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You know it is a tax scam when …

Guest comment

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Tax scam artists and "tax protestors" preach that federal income taxes do not have to be paid because the 16th Amendment to the Constitution (authorizing the income tax) has not been properly ratified, the Internal Revenue Code was never properly enacted by Congress, or the Internal Revenue Service was never properly constituted by either Congress or the Department of the Treasury and is therefore operating as an "illegal" entity. They should be so lucky. In truth, prison sentences are frequently the only benefit that flows from their "creative thinking."

In recent years, much more sophisticated strategies have been advocated, for example Son of BOSS, and sold for very lucrative fees to wealthy victims. The siren songs of tax avoidance are hard to resist. Because these tunes have come from those bearing the aura of respectability ─ major accounting firms, banks, investment advisors, charitable organizations, and law firms ─ even very sophisticated business people has been fooled into believing these tempting yarns.

While most professionals are not only hard working but also honest and ethical, a few bad apples definitely can spoil the barrel.

How to tell the rank from the real? Keeping safe does not require delving into the esoteric minutiae of the tax code and its mind-numbing regulations.

Many recently discovered schemes have similar warning signs and features of flimflam, such as those described below. Here are characteristics to heed and some questions you should ask before "taking advantage" of a tax avoidance strategy, device or product being advocated or sold by your professional:

- Your accountant's fee is tied to a percentage of the tax savings generated by the strategy, device, or product that is being recommended. [And you thought contingency fees were only for personal injury lawyers representing economically challenged clients.] As the knights were wont to say in 'Monty Python & the Quest for the Holy Grail': Run away. Such fee arrangements are often illegal or unethical, or both.

- The strategy, device, or product recommended to you generates losses that just happen to the match the gain or income you would like to shelter. Miracles happen in the Bible, but not in the tax code. Again, run away.

- The lawyer's opinion letter contains phrases like "more likely than not" when describing the Internal Revenue Service's response to the strategy, device, or product, for example, this approach, more likely than not, will not be deemed an abusive tax shelter under the Code. Yes, that is really comforting. Opinion letters should describe why the strategy, device, or product meets legal requirements, and what are the possible risks based on statutes, regulations, and court opinions. Civil evidentiary standards (more likely than not) are what you need to worry about when you are being sued by the IRS.

- Ask if the strategy, device, or product is always "blessed" by an opinion letter from the same law firm. If so, be very suspicious. You are probably getting a canned opinion full of boilerplate phrases, and not an independent evaluation tailored to your unique financial circumstances. Run away.

- Ask if any other law firm, beside the usual one, has given its blessing to the same strategy, device or product, and obtain a copy of both opinion letters. Compare them. There should be differences in their analysis because the types of tax avoidance schemes being advocated are usually pushing the envelope; intelligent minds should differ. If there are no differences, be very suspicious.

- Ask a second accounting firm if they agree that the strategy, device, or product is legitimate. If they have doubts, be sure and run away.

- If serious money is involved (you wouldn't be reading this column if it were not), ask the professional if they use the strategy, device, or product themselves, and to prove it to you by providing certified financials or copies of their tax returns. If they are not willing to put their money where their mouth is, run away. They may also be incredibly stupid or believe their own propaganda; after all, some professional firms have separate sales units. You are frequently not talking to the "genius" that dreamed this one up. So do not rely on this approach alone. Look for the other danger signs also.

- Ask the professional to guarantee that the strategy, device, or product is legitimate, to wit, they will refund their fees plus pay any interest and penalty charges incurred by you if the IRS disallows the strategy, device, or product. If they are not willing to stand by their recommendations, be very suspicious. Even if they are, get it in writing and make sure that the professionals have errors and omissions insurance in satisfactory amounts. Have your own lawyer draft the guarantee so that it is as all-encompassing as possible; include personal guarantees from the professional as well as guarantees from his/her business entity/employer. Serious money (yours, of course) and serious fees (what they charge) demand serious guarantees, especially given the express or wink-wink implied assurance that substantial taxes will be avoided. Remember, in the worst of all worlds, you are risking a felony. And your new prison buddy Bubba can be a lot more of a pain than the loss of a few dollars to the Treasury.

- Since you got burned on the last strategy, device or product that was sold you because the IRS classified it as an abusive tax shelter, your professional wants you to try the new and improved model this year. Come on, even children learn not to get burned playing with matches. If you want to play the sucker, buy some phony pills from an Internet spammer.

- Phrases are tossed your way that harken back to the baloney of the tax protestors, such as "so sophisticated the IRS is not aware of it", "too new for most accountants to be cognizant of", and "the product of our in-house geniuses in (pick a City)". Run very fast.

While it is easy to laugh, or cry, about the never-ending tax avoidance schemes foisted on the successful and fortunate, the rules of thumb described above reflect very real warnings and red flags. Applying them can help you steer clear of abusive tax shelters and their promoters, such as those that have been documented in court cases and Congressional and IRS investigations in the recent past. With the federal deficit looming ever larger, the IRS is ever more vigilant about abusive tax shelters; the risks to taxpayers are also huge, as the very substantial penalties in the Son of BOSS schemes recently have demonstrated.

The key is to avoid being burned. Get second opinions. Keep in mind the old saying that if it sounds too good to be true, it probably is. But, if you are burned, do not let embarrassment or shame deter you from seeking recompense for the incompetence and often outright fraud to which you have been subjected. Promoters count on your feelings of shame to hide their ill-gotten gains. Like all forms of abuse, such conduct is best addressed by seeking compensation.

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