



## Fraudulent Telephone Tax Refunds, Abusive Roth IRAs Top Off 2007 "Dirty Dozen" Tax Scams

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WASHINGTON — The Internal Revenue Service today identified 12 of the most blatant scams affecting American taxpayers and warned people not to fall for schemes peddled by scamsters.

This year the "Dirty Dozen" highlights five new scams that IRS auditors and criminal investigators have uncovered. Topping off the list are fraudulent refunds being claimed in connection with the special Telephone Excise Tax Refund available to most taxpayers this filing season. The IRS is actively investigating instances of this scam involving tax preparers who are preparing inflated refund requests.

Also new to the Dirty Dozen this year are abuses pertaining to Roth IRAs, the American Indian Employment Credit, domestic shell corporations and structured entities.

"Taxpayers shouldn't let their guard down," IRS Commissioner Mark W. Everson said. "Don't get taken by scam artists making outrageous promises. If you use a tax professional, pick someone who is reputable. Taxpayers should remember they are ultimately responsible for what is on their tax return even if some unscrupulous preparers have steered them in the wrong direction."

Involvement in tax schemes leads to problems for scam artists and taxpayers. Tax return preparers and promoters risk significant penalties, interest and possible criminal prosecution.

The IRS urges taxpayers to avoid these common schemes:

- 1. Telephone Excise Tax Refund Abuses:** Early filings show some individual taxpayers have requested large and apparently improper amounts for the special telephone tax refund. In some cases, taxpayers appear to be requesting a refund of the entire amount of their phone bills, rather than just the three-percent tax on long-distance and bundled service to which they are entitled. Some tax preparers are helping their clients file apparently improper requests. The IRS is investigating potential abuses in this area and will take prompt action against taxpayers who claim improper refund amounts and against the return preparers who help them.
- 2. Abusive Roth IRAs:** Taxpayers should be wary of advisers who encourage them to shift under-valued property to Roth Individual Retirement Arrangements (IRAs). In one variation, a promoter has the taxpayer move under-valued common stock into a Roth IRA, circumventing the annual maximum contribution limit and allowing otherwise taxable income to go untaxed.
- 3. 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 loans in their names. These Internet-based criminals pose as representatives of a financial institution — or sometimes the IRS itself — and send out fictitious e-mail correspondence in an attempt to trick consumers into disclosing private information. 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. It is important to 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. Disguised Corporate Ownership:** Domestic shell corporations and other entities are being formed and operated in certain states for the purpose of disguising the ownership of the business or financial activity. Once formed, these anonymous entities can be, and are being, used to facilitate underreporting of income, non-filing of tax returns, listed transactions, money laundering, financial crimes and possibly terrorist financing. The IRS is working with state authorities to identify these entities and to bring their owners into compliance.
- 5. Zero Wages:** In this scam, which first appeared in the Dirty Dozen in 2006, a Form 4852 (Substitute Form W-2) or a "corrected" Form 1099 showing zero or little income is submitted with a federal tax return. The taxpayer may include a statement rebutting wages and taxes reported by the payer to the IRS. An explanation on the Form 4852 may cite statutory language behind Internal Revenue Code sections 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.
- 6. Return Preparer Fraud:** Dishonest return preparers can cause many headaches for taxpayers who fall victim to their schemes. Such preparers make their money by skimming a portion of their

clients' refunds and charging inflated fees for return preparation services. They attract new clients by promising large refunds. Some preparers promote filing fraudulent claims for refunds on items such as fuel tax credits to recover taxes paid in prior years. 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." Remember that 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 2006, 109 tax return preparers were convicted of tax crimes and sentenced to an average of 18 months in prison.

**7. American Indian Employment Credit:** Taxpayers submit returns and claims reducing taxable income by substantial amounts citing an American Indian employment or treaty credit. Although there is an Indian Employment Credit available for businesses that employ Native Americans or their spouses, there is no provision for its use by employees. In a somewhat similar scam, unscrupulous promoters have informed Native Americans that they are not subject to federal income taxation. The promoters solicit individual Indians to file Form W-8 BEN seeking relief from all withholding of federal taxation. A recent "phishing" variation has promoters using false IRS letterheads to solicit personal financial information that they claim the IRS needs in order to process their "non-tax" status.

**8. 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. There are currently more than 150 active abusive trust investigations underway and 49 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.

**9. Structured Entity Credits:** Promoters of this newly identified scheme are setting up partnerships to own and sell state conservation easement credits, federal rehabilitation credits and other credits. The purported credits are the only assets owned by the partnership and once the credits are fully used, an investor receives a K-1 indicating the initial investment is a total loss, which is then deducted on the investor's individual tax return. Forming such an entity is not a viable business purpose. In other words, the investments are not valid, and the losses are not deductible.

**10. Abuse of Charitable Organizations and Deductions:** The IRS continues to observe the use of tax-exempt organizations to improperly shield income or assets from taxation. This can occur 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. Contributions of non-cash assets continue to be an area of abuse, especially with regard to overvaluation of contributed property. In addition, the IRS is noticing the return of private tuition payments being disguised as charitable contributions to religious organizations.

**11. Form 843 Tax Abatement:** This scam 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."

**12. 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.

#### **IRS Still Watches Scams That Fall Off the List**

Five of last year's Dirty Dozen tax scams rotated off the list for 2007. While the IRS has seen a decline in the occurrence of some of these scams — abusive credit counseling agencies, for example — other problems, such as offshore abusive transactions continue to be an area of particular concern for the agency. The absence of a particular scheme from the Dirty Dozen should not be taken as an indication that the IRS is unaware of it or not taking steps to counter it.

#### **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](http://IRS.gov), or by 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.

**Links:**

- [IR-2007-61](#), IRS Identifies 40 Frivolous Positions for Taxpayers to Avoid On Tax Returns
- [Tax Scams Page on IRS.gov](#)
- [Telephone Excise Tax Refund](#)
- [Identity Theft and Your Tax Records](#)
- [Abusive Return Preparer Enforcement](#)
- [How to Report Suspected Tax Fraud Activity](#)
- [Form 3949-A, Information Referral](#)
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