

IRS News Release

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IRS Announces “Dirty Dozen” Tax Scams for 2006

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WASHINGTON — The Internal Revenue Service today issued the 2006 “Dirty Dozen”—its latest annual tally of some of the most notorious tax scams—along with an alert to taxpayers this filing season to watch out for schemes that promise to reduce or eliminate taxes.

Two new schemes have worked their way onto the list in 2006. In recent months IRS personnel have noted the emergence of the two scams—“zero wages” and “Form 843 tax abatement”—in which filers use IRS forms to claim that their tax bills have been wrongly inflated.

Also high on the list in 2006 is “phishing,” a favorite ploy of identity thieves. Over the past few years, the IRS has observed criminals working through the Internet, posing even as representatives of the IRS itself, with the goal of tricking unsuspecting taxpayers into revealing private information that can be used to steal from their financial accounts.

Several of the usual suspects from last year remain on the list. The IRS, for example, continues to see schemes designed to exploit charitable organizations. Some taxpayers, meanwhile, still use frivolous arguments to claim they do not owe taxes, despite the fact such reasoning has been thrown out of court time and again.

“When it comes to taxes, everyone has to pay their fair share,” IRS Commissioner Mark W. Everson said. “I urge taxpayers not to be taken in by hucksters who promise to lower or eliminate taxes. Getting caught up in the Dirty Dozen or similar schemes can lead to big headaches.”

Namely, involvement with tax schemes can lead to imprisonment and fines. The IRS pursues and shuts down promoters of these and numerous other scams. Anyone pulled into these schemes can also face repayment of taxes plus interest and penalties.

The IRS urges people to avoid these common schemes:

1. Zero Wages. In this scam, new to the Dirty Dozen, a taxpayer attaches to his or her return either a Form 4852 (Substitute Form W-2) or a “corrected” Form 1099 that shows zero or little wages or other income. The taxpayer may include a statement indicating the taxpayer is rebutting information submitted to the IRS by the payer.

An explanation on the Form 4852 may cite "statutory language behind IRC 3401 and 3121" or may include some reference to the paying company refusing to issue a corrected Form W-2 for fear of IRS retaliation. The Form 4852 or 1099 is usually attached to a "Zero Return." (See number four below.)

2. Form 843 Tax Abatement. This scam, also new to the Dirty Dozen, rests on faulty interpretation of the Internal Revenue Code. It involves the filer requesting abatement of previously assessed tax using Form 843. Many using this scam have not previously filed tax returns and the tax they are trying to have abated has been assessed by the IRS through the Substitute for Return Program. The filer uses the Form 843 to list reasons for the request. Often, one of the reasons is: "Failed to properly compute and/or calculate IRC Sec 83—Property Transferred in Connection with Performance of Service."

3. Phishing. Phishing is a technique used by identity thieves to acquire personal financial data in order to gain access to the financial accounts of unsuspecting consumers, run up charges on their credit cards or apply for new loans in their names. These Internet-based criminals pose as representatives of a financial institution and send out fictitious e-mail correspondence in an attempt to trick consumers into disclosing private information. Sometimes scammers pose as the IRS itself. In recent months, some taxpayers have received e-mails that appear to come from the IRS. A typical e-mail notifies a taxpayer of an outstanding refund and urges the taxpayer to click on a hyperlink and visit an official-looking Web site. The Web site then solicits a social security and credit card number. In a variation of this scheme, criminals have used e-mail to announce to unsuspecting taxpayers they are "under audit" and could make things right by divulging selected private financial information. Taxpayers should take note: The IRS does not use e-mail to initiate contact with taxpayers about issues related to their accounts. If a taxpayer has any doubt whether a contact from the IRS is authentic, the taxpayer should call 1-800-829-1040 to confirm it.

4. Zero Return. Promoters instruct taxpayers to enter all zeros on their federal income tax filings. In a twist on this scheme, filers enter zero income, report their withholding and then write "nunc pro tunc"—Latin for "now for then"—on the return. They often also do this with amended returns in the hope the IRS will disregard the original return in which they reported wages and other income.

5. Trust Misuse. For years unscrupulous promoters have urged taxpayers to transfer assets into trusts. They promise reduction of income subject to tax, deductions for personal expenses and reduced estate or gift taxes. However, some trusts do not deliver the promised tax benefits, and the IRS is actively examining these arrangements. There are currently more than 200 active investigations underway and three dozen injunctions have been obtained against promoters since 2001. As with other arrangements, taxpayers should seek the advice of a trusted professional before entering into a trust.

6. Frivolous Arguments. Promoters have been known to make the following outlandish claims: the Sixteenth Amendment concerning congressional power to lay and collect income taxes was never ratified; wages are not income; filing a return and paying taxes

are merely voluntary; and being required to file Form 1040 violates the Fifth Amendment right against self-incrimination or the Fourth Amendment right to privacy. Don't believe these or other similar claims. 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.

7. Return Preparer Fraud. Dishonest return preparers can cause many headaches for taxpayers who fall 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. Taxpayers should choose carefully when hiring a tax preparer. As the old saying goes, "If it sounds too good to be true, it probably is." And remember, no matter who prepares the return, the taxpayer is ultimately responsible for its accuracy. Since 2002, the courts have issued injunctions ordering dozens of individuals to cease preparing returns, and the Department of Justice has filed complaints against dozens of others. During fiscal year 2005, more than 110 tax return preparers were convicted of tax crimes.

8. Credit Counseling Agencies. Taxpayers should be careful with credit counseling organizations that claim they can fix credit ratings, push debt payment plans or impose high set-up fees or monthly service charges that may add to existing debt. The IRS Tax Exempt and Government Entities Division is in the process of revoking the tax-exempt status of numerous credit counseling organizations that operated under the guise of educating financially distressed consumers with debt problems while charging debtors large fees and providing little or no counseling.

9. Abuse of Charitable Organizations and Deductions. The IRS has observed increased use of tax-exempt organizations to improperly shield income or assets from taxation. This can occur, for example, when a taxpayer moves assets or income to a tax-exempt supporting organization or donor-advised fund but maintains control over the assets or income, thereby obtaining a tax deduction without transferring a commensurate benefit to charity. A "contribution" of a historic facade easement to a tax-exempt conservation organization is another example. In many cases, local historic preservation laws already prohibit alteration of the home's facade, making the contributed easement superfluous. Even if the facade could be altered, the deduction claimed for the easement contribution may far exceed the easement's impact on the value of the property.

10. Offshore Transactions. Despite a crackdown by the IRS and state tax agencies, individuals continue to try to avoid U.S. taxes by illegally hiding income in offshore bank and brokerage accounts or using offshore credit cards, wire transfers, foreign trusts, employee leasing schemes, private annuities or life insurance to do so. The IRS and the tax agencies of U.S. states and possessions continue to aggressively pursue taxpayers and promoters involved in such abusive transactions. During fiscal 2005, 68 individuals were convicted on charges of promotion and use of abusive tax schemes designed to evade taxes.

11. Employment Tax Evasion. The IRS has seen a number of illegal schemes that instruct employers not to withhold federal income tax or other employment taxes from

wages paid to their employees. Such advice is based on an incorrect interpretation of Section 861 and other parts of the tax law and has been refuted in court. Lately, the IRS has seen an increase in activity in the area of “double-dip” parking and medical reimbursement issues. In recent years, the courts have issued injunctions against more than a dozen persons ordering them to stop promoting the scheme. During fiscal 2005, more than 50 individuals were sentenced to an average of 30 months in prison for employment tax evasion. Employer participants can also be held responsible for back payments of employment taxes, plus penalties and interest. It is worth noting that employees who have nothing withheld from their wages are still responsible for payment of their personal taxes.

12. “No Gain” Deduction. Filers attempt to eliminate their entire adjusted gross income (AGI) by deducting it on Schedule A. The filer lists his or her AGI under the Schedule A section labeled “Other Miscellaneous Deductions” and attaches a statement to the return that refers to court documents and includes the words “No Gain Realized.”

Two Fall off the List

Two noteworthy scams have dropped off the “Dirty Dozen” this year: “claim of right” and “corporation sole.” IRS personnel have noticed less activity in these scams over the past year following court cases against a number of promoters.

How to Report Suspected Tax Fraud Activity

Suspected tax fraud can be reported to the IRS using IRS Form 3949-A, Information Referral. Form 3949-A is available for download from the IRS Web site at IRS.gov, or through the U.S. Mail by calling 1-800-829-3676. 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 person filing the report is not required to self-identify, although it is helpful to do so. The identity of the person filing the report can be kept confidential. The person may also be entitled to a reward.