INTERNAL REVENUE SERVICE

IRS News Release

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Don't Fall Prey to the 2011 Dirty Dozen Tax Scams

Video: Dirty Dozen: English | Spanish | ASL

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WASHINGTON — Hiding income in offshore accounts, identity theft, return preparer fraud, and filing false or misleading tax forms top the annual list of "dirty dozen" tax scams in 2011, the Internal Revenue Service announced today.

"The Dirty Dozen represents the worst of the worst tax scams," IRS Commissioner Doug Shulman said. "Don't fall prey to these tax scams. They may look tempting, but these fraudulent deals end up hurting people who participate in them."

The IRS works with the Justice Department to pursue and shut down perpetrators of these and other illegal scams. Promoters frequently end up facing heavy fines and imprisonment. Meanwhile, taxpayers who wittingly or unwittingly get involved with these schemes must repay all taxes due plus interest and penalties.

Following is the Dirty Dozen for 2011:

Hiding Income Offshore

The IRS aggressively pursues taxpayers involved in abusive offshore transactions as well as the promoters, professionals and others who facilitate or enable these schemes. Taxpayers have tried to avoid or evade U.S. income tax by hiding income in offshore banks, brokerage accounts or through the use of nominee entities. Taxpayers also evade taxes by using offshore debit cards, credit cards, wire transfers, foreign trusts, employee-leasing schemes, private annuities or insurance plans.

In early February, the IRS announced a special voluntary disclosure initiative designed to bring offshore money back into the U.S. tax system and help people with undisclosed income from hidden offshore accounts get current with their taxes. The new voluntary disclosure initiative will be available through Aug. 31, 2011. The IRS decision to open a second special disclosure initiative follows continuing interest from taxpayers with foreign accounts. In response to numerous requests, information about this initiative is available on IRS.gov in eight different languages, including: Chinese, Farsi, German, Hindi, Korean, Russian, Spanish, and Vietnamese.

Identity Theft and Phishing

Identity theft occurs when someone uses an unsuspecting individual's name, Social Security number, credit card number or other personal information without permission to commit fraud or other crimes. For example, a criminal can use someone else's information to run up bills on that person's credit card, empty that person's bank account or take out a loan in that person's name. And when it comes to taxes, a criminal with someone else's personal information can file a fraudulent tax return and collect a refund.

Phishing is one tactic used by scam artists to trick unsuspecting victims into revealing personal or financial information online. Phishing involves the use of phony e-mail or websites -- even social media. A scammer may pose as an institution such as the IRS. IRS impersonation schemes flourish during tax season. Spyware, which can be loaded onto an unsuspecting taxpayer's computer by opening an e-mail attachment or clicking on a link, is another tool identity thieves use to steal personal information.

Identity theft is a major problem that affects many people each year. That's why it's important that taxpayers protect their personal information. Anyone who believes his or her personal information has been stolen and used for tax purposes should immediately contact the IRS Identity Protection Specialized Unit at 1-800-908-4490. More information on identity theft and taxes is available on the IRS website.

A suspicious e-mail or an "IRS" Web address that does not begin with http://www.irs.gov should be forwarded to the IRS at phishing@irs.gov.

Return Preparer Fraud

While most return preparers are professionals who provide honest and excellent service to their clients, some make basic errors or engage in fraud and other illegal activities.

Dishonest return preparers can cause big trouble for taxpayers who fall victim to their ploys. These fraudsters derive benefit by skimming a portion of their clients' refunds, charging inflated fees for return preparation services and attracting new clients by making false promises. Taxpayers should choose carefully when hiring a tax preparer. Federal courts have issued hundreds of injunctions ordering individuals to cease preparing returns, and the Department of Justice has pending complaints against dozens of others.

To increase confidence in the tax system and improve compliance with the tax law, the IRS is implementing a number of requirements for paid tax preparers, including registration with the IRS and a preparer tax identification number (PTIN), as well as competency tests and ongoing continuing professional education.

The new regulations require paid tax preparers (including attorneys, CPAs, and enrolled agents) to apply for a Preparer Tax Identification Number (PTIN) before preparing any federal tax returns in 2011.

Higher standards for the tax preparer community will result in greater compliance with tax laws, increase confidence in the tax system and ultimately lead to a better experience for taxpayers.

Filing False or Misleading Forms

IRS personnel are seeing various instances in which scam artists file false or misleading returns to claim refunds to which they are not entitled. In one variation of this scheme, a taxpayer seeks a refund by fabricating an information return and falsely claiming the corresponding amount as withholding. Phony information returns, such as a Form 1099 Original Issue Discount (OID), which claims false withholding credits, are usually used to legitimize erroneous refund claims. One version of the scheme is based on the bogus theory that the federal government maintains secret accounts for its citizens and that taxpayers can gain access to funds in those accounts by issuing 1099-OID forms to their creditors, including the IRS.

The IRS continues to see instances in which people file false or fraudulent tax returns to try to obtain improper tax refunds. The IRS takes refund fraud seriously, has programs to aggressively combat it and stops the vast majority of incorrect refunds.

Because scammers often use information from family or friends in filing false or fraudulent returns, beware of requests for such data. Don't fall prey to people who encourage you to claim deductions or credits you are not entitled to or willingly allow others to use your information to file false returns. If you are a party to such schemes, you could be liable for financial penalties or even face criminal prosecution.

Frivolous Arguments

Promoters of frivolous schemes encourage people to make unreasonable and outlandish claims to avoid paying the taxes they owe. The IRS has a list of frivolous legal positions that taxpayers should avoid. These arguments are false and have been thrown out of court. While taxpayers have the right to contest their tax liabilities in court, no one has the right to disobey the law or IRS guidance.

Nontaxable Social Security Benefits with Exaggerated Withholding Credit

The IRS has identified returns where taxpayers report nontaxable Social Security Benefits with excessive withholding. This tactic results in no income reported to the IRS on the tax return. Often both the withholding amount and the reported income are incorrect. Taxpayers should avoid making these mistakes. Filings of this type of return may result in a $5,000 penalty.

Abuse of Charitable Organizations and Deductions

The IRS continues to observe the misuse of tax-exempt organizations. Abuse includes arrangements to improperly shield income or assets from taxation and attempts by donors to maintain control over donated assets or income from donated property. The IRS also continues to investigate various schemes involving the donation of non-cash assets including situations where several organizations claim the full value for both the receipt and distribution of the same non-cash contribution. Often these donations are highly overvalued or the organization receiving the donation promises that the donor can repurchase the items later at a price set by the donor. The Pension Protection Act of 2006 imposed increased penalties for inaccurate appraisals and set new definitions of qualified appraisals and qualified appraisers for taxpayers claiming charitable contributions.

Abusive Retirement Plans

The IRS continues to find abuses in retirement plan arrangements, including Roth Individual Retirement Arrangements (IRAs). The IRS is looking for transactions that taxpayers use to avoid the limits on contributions to IRAs, as well as transactions that are not properly reported as early distributions. Taxpayers should be wary of advisers who encourage them to shift appreciated assets at less than fair market value into IRAs or companies owned by their IRAs to circumvent annual contribution limits. Other variations have included the use of limited liability companies to engage in activity that is considered prohibited.

Disguised Corporate Ownership

Corporations and other entities are formed and operated in certain states for the purpose of disguising the ownership of the business or financial activity by means such as improperly using a third party to request an employer identification number.

Such entities can be used to facilitate underreporting of income, fictitious deductions, non-filing of tax returns, participating in listed transactions, money laundering, financial crimes and even terrorist financing. The IRS is working with state authorities to identify these entities and to bring the owners of these entities into compliance with the law.

Zero Wages

Filing a phony wage-or-income-related informational 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 may also submit a statement rebutting wages and taxes reported by a payer to the IRS.

Sometimes, fraudsters even include an explanation on their Form 4852 that cites statutory language on the definition of wages or may include some reference to a paying company that refuses to issue a corrected Form W-2 for fear of IRS retaliation. Taxpayers should resist any temptation to participate in any of the variations of this scheme. Filings of this type of return may result in a $5,000 penalty.

Misuse of Trusts

For years, unscrupulous promoters have urged taxpayers to transfer assets into trusts. While there are many legitimate, valid uses of trusts in tax and estate planning, some highly questionable transactions promise reduction of income subject to tax, deductions for personal expenses and reduced estate or gift taxes. Such trusts rarely deliver the tax benefits promised and are used primarily as a means to avoid income tax liability and hide assets from creditors, including the IRS.

IRS personnel have recently seen an increase in the improper use of private annuity trusts and foreign trusts to shift income and deduct personal expenses. As with other arrangements, taxpayers should seek the advice of a trusted professional before entering a trust arrangement.

Fuel Tax Credit Scams

The IRS receives claims for the fuel tax credit that are excessive. Some taxpayers, such as farmers who use fuel for off-highway business purposes, may be eligible for the fuel tax credit. But other individuals are claiming the tax credit for nontaxable uses of fuel when their occupations or income levels make the claim unreasonable. Fraud involving the fuel tax credit is considered a frivolous tax claim and can result in a penalty of $5,000.

How to Report Suspected Tax Fraud Activity

Suspected tax fraud can be reported to the IRS using Form 3949-A, Information Referral. The completed form or a letter detailing the alleged fraudulent activity should be addressed to the Internal Revenue Service, Fresno, CA 93888. The mailing should include specific information about who is being reported, the activity being reported, how the activity became known, when the alleged violation took place, the amount of money involved and any other information that might be helpful in an investigation. The identity of the person filing the report can be kept confidential.

Whistleblowers also may provide allegations of fraud to the IRS and may be eligible for a reward by filing Form 211, Application for Award for Original Information, and following the procedures outlined in Notice 2008-4, Claims Submitted to the IRS Whistleblower Office under Section 7623.