

**A CHEATING EPIDEMIC!**

The General Accounting Office (a congressional investigative agency) was sharply critical of the sharp declines in IRS audit and collection programs. Larry R. Levitan, chairman of the IRS Oversight Board, said that there is much evidence to suggest the IRS is facing an increase of corporate and individual behavior that makes going to any lengths to not pay taxes acceptable behavior. Taxpayers were asked in a survey what was an acceptable amount to cheat in paying their taxes. Last year, 76% said not at all, which is down from 87% in 1999. What this says is that nearly one-quarter of taxpayers believe cheating is appropriate behavior. The Government could be heading toward a noncompliance train wreck. IRS budget woes compound the problem. The IRS Oversight Board is very concerned that without additional meaningful resources, enforcement levels will continue to deteriorate.

The Department of Justice has issued several injunctions against promoters of illegal tax plans or shelters that urge taxpayers to violate the tax laws. IRS has implemented a multi-functional, comprehensive effort called the National Nonfiler Strategy. The overall goal of this strategy is to bring taxpayers back into compliance and keep them there. In addition to nonfilers, the IRS will reach out to individual taxpayers who are not legally required to file but are potentially entitled to refunds or credits.

*The following nonfiler statistics represent CI's efforts:*

Nonfiler Statistics*	FY 2000	FY 2001	FY 2002	FY 2003
Prosecution Recommendations	257	269	244	302
Indictments/Informations	265	257	233	234
Convictions	232	219	227	220
Incarceration * Rate	80.1%	83.9%	88.1%	81.7%
Avg. Months to Serve	33	36	49	40

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Scott Kauffman's...  
**IRS Tax Advocate**

A Legal Newsletter

*"Read About Taxpayers with IRS Problems & Learn Helpful Tips on How To End Them."*

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Learn How to Avoid  
**IRS**  
problems and solve  
them if you find  
yourself with one!

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**THE FIRESTORM NEXT TIME**

With the IRS, Congress, and even their own clients on their case, tax-shelter promoters are changing their act to survive. Deloitte and Touche has ditched the name "Predator" and morphed it into "Comprehensive Tax Solutions". KPMG has taken a similar tack and disbanded the teams that pitched aggressive tax strategies named "The Tempest" and "Othello." Shelter promoters have abandoned their strategies of selling one-size fits all tax avoidance plans to hundreds or even thousands of corporate and individual clients and are now going down market to real estate agents and car dealers. One individualized tax avoidance strategy growing in popularity uses an insurance policy to shield hedge fund investment gains from taxes. Some advisers are turning to offshore insurance companies that agree to take investors' money as a policy premium and invest the money in the hedge fund of the investor's choosing thereby avoiding taxes. Such blue-chip names as Massachusetts Mutual Life Insurance and Oppenheimer Funds have acquired the infrastructure for mass marketing insurance related tax strategies.

**TURN IN A CHEAT FOR FUN AND PROFIT**

Know of a tax cheat? Well turn her in for fun and profit. You can take the high moral ground by exposing these shirkers especially if the they've been cheating you out of child support or rubbing their shiny new Jag in your face. That's the fun part. The profitable portion is if you provide sufficiently detailed information on a tax cheat to the Criminal Investigative Division of the IRS you may receive up to 15% of the amount recovered. It can take up to two years for the wheels of justice to turn and even then the IRS need not pay you a dime. The IRS says that one 1 in 10 informants asks for a reward and of those that ask, only 1 in 10 actually receive something. Still, in 2002, the IRS paid \$7.7 Million in rewards. If your ready to turn someone in, start by dialing the Informant Communication Hotline at 1-800-829-0433. Be certain to state upfront that you want to file Form 211, Application for Reward for Original Information. As the IRS investigators are swamped with leads, most of them more vindictive than substantial, you will obtain best results if your information is as specific as possible.



"Let's just say, with accounting, it's best to think inside the box."

## IRS AIMS TO ELIMINATE EMPLOYEE-LEASING DODGE

The IRS is saying it intends to put an end to an employee-leasing scheme used by many physicians, dentists, and other professionals that has been widely advertised in many medical journals and variations were described in Forbes magazine in 2001. In a typical arrangement, a physician signs an employment contract with an employee-leasing company established in an offshore tax haven. The company then leases the physician's services back to his domestic employer. The offshore company provides the doctor with enough money to cover his expenses and holds the rest offshore and sheltered from the IRS. The IRS says it intends to challenge the supposed tax benefits claimed and to assess interest and penalties. The IRS also says it is conducting a significant number of audits and is also investigating several promoters of the strategy. Among other things, the IRS intends to obtain client lists from promoters and pursue those leads. The scheme is described as pretty widespread.

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**IT OUT**

## IRS TO AUDIT HUNDREDS OF OWN WORKERS

The IRS is auditing 800 of its own employees after discovering that some of them may have cheated on their own returns. A tip from an IRS employee that some agency workers might be filing bogus Schedule C tax forms, used to list profit and loss from self-employment, triggered the audits. The Treasury Inspector General for Tax Administration examined 25 IRS employee returns that included Schedule Cs and found about half contained questionable deductions or other information. Several employees have been fired and others are still under investigation.

## IRS LOSES MORE COMPUTERS

Last month I reported that the IRS had lost 2300 computers. The Office of the Treasury Inspector General for Administration has now found that the IRS cannot account for at least 6600 laptop and desktop computers that it lends to volunteers who assist the disabled and senior citizen taxpayers in preparing their returns. There are fears that the missing computers will contain private taxpayer information and social security numbers.

## AMNESTY FOR DISCLOSURE OF OFFSHORE ACCOUNTS ENDS *IRS Plans Next Step*

Just over 1200 taxpayers applied for partial amnesty under the Offshore Voluntary Compliance Initiative before expiration of the initiative on April 15th. The IRS has identified more than \$50 million in uncollected taxes and 80 new offshore promoters. Individuals, estates, trusts, and foreign and domestic corporations were among the taxpayers applying for amnesty. Several of the cases involved tax liabilities in excess of seven figures. The number of disclosures has to be disappointing to the IRS, which estimates that the number of taxpayers hiding income in offshore accounts reaches into the millions. The silver lining may be the identification of the 80 promoters from whom the IRS may learn the identities of thousands of taxpayers who chose not to voluntarily disclose. Florida, at 148, had the highest number of applications. California was second with 115. The IRS has also reported that it received a high number of questionable amended returns this filing season reporting offshore accounts.

## INSIDE THE IRS

With this issue of the Tax Advocate, I introduce a new section that explains the workings of the IRS as to particular issues. The subject this month is nonfilers. In the eyes of the IRS, taxpayers who fail to file income tax returns and stop paying income tax pose a serious threat to tax administration and the American economy. The IRS believes that the actions of a few undermine public confidence in the ability of the IRS to administer the tax laws fairly and effectively. In 1991, the IRS adopted a Nonfiler Strategy to address this growing problem. The strategy was based on the realization that the

## NEVADA DOCTOR SENTENCED

Elliott Schmerler of Incline Village, Nevada, has been sentenced to 15 months in prison and fined \$15,000 following his guilty plea to an indictment for tax evasion. From 1994 through 1998, Dr. Schmerler used his medical practice, Lakeview Medical Associates, and a Bahamian corporation he controlled, to pay more than \$500,000 in personal expenses, which he did not report as income on his returns resulting in a tax loss to the United States of \$156,000. In addition, Schmerler failed to pay more than \$26,000 in federal employment taxes consisting of income, social security and Medicare taxes withheld from employee's salaries and related employer payroll and employment taxes.

## IRS PROBES OFFSHORE INSURANCE INVESTMENTS FOR ABUSE

The IRS recently warned taxpayers that it is cracking down on abusive offshore insurance shelters. The scheme typically involves investing in an offshore insurance company, which, in turn, invests in hedge funds. The IRS has found that the insurance activities are usually investment activities. Contracts minimize, limit, or negate any genuine insurance risks. Consequently, the IRS says that U.S. stakeholders should not be entitled to claim that the foreign entity is an insurance company for federal income tax purposes.



traditional approach to solving such problems wasn't enough.

Initial efforts by the IRS focus primarily on individual income tax nonfilers and incorporate a two-fold element of the strategy-outreach and enforcement. Criminal Investigation's (CI) role is the second element of Nonfiler Strategy - enforcement. The IRS believes that there are those who will not respond to outreach efforts and simply refuse to comply with the law. For individuals who deliberately fail to comply with their obligation to file and pay taxes. CI has devoted resources to identify these individuals and in the most egregious cases, criminal prosecution is recommended. CI's ability to investigate and prosecute flagrant cases and generate publicity relating to these prosecutions is an important compliance tool.

All citizens must comply with the requirements of the tax law to file returns and pay taxes. Some, however, whether because of an inability to pay or severe procrastination, drop out of the tax system. The IRS has made attempts to make it easier for persons to voluntarily comply with the tax laws and to bring themselves current on any outstanding filings or tax due. Assistance is provided to those persons to resolve issues that caused them to drop out of the tax system and bring them back into compliance.

When the 16th Amendment to the Constitution was ratified (February 3, 1913) giving Congress the power "to lay and collect taxes on incomes" citizens began arguing that it was not properly ratified and income taxes are illegal. The Courts have repeatedly rejected their argument as frivolous, but unfortunately, some citizens continue to raise arguments in spite of the fact that they have no basis in law. Unscrupulous promoters and their followers have long employed frivolous arguments concerning the legality of the income tax as pretexts to enrich themselves or evade their taxes. Their motivation is monetary, not some legitimate purpose or belief.

Anti-taxation groups have been around for a long time. Some using the frivolous argument mentioned here. These groups are small but vocal. In the past, organizations like Your Heritage Protection Society, The Save a Patriot Society, The Pilot Connection, and the Freeman all attracted followings. Though the leadership of these movements used different arguments to gain followers, they all share one thing in common; they received substantial sentences in a federal prison for their activities. Their followers also paid a steep price for following bad advice. Some were prosecuted, many more were involved in years of litigation and ultimately had to pay all taxes owed along with penalties and interest. The IRS and Treasury have issued notices warning taxpayers that if returns are filed under the theory that U.S. citizens and residents aren't subject to tax on their wages and other income earned or derived within the United States, they may be subject to penalties. This argument is known as the "zero tax theory" and is possibly known by other names. Despite all the warnings about this and other frivolous arguments in the court system, some taxpayers insist on presenting frivolous arguments in court. The law allows the courts to impose a penalty of up to \$25,000 when the courts comes to any of three conclusions:

- a taxpayer instituted a proceeding primarily for delay,
- a position is frivolous or groundless, or
- a taxpayer unreasonably failed to pursue administrative remedies.