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**MEMORANDUM**

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**RE:**     **UNREPORTED INCOME (IRS)**: IRS CIVIL TAX FRAUD AND  
          CRIMINAL TAX EVASION

**DATE:**  NOVEMBER 12, 2007

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The IRS will often pursue a Taxpayer first, on criminal tax evasion, and then, civil tax fraud (otherwise, the taxpayer could assert, during the civil investigation, his Fifth Amendment privilege against self-incrimination).

If the IRS pursues civil tax fraud first and wins, they may collect civil penalties, tax and obtain discovery information, and then pursue criminal proceedings (and use the civil file to prosecute).

Civil Tax Fraud, and Criminal Tax Evasion cases have different:

- I. **Burdens of Proof**
- II. **Statutes of Limitations (Unreported Income)**
- III. **Penalties**
- IV. **Collateral Estoppel (Civil/Criminal Issues)**

- I. **Burdens of Proof**  
    (Evidentiary Standard)
  - a. **Civil Tax Fraud**: “Clear and Convincing Evidence” (a.k.a. Preponderance of the Evidence)
  - b. **Criminal Tax Evasion**: “Beyond a Reasonable Doubt”  
    (Higher Standard)

## II. Statutes of Limitations

- a. Civil Tax Fraud: No statute of limitations (tax can be assessed at any time).
- b. Criminal Tax Fraud (Evasion): The criminal statute of limitations is only on the prosecution of the crime i.e. tax evasion (not the assessment of tax owed).

Generally, 3 years after the offense is committed.

**Six (6) years for specified offenses (including: unreported income) (IRC §6531)**

Under Federal Criminal Code (Title 18 U.S.C.A.) 5 years after the commission of a crime.

The statute begins to run when the last of the acts constituting the tax evasion is committed.

## III. Penalties (Unreported Income)

### (a) Civil Tax Fraud

#### (1) Fraudulent Failure to File Tax Return (IRC §6651(f))

15% of net amount of tax due for each month, (up to a maximum of 5 months), for a maximum penalty of 75% (of unpaid tax) (IRC §6651(f)). **This is the only penalty imposed for failure to file.**

(2) Fraudulent Tax Return (Unreported Income) **(IRC §6663(d))**

If any part of an underpayment of tax (required to be shown on a tax return) is due to fraud, a penalty equal to 75% of the portion of the underpayment.

(3) Accuracy – Related Penalty **(IRC §6662(b)(1)-(5))**

A penalty at a flat rate of 20% on portion of underpayment of tax.

**The fraud penalty and accuracy-related penalty apply only for filed tax returns.**

(4) Spousal Liability **(IRC §6663(c))**

For a joint tax return, both spouses are subject to joint and several liability for the entire tax liability.

The civil fraud penalty applies only to the spouse responsible for the underpayment that is attributable to fraud.

(5) Failure to Pay Tax

The penalty applies to the amount of unpaid tax due:

Unpaid tax shown as due on a tax return **(IRC §6651(a)(2))**

½ percent (of unpaid tax) for each month, up to a maximum of 25% (of unpaid tax)

Unpaid tax not shown as due on a return (i.e., unreported income (IRC §6651(a)(3))

½ percent (of unpaid tax) for each month up to a maximum of 25% (of unpaid tax)

**OFFSETTING PENALTIES (IRC §6651(c)(1))**

If taxpayer is liable for more than one of the delinquency penalties with respect to any tax return, the amount of the penalty for failure to file, is reduced by the amount of the penalty for failure to pay (the amount shown on a return for any month for which both penalties apply )

**There is no offset for the penalty for failure to pay tax (IRC §6651(a)(3)) not shown as due on a return (i.e., unreported income).**

**No credit is allowed against the civil fraud penalty for any criminal fines paid for income tax evasion and conspiracy to defraud the U.S.**

(b) Criminal Tax Evasion (Unreported Income)

(1) IRC §7201: Criminal penalty for willful attempt by any person to evade or defeat any tax or the payment of any tax

Conviction, punishable:

Fine: \$100,000 (individual)

\$500,000 (corporation)

Imprisonment: Not more than 5 years (or both fine and imprisonment)

(2) IRC §7203: **Criminal Failure to File or Pay Taxes**

**Willful failure to pay tax, file a return, keep required records, or supply required information**

Fine: \$25,000 (individual)

\$100,000 (corporation)

Imprisonment: Up to one year (or both fine and imprisonment)

IV. Collateral Estoppel: When criminal proceedings are followed by civil proceedings, the legal doctrine of collateral estoppel may apply. This doctrine provides that an issue necessarily decided in a previous proceeding (the 1<sup>st</sup> proceeding) will determine the issue in a subsequent proceeding (the 2<sup>nd</sup> proceeding), but only as to matters in the 2<sup>nd</sup> proceeding that were actually presented and determined in the 1<sup>st</sup> proceeding.

**a. Conviction for criminal tax evasion collaterally estops the taxpayer from contesting the existence of fraud for**

**purposes of the civil fraud penalty because a finding of criminal fraud (beyond a reasonable doubt) establishes proof of civil fraud (by clear and convincing evidence).**

- b. Acquittal of criminal tax evasion does not collaterally estop the government from proving civil fraud (by clear and convincing evidence). The acquittal established that proof of fraud did not exist beyond reasonable doubt, but that does not mean that proof of fraud by clear and convincing evidence does not exist.**

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