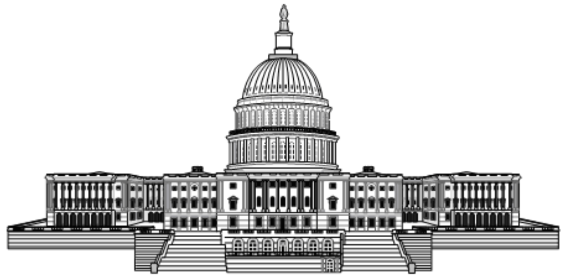

National Tax Advisory®

TO: **All Professional Tax Personnel** **NTA-737**
FROM: **Robin Tuttle Christian, CPA** **DATE:** **May 18, 2010**

RE: **IRS Releases Its List of 2010 Dirty Dozen Tax Scams**

Background

The annual IRS list of the most notorious tax scams, the "Dirty Dozen," has been released. (See IRS News Release IR-2010-32.) New to this year's list is a scheme where taxpayers report nontaxable social security benefits with excessive withholding to inflate their tax refunds. "Taxpayers should be wary of anyone peddling scams that seem too good to be true," IRS Commissioner Doug Shulman said. Tax schemes are illegal and can lead to imprisonment and fines for both scam artists and taxpayers. Taxpayers pulled into these schemes must repay unpaid taxes plus interest and penalties.

2010 Dirty Dozen

Without further ado, the following dastardly deeds make-up the IRS's 2010 dirty dozen:

1. *Phishing*. Phishing is a tactic used by scam artists to trick unsuspecting victims into revealing personal or financial information, usually by promising a tax refund if the victim provides this information. IRS impersonation schemes can take the form of emails, tweets, or phony websites. Scammers may also use phones and faxes to reach their victims. (To protect your clients, warn them to not open any attachments or click on any of the links in suspicious emails claiming to be from the IRS. Also, the IRS requests that suspicious emails and Web addresses that do not begin with **http://www.irs.gov** be forwarded to the IRS mailbox: **phishing@irs.gov**.)

2. *Hiding Income Offshore*. Individuals continue to try to avoid paying U.S. taxes by illegally hiding income in off-shore bank and brokerage accounts or using offshore debit cards, credit cards, wire transfers, foreign trusts, employee leasing schemes, private annuities or insurance plans. The IRS, state, and U.S. possession tax agencies aggressively pursue taxpayers and promoters of these scams. Also, IRS agents continue to develop their investigations of these offshore tax avoidance transactions using information gained from over 14,700 voluntary disclosures received last year.

3. *Filing False or Misleading Forms*. This tactic is used by scam artists who file false or misleading returns to claim refunds that they are not entitled to receive. Frivolous information returns, such as Form 1099-OID (Original Issue Discount), claiming false withholding credits are used to legitimize erroneous refund claims.

4. *Reporting Nontaxable Social Security Benefits with Excessive Withholding*. New to the list this year, the IRS is finding returns where taxpayers report nontaxable social security benefits with excessive withholding. This tactic increases withholding but not taxable income, thus inflating the taxpayer's refund. Often both the withholding amount and the reported income are incorrect. The IRS warns that this indiscretion can result in a $5,000 penalty.

5. *Abuse of Charitable Organizations and Deductions*. The IRS continues to see misuses of tax-exempt organizations. These include arrangements to improperly shield income or assets from taxation, attempts by donors to maintain control over donated assets or income from donated property, and overvaluation of contributed property. Often, the donations are highly overvalued or the organization receiving the donation promises that the donor can purchase the items back at a later date at a price the donor sets.

6. *Return Preparer Fraud.* Dishonest preparers cause many problems for taxpayers falling victim to their schemes. Such preparers derive financial gain by skimming a portion of their clients' refunds and charging inflated fees for return preparation services. They attract new clients by promising large refunds. The IRS is implementing a number of steps for future filing seasons aimed at thwarting such dishonest deeds. These include requiring all paid tax return preparers to register with the IRS and obtain a Preparer Tax Identification Number (PTIN), as well as both competency tests and ongoing continuing professional education for any paid tax return preparer who isn't an attorney, CPA, or enrolled agent.

7. *Frivolous Arguments.* Frivolous scheme promoters encourage people to make unreasonable and unfounded claims to avoid paying the taxes they owe. The IRS has a list of frivolous legal positions that taxpayers should stay away from (search for "The Truth About Frivolous Tax Arguments" on **www.irs.gov**.) Taxpayers who file a return or make a submission based on one of the listed positions are subject to a $5,000 penalty.

8. *Abusive Retirement Plans*. The IRS continues to uncover abuses in retirement plan arrangements, including Roth IRAs. It is looking for transactions that taxpayers use to avoid the limits on IRA contributions (such as, shifting appreciated assets into IRAs or companies owned by their IRAs at less than fair market value), as well as transactions that are not properly reported as early distributions.

9. *Disguised Corporate Ownership*. Domestic shell corporations and other entities are formed and operated in certain states to disguise ownership of a business or financial activity. Such entities can be used to facilitate under-reporting of income, fictitious deductions, nonfiling of tax returns, participation in listed transactions, money laundering, financial crimes, and even terrorist financing. The IRS is working with state authorities to identify these entities and bring their owners into compliance.

10. *Zero Wages.* Filing a phony wage-related or income-related information return to replace a legitimate information return has been used as an illegal method to lower the amount of taxes owed. Typically, a Form 4852 (Substitute Form W-2) or a "corrected" Form 1099 is used as a way to improperly reduce taxable income to zero. The taxpayer also may submit a statement rebutting wages and taxes reported by a payer to the IRS. The IRS warns that this indiscretion can result in a $5,000 penalty.

11. *Misuse of Trusts*. Unscrupulous promoters have urged taxpayers to transfer assets into trusts, promising reduction of income subject to tax, deductions for personal expenses and reduced estate or gift taxes. However, some trusts don't deliver as promised. The IRS has recently seen an increase in the improper use of private annuity trusts and foreign trusts to divert income and deduct personal expenses.

12. *Fuel Tax Credit Scams.* The IRS is receiving unreasonable claims for the fuel tax credit. Some taxpayers, such as farmers who use fuel for off-road business purposes, may be eligible for the credit. But, others are claiming the credit for nontaxable uses of fuel when their occupation or income level makes the claim unreasonable. Fraud involving the credit is on the list of frivolous tax claims subject to a $5,000 penalty.

Conclusion

Tax professionals should counsel taxpayers to steer clear of these schemes and take steps to remedy the situation for any client involved in one. Suspected tax fraud can be confidentially reported to the IRS using Form 3949-A (Information Referral) available at **www.irs.gov**.

Reference:

IRS News Release IR-2010-32.