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THE TAX LAWYER

IRS Polices What Is Tax Planning Or Tax Evasion

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Tax planning–even tax *avoidance*–can be OK, but not tax *evasion*, so how do you tell the difference? It is tax filing season and whether you've started or not, it isn't pleasant. And the stakes are high. After all, every IRS tax return must be filed under penalties of perjury. Many people assume that the IRS will not impose penalties if you weren't actually *trying* to cheat on your taxes. Taxes are complex, and mistakes happen. But the burden is on *you* to show that you acted reasonably (such as by relying on professional tax advice). If you can't, you will probably end up with penalties.

The size of penalties varies, but often they are 25%. Higher penalties or even criminal prosecution is possible. The burden can be placed on you to prove you are right or that your mistakes were innocent. If the IRS believes you were trying to cheat, you could face a 75% penalty or even criminal prosecution. Most criminal tax cases start with civil audits. Innocent mistakes can often be forgiven if you can show that you tried to comply and got some advice. But it would be a mistake to assume that just about anything can be called an innocent mistake. In fact, you can be *attributed* knowledge.

Everyone has heard that ignorance of the law is no excuse. On many key tax subjects, the IRS says that with hardly any effort, you could easily learn the IRS requirements. The tax law draws a line between non-willful and willful, and penalties or even prosecution can hang in the balance. Willfulness can be shown by your knowledge of reporting requirements and your conscious choice not to comply.

Willfulness involves a voluntary, intentional violation of a known legal duty. In taxes, it applies for civil and criminal violations. This definition causes many people to think they are home free. You may not have *meant* any harm, but that may not be enough. The failure to learn of filing requirements, coupled with efforts to conceal the facts, can spell willfulness. Willfulness means you acted with knowledge that your conduct was unlawful—a voluntary, intentional, violation of a known legal duty. Watch out for conduct meant to conceal.

Anyone who is hiding income or assets from the taxman should consider how long they need to be looking over their shoulder. Even if you aren't actively hiding anything and truly did your best, you might be worried. Taxes are complex, and the line between creative tax planning and tax evasion can be less clear than you might think. The IRS usually has three years after you file to audit you. But there are many exceptions. If you omit more than 25% of your income and in some other situations, the IRS gets double that time, six years.

The time on civil tax fraud is longer–no limit. And there are other no-time-limit cases too. But most criminal tax situations, say involving a false return under-reporting income or willfully failing to file, linger for six years. That's six years from filing or from the time you willfully failed to file.

In some cases, the statute is "tolled"–so stops running. For example, the statute stops running if the target is outside the U.S. or is a fugitive. Even when the alleged tax crime is committed can be hard to pinpoint. For example, does filing a false return start the six year clock?

What about failing to file by the due date? How about covering it up later, hiding money, or lying about it? Watch out for this, for it might occur many years after the tax return was (or should have been) filed. Thus, you might have to worry for well beyond six years. Some courts have concluded that the six year statute doesn't even *start* to run until the last act of tax evasion.

So if you want to sleep well, don't get too creative or too aggressive. The U.S. taxes all income wherever you earn it. So forget arguing that only foreign-source income is taxable. A variation of this bogus theory is what got Wesley Snipes in trouble. In 2008, Mr. Snipes was convicted of three misdemeanor counts of failing to file tax returns, and spent several years in prison. Failing to file carries smaller penalties than filing fraudulently.

When possible, file once accurately and truthfully. Once you've filed your return, you can't be prosecuted for failing to file an *amended* return, even though something may happen *after* you file that makes it clear that your original return contained mistakes. On the other hand, if you *knew* the return was inaccurate when you filed it, watch out. You should amend it to make it accurate without delay.

The IRS rarely brings up an originally filed return in audits or criminal prosecutions once the taxpayer comes forward and attempts to correct it by filing an amended return. But to take advantage of this rule you need to be proactive. You need to make the correction *before* the IRS finds your error.

For alerts to future tax articles, email me at Wood@WoodLLP.com. This discussion is not legal advice.