



Crossing the Line: When Aggressive Tax Planning Becomes Criminal Tax Fraud

Presented by Bryan C. Skarlatos & Don Fort

Bryan Skarlatos

Partner, Kostelanetz & Fink, LLP

For more than thirty-five years, Bryan C. Skarlatos has represented individuals and corporations in tax controversies, white collar criminal matters, regulatory investigations and voluntary disclosures. He is often hired as an expert on tax standards, penalties and procedures.

Mr. Skarlatos is an adjunct professor at New York University School of Law, where he teaches a course on Tax Penalties and Prosecutions. He created and chairs the annual New York University Tax Controversy Forum and the Practicing Law Institute program on Nuts and Bolts of Tax Penalties. Mr. Skarlatos is a fellow in the American College of Tax Counsel, and he also has served as the chair of tax committees for many bar associations including the American Bar Association, New York State Bar Association and New York City Bar Association.

Mr. Skarlatos has been recognized by New York Super Lawyers as one of the Top 100 lawyers in New York and he is listed in Best Lawyers in America where he was named Tax Litigator of the Year in New York for 2014 and 2017. He also is ranked in Band One of Chambers USA: America's Leading Lawyers for Business, which describes him as having a, "smart reassuring presence with insight into the government...extremely knowledgeable and very well connected to the various taxing authorities...Clients applaud him as being exceptionally brilliant at coming up with great outcomes."

Mr. Skarlatos speaks throughout the country on tax-related topics, and he frequently is quoted in publications such as The Wall Street Journal, USA Today, Forbes, Bloomberg, Reuters, Financial Times, Tax Analysts-Tax Notes, and Bloomberg BNA Daily Tax Report.



DON FORT

**Director of Investigations, Kostelanetz & Fink, LLP
(FORMER CHIEF, IRS CRIMINAL INVESTIGATION)**

John D. (Don) Fort is the Director of Investigations at Kostelanetz & Fink, LLP, and the immediate past Chief of the Internal Revenue Service's Criminal Investigation (CI) Division. Having spent nearly 30 years in law enforcement for the federal government, Mr. Fort has deep expertise in financial crimes, and has developed an extensive network of connections both within the government and in private industry. At K&F, he now assists clients facing governmental investigations involving all manner of alleged financial and economic crimes, including tax controversies or suspected tax crimes, money laundering, and Bank Secrecy Act violations. Mr. Fort also is involved in conducting internal investigations and advising clients on compliance regimes. He is available as an expert witness and for voluntary or court-mandated monitorships.



Tax Planning is Legitimate

- “Over and over again, courts have said that *there is nothing sinister in so arranging one’s affairs as to keep taxes as low as possible. Everybody does so, rich or poor, and all do right, for nobody owes any public duty to pay more than the law demands: taxes are enforced exactions, not voluntary contributions.* To demand more in the name of morals is mere cant.”
Commissioner v. Newman, 159 F2d 848, 850-51 (2nd Cir. 1947) (Learned Hand dissenting)
- Avoidance of taxes is not a criminal offense. Any attempt to reduce, avoid, or alleviate taxes by legitimate means is permissible. Internal Revenue Manual 9.1.3.3.2.1

But Where Is the Line?



Where is the line between legitimate tax planning, unethical conduct and criminal tax evasion?

The Line Is Not Always Clear



How Do You Know Where To Go?

Civil Penalties vs. Criminal Penalties

Avoidance of taxes is not a criminal offense.

- Any attempt to reduce, avoid, or alleviate taxes by legitimate means is permissible.
- The distinction between avoidance and evasion is fine, yet definite. One who avoids tax does not conceal or misrepresent. He/she shapes events to reduce or eliminate tax liability and, upon the happening of the events, makes a complete disclosure.
- Evasion on the other hand, involves deceit, subterfuge, camouflage, concealment, some attempt to color or obscure events, or makes things seem other than they are.

- Avoidance Distinguished from Evasion, IRM 9.1.3.3.2.1

Willfulness is the Key to Fraud

The 75% civil fraud penalty requires willfulness

All of the criminal tax statutes require some form of willfulness

Differences between civil fraud and criminal fraud

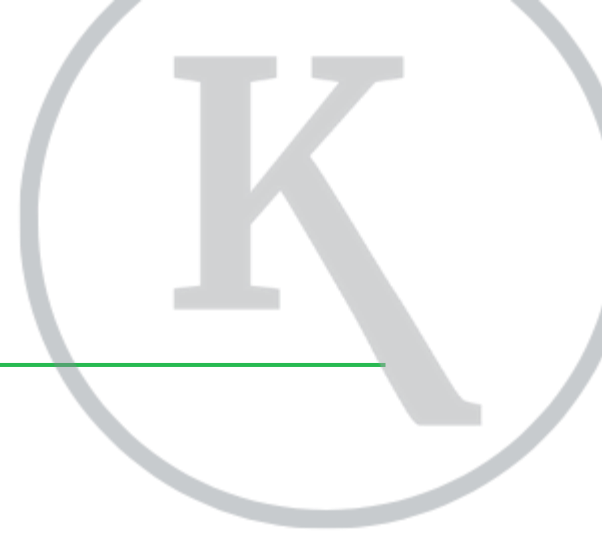
- Consequences
 - Money vs. incarceration
- Burden of proof
 - Clear and convincing vs. beyond a reasonable doubt
- Statutes of limitations
 - Unlimited vs. six years

Willfulness

- Willfulness is an intentional violation of a known legal duty.
- In criminal tax cases, ignorance of law is a defense.
- A defendant can raise affirmative defense that he did not know what his duties were under the law, or that he believed that he was in compliance.
- Even if that belief is outrageous and unreasonable, so long as the belief is true, it can be a defense to tax evasion.
- However, a jury may consider reasonableness of the asserted beliefs in determining whether the belief was honestly or genuinely held.
- Absent an admission, confession, or accomplice testimony, willfulness is rarely subject to direct proof and must generally be inferred from the defendant's acts or conduct.

Circumstantial Evidence of Willfulness

- a/k/a “Badges of fraud”
 - Repeated failure to report income or pay tax
- Serial “mistakes”
 - Attempts to confuse, conceal or “overly advocate”
 - False invoices or other documents
 - Destruction of records
 - Failure to produce damaging documents or information
 - Overly complex structures or arrangement with no legitimate business purpose
 - Off-books bank accounts
 - Use of pseudonyms or fake names
 - Lying or excessive delaying during an audit
- Admissions
 - Double set of books
 - Incriminating e-mails, notes or statements to witnesses



Who's Who?

- IRS Examination Divisions
- IRS Field Collection
- IRS Office of Fraud Enforcement
- **IRS Criminal Investigation**

IRS Civil Enforcement Priorities



1. IRS Focus on Hiring and Staffing
2. IRS Office of Fraud Enforcement and Initiatives
3. High-Income Non-Filers
4. International Collection
5. Global High Wealth Taxpayers
6. International Tax Enforcement
7. Crypto-currency Enforcement
8. Micro-captive Insurance Schemes
9. Syndicated Conservation Easements
10. Puerto Rico Residency Incentive Programs

IRS Criminal Enforcement Priorities



1. Focus on Hiring and Staffing
2. Fraud Awareness and Fraud Referrals
3. International Tax Enforcement
4. Crypto-currency Enforcement
5. Refund Fraud
6. Abusive Tax Schemes
7. Employment Tax
8. COVID-19 Fraud
9. General Tax Fraud that creates Deterrence

IRS Focus on Collaboration and Fraud Awareness



-
- Current Commissioner Charles Rettig has brought renewed focus to intra-agency cooperation and collaboration.
 - Fraud Awareness and Fraud Referrals are a point of emphasis across the agency.
 - Increasing, the IRS is turning to the use of sophisticated data analytics, data modeling and AI in identifying tax non-compliance.
 - The priorities and campaigns of one IRS Operating Division are likely complementary across Operating Divisions (Example: Cryptocurrency, Syndicated Conservation Easements)

IRS Office of Fraud Enforcement (OFE)

IR-2020-49, March 5, 2020

WASHINGTON — As part of a continuing focus on compliance issues, the Internal Revenue Service announced today that Damon Rowe will serve as the agency's director of the newly created Fraud Enforcement Office beginning in mid-March.

Rowe and the new office will reside in the IRS Small Business/Self Employed Division and work on agency-wide compliance issues. He will serve as the principal advisor and consultant to IRS Division Commissioners and Deputy Commissioners on all issues involving Fraud Enforcement strategic plans, programs and policy.

A veteran of IRS Criminal Investigation, he will also provide agencywide executive leadership and direction in the design, development and delivery of major activities within the Fraud Enforcement office in support of IRS efforts to detect and deter fraud while strengthening the National Fraud Program.

In addition to leveraging existing law enforcement relationships, Rowe will have a continued focus on unscrupulous activities of taxpayers and professional enablers that undermine our Federal Tax Laws in a manner that is consistent and fair to the American public. With additional training, resources and applied analytics, SB/SE will thwart emerging threats as it relates to fraudulent filings and related activities.

"Our compliance and enforcement functions are working together to improve tax administration for everyone," said IRS Commissioner Chuck Rettig. "Every compliance employee has a commitment for a general awareness of tax fraud related issues, which is a priority for the agency. Damon's exceptional leadership skills, background and expertise will strongly support agency determinations regarding the existence of fraud, and, just as important, determinations where a fraud referral should not occur. We are proud to have Damon lead the coordination of our fraud enforcement efforts."

IRS – CI Overview

Mission

To serve the American public by investigating potential criminal violations of the Internal Revenue Code and related financial crimes in a manner that fosters confidence in the tax system and compliance with the law.

Organization / History

- Formed in 1919, 6th largest Federal Law Enforcement Agency
- Jurisdiction includes tax, money laundering and Bank Secrecy Act (BSA) laws
- Notable cases: Al Capone, John Gotti, Vice President Spiro Agnew, FIFA, Leona Helmsley, Pete Rose, Chuck Berry and Willie Nelson

Program Areas

Employment Tax	International Tax Fraud	Abusive Tax Schemes	Cyber Crimes
Virtual Currency	Refund Fraud	QRP/RRP	OCDETF
		Terrorism	Public Corruption

Investigative Time

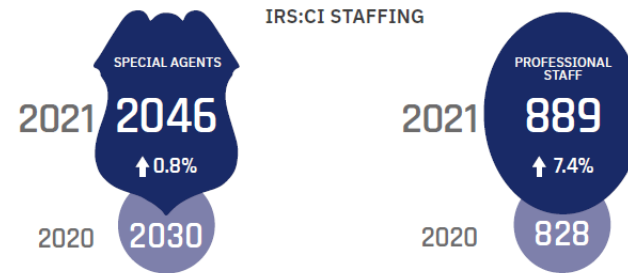
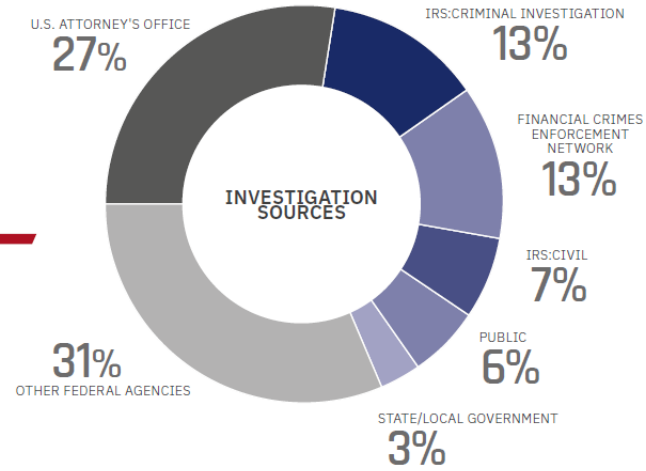
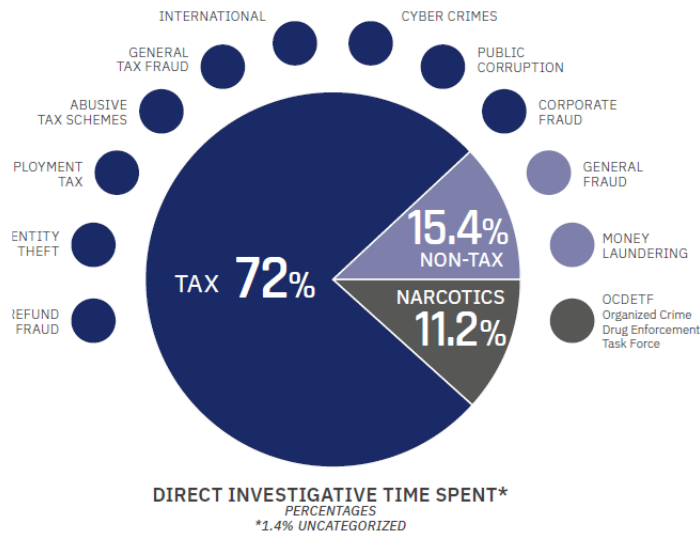
- 73+% of Direct Investigative Time on Tax
- 11% high level OCDETF/Narcotics
- 15% other significant financial crimes (high level money laundering, terrorist financing, cyber crimes, BSA violations)

Jurisdiction

CI is the only federal agency authorized to investigate potential criminal violations of the Internal Revenue Code

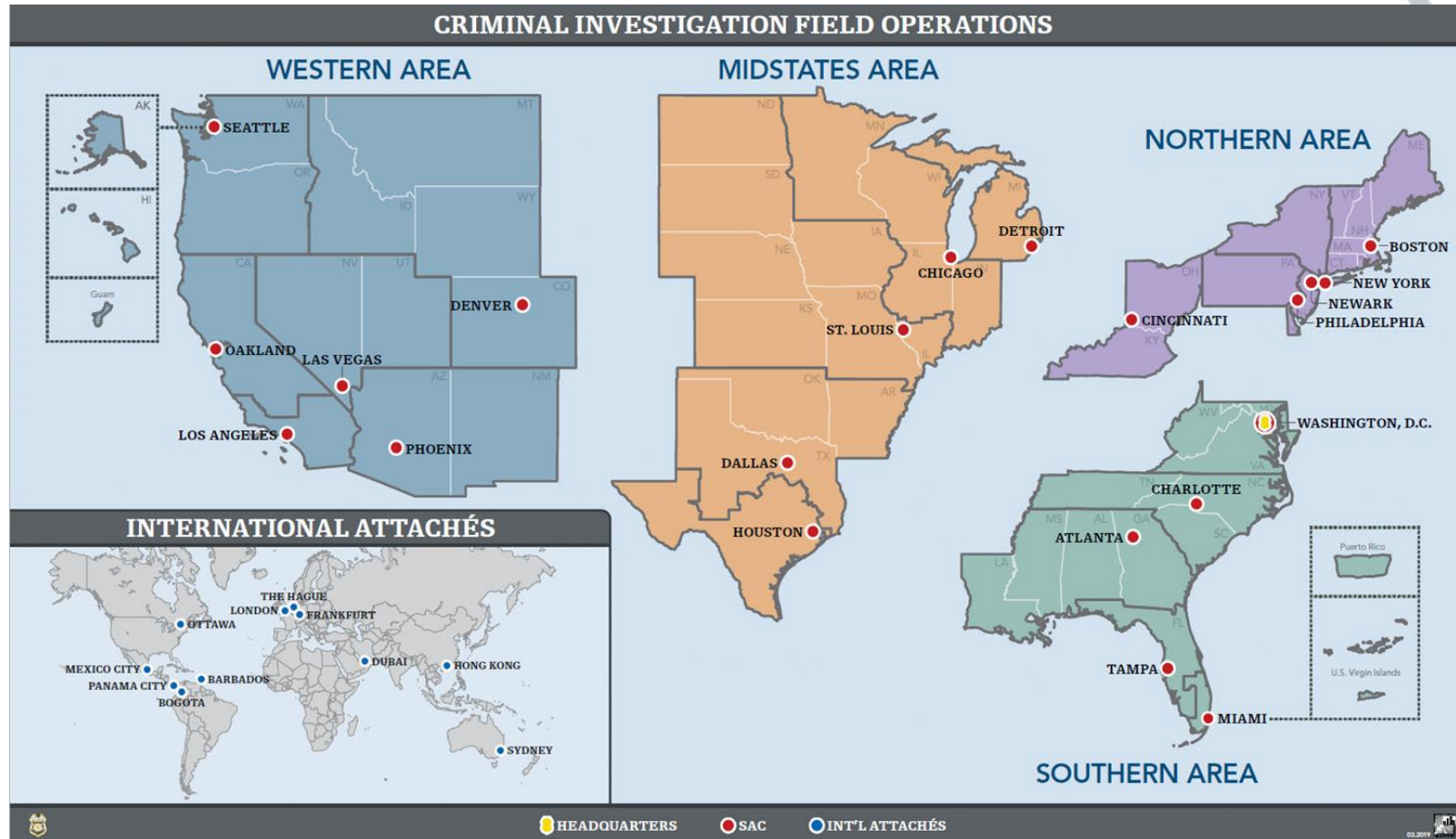
2021 IRS-CI Summary Snapshot

2021 Snapshot

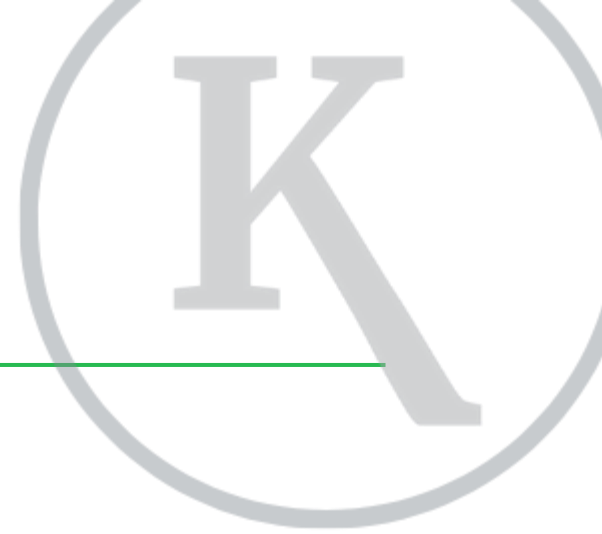


IRS:CI Annual Report 2021

CI Areas, Field Offices, and International Posts



Sources of Criminal Tax Investigations



- Fraud Referrals
- Informants
- Whistleblowers
- Cooperators
- Voluntary Disclosures
- Financial Institutions
- Other Federal or State Agencies
- IRS Criminal Investigation

Selection of Cases

- A Pattern of Behavior (3 years or more....)
- Intended and Actual Tax Loss
- Prior History with IRS Criminal Investigation
- Deterrent Impact
- Enforcement Priorities



Investigative Actions

Activities Not Requiring Authorized Investigations

- Obtaining leads and information from news media (electronic, radio, print, and/or the web)
- Accessing IRS and other government databases
- Maintaining liaisons with other law enforcement agencies
- Viewing information via Integrated Data Retrieval System
- Interviewing informants
- Observing home, office, real estate, personal property

Administrative Investigation

Additional Techniques in Subject Criminal Investigations

- An SCI is a full-scale criminal investigation and can use the broad spectrum of investigative techniques available. For example:
 - Summonses
 - Interviews of subjects/targets (generally within 30 days and simultaneous with return preparer and/or accountant)
 - Execution of search warrant where CI is affiant

Administrative Investigation



Administrative is still criminal...

Initial Procedures in Criminal Tax Investigations

- Which criminal statutes are alleged to have been violated.
- By whom, when, where, by what means the offense was committed.
- The elements of each alleged offense, what evidence must be obtained to establish the elements, and the probable sources of the evidence.
- The timing and sequence of key interviews and service of summonses.
- Whether the subject will be contacted for an initial interview.
- Whether the subject's books and records have been examined.

Investigative Techniques

What are the Agents doing?

- Federal financial investigations take time, the approximate average of investigating a criminal tax case is 18+ months.
- Gathering evidence to prove or disprove allegation
 - Interview witnesses
 - Subpoena and analyze financial records
 - Conduct surveillance, undercover, etc.
 - Attempting to prove “Willfulness”
- Agents are the fact-finders, DOJ are the Government attorneys

Discontinued Investigations

- Information developed in an administrative investigation is not subject to Rule 6(e) and can be used by the other operating divisions in the assessment and collection of a tax liability.
- The SSA will communicate the withdrawal to the cooperating and/or referring group manager of the other operating division. If a fraud referral prompted the investigation, the SSA will also communicate the withdrawal to the FTA Group Manager.
- The SA will prepare a discontinuance report and Criminal Investigation Closing Report (*see IRM 9.5.14.15*) .
- The discontinued investigation report will include:
 - A. Summary of evidence that supports or negates a civil fraud penalty.
 - B. In joint investigations, the discontinuance report should state that the cooperating officer's group manager was advised of proposed action.

Parallel Investigations

- In most cases, IRS will suspend a civil investigation until a related criminal investigation is complete
- In some cases, there are parallel proceedings
- IRM 1.2.1.5.11 (10-05-2005), *Policy Statement 4-26*, Criminal and civil aspects in enforcement
- IRM 9.5.1.5 (09-27-2011), *Parallel Investigations*
- IRM 38.3.1.8 (10-03-2007), *Balancing Criminal and Civil Aspects*
- Justice Manual – 6-4.400 (Feb. 2018)

IRS CI Units – Domestic/International

IRS CI Nationally Coordinated Investigation Unit

- Formed 5.1.2017 as part of the Future State initiative
- Primary goal: nationwide coverage of all programs
- Formed strong partnerships within/outside IRS
- Uses data driven case selection (with Research, Applied Analytics & Statistics (RAAS)), data scientists, and a new Data Section

Quickly analyzing large pools of data using tools such as Palantir, which integrates and conducts searches on 40+ internal/external data sets in a matter of seconds

Leveraging existing data & new data sets

Collaboration with IRS business operating divisions and outside contractors

- Focuses on developing investigative strategy that impacts and proactively addresses nationwide key noncompliance areas and emerging threats
- Continual resource to Field Offices

International Presence

Only division with physical int'l presence

Attachés located in 11 countries (Germany, China, England, Australia, the Netherlands, Colombia, Barbados, Mexico, Canada, UAE and Panama)

FY13-17: 982 international pros recommendations (6.1% of total) , includes charges brought against 21 International Financial Institutions

International Tax & Financial Crimes Group

Ex-Patriates - Investigation of U.S. expatriates residing in foreign jurisdictions to include renunciations and purchase of economic citizenship through the EB-5 program

Offshore Compliance Initiative - U.S. domesticated taxpayers using foreign abusive trusts, companies, accounts, transactions and structures to achieve a tax evasion purpose

FATCA - Entities / individuals specifically engaging in schemes to evade the reporting requirements imposed by FATCA legislation

Joint Chiefs of Global Tax Enforcement (J5)

'Their days are over': Global tax sting implicates hundreds of Aussies



Lucy Dean

Yahoo Finance AU 23 January 2020

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Australians caught up in global tax sting. Images

Hundreds of Australians have been cau

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Billionaires Innovation Leadership Money Business Small Business Life

EDITORS' PICK | 2,188 views | Jan 23, 2020, 12:32pm EST

Tax Chiefs Combine Forces In Global Tax Evasion Fight

Kelly Phillips Erb Senior Contributor © Taxes

GETTY

Five countries unite in global tax evasion crackdown

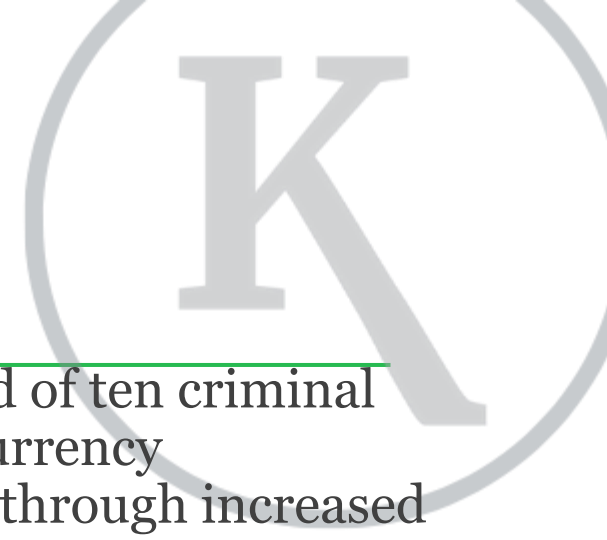
By Robbie Lawther, 23 Jan 20

Cheats around the world 'should be on notice that their days of non-compliance are over'

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A Global Scale – J5

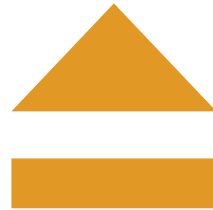


- Feb. 2018: IRS announces new international tax enforcement group comprised of ten criminal investigators focusing on international crimes by tax evaders who use cryptocurrency
- Jul. 2018: IRS joins the J5, committing to combatting transnational tax crime through increased enforcement collaboration.
 - Australian Criminal Intelligence Commission (ACIC) and Australian Taxation Office (ATO)
 - Canada Revenue Agency (CRA)
 - Fiscale Inlichtingen-en Opsporingsdienst (FIOD)
 - HM Revenue & Customs (HMRC)
 - Internal Revenue Service Criminal Investigation (IRS-CI)
- J5 works work together to gather information, share intelligence, conduct operations and build the capacity of tax crime enforcement officials.
- **Working Groups:** Professional Enablers (UK), Cyber/Virtual Currency (US), Platforms/Data (NL), and Media and Communications (US)

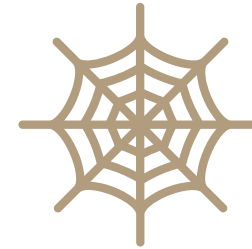
Coming Into Compliance



Voluntary Disclosure
Practice



Amending Returns /
Quiet Disclosures



Do Nothing?

US Sentencing Guideline

Quick Facts – Tax Fraud Offenses

- 68% of tax offenders are men
- Average age of tax offenders was 50 years old
- 80% had little or no criminal history
- More than 86% of cases involved loss of \$1.5M or less
- 59% of tax offenders received a variance
 - of those, 57% received a downward variance
 - Average downward variance was 61%
- 41% of tax offenders received no variance
 - of those, 60% sentenced within the USSG advisory range
- 65% sentenced to prison
- Average Sentence was 16 months



Thank you!

Questions?

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