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IRS Warns Not To Inflate Your Tax Deductions

Some people search high and low for tax deductions. But making them up--or artificially enhancing the ones you have--isn't exactly keeping to the straight and narrow. Indeed, the IRS this year has specifically cautioned people about what it calls padding deductions. The IRS warns to avoid the temptation to falsely inflate deductions or expenses. In fact, the IRS includes the issue on its 2018 Dirty Dozen list of tax scams. In the IRS's words, the majority of taxpayers file honest and accurate tax returns each year.

However, as the IRS puts it, each year some people “fudge” their information. Falsely claiming deductions, expenses or credits on tax returns is serious, regardless of their type. The IRS notes that it happens with overstating deductions such as charitable contributions, padding business expenses, or including tax credits to which you are not entitled. Two big ones to watch? The Earned Income Tax Credit and the Child Tax Credit.

The IRS is also putting the public on notice that IRS automated systems are increasingly efficient, and they generate most IRS audits. The IRS can normally audit returns filed within the last three years. But not only three years are at risk. The

IRS can add additional years for big errors or fraud. If being audited is not bad enough, the IRS warns about the penalties or worse. Significant penalties may apply for taxpayers who file incorrect returns including:

- 20% of the disallowed amount for filing an erroneous claim for a refund or credit.
- $5,000 if the IRS determines a taxpayer has filed a “frivolous tax return.” A frivolous tax return is one that does not include enough information to figure the correct tax or that contains information clearly showing that the tax reported is substantially incorrect.
- In addition to the full amount of tax owed, a taxpayer could be assessed a penalty of 75% of the amount owed if the underpayment on the return resulted from tax fraud.

If these costs are not scary enough, the IRS also reminds taxpayers that they could even be subject to criminal prosecution. The range of potential offenses includes:

- Tax evasion;
- Willful failure to file a return, supply information, or pay any tax due;
- Fraud and false statements;
- Preparing and filing a fraudulent return; or
- Identity theft.

Criminal prosecution could lead to additional penalties and even prison time. But what is willful conduct? Innocent, even *stupid* mistakes can be forgiven. Intentional wrongdoing, no. Since taxes are complex, you might assume that just about *anything* can be called an innocent mistake. However, you can be *attributed* knowledge.

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. If you didn’t *know*, how can you be prosecuted? It’s not that simple. You may not have *meant* any harm, but that may not be enough. Many people think that even civil penalties cannot be imposed if you weren’t actually trying to cheat anyone.

Unfortunately, willfulness can be shown by your knowledge of reporting requirements and your conscious choice not to comply. “Gee, I didn’t know,” can get you off the hook in a variety of circumstances. Sometimes it can even work with the IRS. But it is hardly a Get Out of Jail Free card. Everyone has heard that ignorance of the law is no excuse. Even if it can explain one failure, repeated failures to comply can morph conduct from inadvertent neglect into reckless or deliberate disregard. Even willful blindness--a conscious effort to *avoid* learning about reporting requirements--may be enough.

With most tax mistakes, the question is just whether you pay penalties on top of taxes and interest when they catch your mistake. The size of penalties varies but often, 25% is at stake. Civil fraud is 75%, but it is not often asserted. Criminal violations are asserted even less frequently. Still, most criminal tax cases start with civil audits. Even a smidgen of fraud or intentional misstatements can be serious enough to be potentially criminal. The burden can be placed on you to prove you are right or that your mistakes were innocent.

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