

Canadian rapper Drake loves the feeling you get from skirting taxes while living large. Yes, "there's some bills and taxes I'm still evading," he muses in The Ride, "but I blew six million on myself and I feel amazing." Drake is probably not the only one to feel amazing after blowing money on luxuries instead of paying taxes.

Electronic Arts founder Trip Hawkins may be feeling pretty good too after his court victory. On the surface, *Hawkins v. Franchise Tax Board* is about whether lavish spending *itself* is tax evasion. It isn't, said the court. But its conclusions may have a broader impact on the tax law. After all, just what is willful and what's not?

Willfulness is much in the news, from Lionel Messi to Dolce & Gabanna and Beanie Babies. It is also a key concern in offshore bank account cases. Taxpayers often seek reassurance that their missteps were ill-advised but weren't willful, which can mean big penalties or even jail.

It is hard to see how excessive spending alone manifests a willful attempt to evade or defeat taxes, no matter how outlandish the expense. Concern with big spenders isn't new. President John F. Kennedy didn't like expense accounts in the era of three martini lunches. JFK said, ''The slogan —'It's deductible'—should pass from our scene.'' See Special Message to Congress on Taxation, Apr. 20, 1961.

More than 50 years later, ''it's deductible'' can still sound obnoxious. Spend freely and deduct it so someone else—American taxpayers—will pay the bill. Trip Hawkins may have behaved in an unseemly and irresponsible way, blowing money when he owed millions to the IRS. But was he willful?

The question was raised in his bankruptcy case, where Section 523(a)(1)(C) of the Bankruptcy Code requires a willful attempt to "evade or defeat" taxes. The court said spending alone isn't willful, but it could be too soon to applaud the fact that the IRS lost. Will the decision impact willfulness analysis in other tax contexts?

Notably, the Hawkins case was about whether his tax debts would be discharged in bankruptcy. The IRS was desperate to hang on to try to collect despite the bankruptcy. But could the same willfulness analysis apply in jeopardy tax collection cases? Maybe.

And what about in offshore account cases, where what's willful and what's not are so important today? The statutory language for willful failures to file FBARs does not include the same language. But one can argue that the purpose of the bankruptcy laws and some parts of the offshore disclosure rules are more similar than you might expect at first blush.

After all, the overriding purpose of the Bankruptcy Code is to ensure that debtors get a fresh start. Isn't that like the IRS offshore amnesty program known as the OVDP? It is designed to encourage taxpayers to come clean with their foreign accounts and get back into compliance with the IRS. The OVDP ends in a closing agreement with the IRS. That conclusiveness provides a fresh start, just as a bankruptcy discharge does.

Plus, now that the IRS has the two new Streamlined programs, the seeing the OVDP as analogous to the fresh start of a bankruptcy discharge seems even stronger. Of course, excessive spending may both be objectionable. From the IRS's perspective, a failure to report foreign accounts can be too.

The *Hawkins* case says the government must prove the taxpayer was willful. Since huge dollars and even one's freedom can turn on what's willful, it's comforting to know that despite IRS arguments, big spending alone doesn't make you willful. At least that's something. *Hawkins* suggests that we haven't heard the last word about willfulness.

You can reach me at Wood@WoodLLP.com. *This discussion is not intended as legal advice, and cannot be relied upon for any purpose without the services of a qualified professional.*