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COMMENTARY

Heightened IRS Oversight: Preparing High Earners for Scrutiny

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By Heather L. Wilson | September 09, 2024 at 11:39 AM



Given recent technological advancements, increased accounting complexity, and economic pressures, the threat of criminal tax fraud has become more pronounced. This presents formidable obstacles for individuals and institutions alike. In September 2023, the Internal Revenue Service (IRS) announced a significant initiative to increase tax compliance by employing over 3,700 new revenue agents (RAs).

Expanded IRS Initiatives

Continuing its compliance efforts, the IRS introduced a new initiative on Feb. 29, 2024, targeting high-income taxpayers who have failed to file federal tax returns since 2017. Since then, over 125,000 compliance letters have been dispatched, including 25,000 to individuals earning over \$1 million and more than 100,000 to those with incomes between \$400,000 and \$1 million for tax years spanning 2017 to 2021. Noncompliance with these letters may prompt further actions, including collection and audit actions, as well as potential criminal prosecution.

As of July 2024, the IRS intensified its efforts on 1,600 individuals whose annual incomes exceeded \$1 million and had more than \$250,000 in tax debt. Of the 1,600 cases, 1,500 have already been assigned to RAs. However, these efforts only involve a segment of the initiative's high-income individual taxpayer cases, and the compliance efforts are expected to continue to ramp up in the months ahead.

RA and CI Investigations

The IRS's Internal Revenue Manual, Part 25 Fraud Handbook, defines fraud as a "deception by misrepresentation of material facts, or silence when good faith requires expression, which results in material damage to one who relies on it and has the right to rely on it." Tax fraud is an intentional wrongdoing by the taxpayer, specifically to evade a known tax. Tax fraud requires both a tax liability and fraudulent intent.

RAs are tasked with auditing filed returns to ensure compliance. Discrepancies may lead to the assessment of additional taxes and penalties. While their primary focus is civil in nature, RAs are trained to identify "badges of fraud" or circumstantial evidence that may indicate fraudulent intent.

The IRS delineates six categories of fraud badges, including:

- **Income:** Omitting entire income sources, failing to explain substantial net worth increases, concealing domestic or foreign bank accounts, not depositing business receipts in a bank account, and cashing checks via check-cashing services.
- **Expenses or Deductions:** Reporting false or exaggerated deductions and including personal expenses as business expenses.
- **Books and Records:** Keeping multiple sets of books, inadequate record-keeping, falsifying or altering entries, and issuing irregular invoices.
- **Allocations of Income:** Distributing profits to nonexistent partners.
- **Conduct of Taxpayer:** Making false statements during investigations, withholding relevant facts, and destroying records.
- **Method of Concealment:** Inadequate consideration, transferring assets to others, using secret bank accounts, and conducting transactions under false identities.

If fraud is detected during an audit, the RA may refer the case to special agents in the IRS's Criminal Investigation Division (CI) for further investigation. CI investigations may lead to prosecution and potential incarceration. According to the IRS Tax Data Book for FY23 and the IRS-CI FY23 Annual Report, in 2023 the IRS CI completed 2,584 investigations, identifying \$5.5 billion in tax fraud, referring 1,838 cases for prosecution, and achieving a conviction rate of 88.4%. If criminal criteria are not met, the case is returned to the RA, who may impose a civil fraud penalty under IRC 6663. If the civil fraud penalty is imposed, the IRS must establish, with clear and convincing evidence, that part of the tax underpayment resulted from fraud, demonstrating both knowledge and intent. The civil fraud penalty equates to 75% of the tax underpayment attributable to fraud.

The Role of Forensic Accountants

Forensic accountants can provide critical expertise in tax fraud cases. Their skills in substantiating tax losses and rebutting fraud allegations are invaluable. Forensic accountants' meticulous analyses serve as crucial defense mechanisms, significantly influencing the case outcome in favor of the accused. As the IRS ramps up enforcement, the expertise of forensic accountants will be essential in navigating and mitigating the impact of these intensified compliance measures.

Specifically, forensic accountants can assist lawyers and their clients in both civil and criminal audits by:

- Conducting comprehensive forensic financial analysis of records.
- Gathering evidence to support financial analyses.
- Assisting in interviews of taxpayers/clients and critical witnesses.
- Identifying and tracing funding sources and related transactions.
- Analyzing the government's accountant/expert's calculations.
- Assessing fraud loss in relation to sentencing guidelines.
- Completing the Net Worth Statement for Probation (PROB 48).

High-income individuals and entities face increased scrutiny as the IRS ramps up its compliance and enforcement efforts. The IRS's introduction of new RAs and initiatives targeting noncompliant taxpayers underscores the importance of careful tax practices. Forensic accountants play a critical role in defending against allegations and navigating tax audits.

Staying informed, maintaining thorough documentation, and seeking expert advice are crucial strategies to ensure compliance and reduce the risk of penalties or criminal charges.

Heather L. Wilson is a director with Marcum LLP and has over 25 years of public accounting and consulting experience. Heather provides forensic accounting and litigation support services in civil and criminal litigation matters. She regularly handles fraud investigations, employee dishonesty investigations, business loss claims, partnership/shareholder disputes, financial investigations to pierce the corporate veil, professional liability and lost earnings capacity analyses.