

## **Session 8**

### **Avoiding Criminal and Civil Practitioner Liability (2019)**

#### **I. INTRODUCTION**

- A. Client hasn't filed in 10 years and gets IRS notice
  - 1. Real estate is in trust
  - 2. Bank account in Switzerland
  - 3. Gold, silver, and cash buried in backyard
  - 4. You can get a sweetheart deal if you don't include these hidden assets!
  - 5. By the way, the "client" is actually an undercover IRS agent!
- B. Client needs you to file tax return, due in two weeks
  - 1. Provides spreadsheet of income and expenses
  - 2. Provides no source documents
  - 3. Time crunch – no time to do bookkeeping
  - 4. Circular 230 requirements?
  - 5. What are your responsibilities – both to the client and IRS/state?

#### **II. OVERVIEW**

- A. There are issues of both criminal and civil liability
- B. Aiding and abetting – not your own taxes, but those of a client:
  - 1. "Aiding and Assisting" is itself a tax crime – §7206(2) – and a civil violation – §6701.

2. “Aiding and Abetting” is an add-on to an underlying crime, similar to conspiracy – 18 USC §2 (U.S. Criminal Code)

a. What are the elements of “aiding” and how does it differ from “conspiracy”?

b. Tax resolution and return preparation could be “aiding and abetting” or “conspiracy”

3. All are applicable in both criminal and civil context.

### C. Crimes

1. Evasion

2. Fraudulent returns or statements

3. Other related white collar crimes

### D. Civil law: Ethics vs. Morality

1. Circular 230 (several sections)

2. Code §6701 (“aiding and assisting”)

3. Attorney RPC

4. CPA RPC

5. Do the right thing; serve your client!

### E. Collection representative examples

### F. Return preparer examples

## III. PART I: CRIMINAL LAW CONTEXT

### A. Evasion

1. Code §7201

2. Elements:

a. Willfully

b. Attempts in any manner

c. To evade or defeat any tax imposed by this title or the payment thereof

3. 5-year felony

4. Bottom line: willfully attempting to evade assessment or collection of client's "fair share"

B. Fraud and false statements

1. Code §7206

2. Elements:

a. Make/Subscribe:

(1) Willfully

(2) makes and subscribes

(a) any return, statement, or other document,

(3) which contains or is verified by a written declaration that it is made under the penalties of perjury, and

(4) which he does not believe to be true and correct as to every material matter; or

b. Aid/Assist:

(1) Willfully

(2) aids or assists in, or procures, counsels, or advises

(a) the preparation or presentation under, or in connection with any matter arising under, the internal revenue laws,

(b) of a return, affidavit, claim, or other document,  
(3) which is fraudulent or is false as to any material matter; or

c. Simulates or falsely or fraudulently executes or signs any bond, permit, entry, or other document required by the provisions of the internal revenue laws, or by any regulation made in pursuance thereof, or procures the same to be falsely or fraudulently executed, or advises, aids in, or connives at such execution thereof; or

d. Removes, deposits, or conceals, or is concerned in removing, depositing, or concealing, any goods or commodities for or in respect whereof any tax is or shall be imposed, or any property upon which levy is authorized by section 6331, with intent to evade or defeat the assessment or collection of any tax imposed by this title; or

e. In connection with an OIC or closing agreement

(1) In connection with and OIC or closing agreement,  
(2) Conceals from any officer or employee of the United States

(a) any property belonging to the estate of a taxpayer or other person liable in respect of the tax, or

f. In connection with an OIC or closing agreement:

(1) In connection with an OIC or closing agreement,  
(2) Receives, withholds, destroys, mutilates, or falsifies  
(a) any book, document, or record, or  
(3) makes any false statement,  
(4) relating to the estate or financial condition of the taxpayer or other person liable in respect of the tax.

3. 3-year felony

## C. Fraudulent returns or statements

1. Code §7207

2. Elements:

a. Willfully delivers or discloses to the Secretary

(1) any list, return, account, statement, or other document

b. Known to be fraudulent or to be false as to any material matter

3. Or these elements:

a. Any person required pursuant to §6047(b) [trusts and annuities], §6104(d) [charitable organizations], or §527(i), or §527(j) [political organizations] to furnish any information to the Secretary or any other person who willfully furnishes to the Secretary

b. Any information known by him to be fraudulent or to be false as to any material matter

4. 1-year felony

D. Attempt to interfere

1. Code §7212

2. Elements:

a. Whoever corruptly or by force or threats of force (including any threatening letter or communication)

b. Endeavors to intimidate or impede any officer or employee of the United States acting in an official capacity under this title,

c. Or in any other way corruptly or by force or threats of force (including any threatening letter or communication) obstructs or impedes, or endeavors to obstruct or impede, the due administration of this title.

d. The term “threats of force” means threats of bodily harm to an officer or employee of the U.S. or to a member of his family

3. 3-year felony if force is used; 1 year if merely “threats”

#### E. Other types of fraud

##### 1. Mail fraud – 18 USC §1341 (US Criminal Code)

a. The elements of the offense of mail fraud under... §1341 are (1) a scheme to defraud, and (2) the mailing of a letter, etc., for the purpose of executing the scheme

b. 20-year felony

##### 2. Wire fraud – 18 USC §1343

a. Elements:

1. Devised or intending to devise any scheme to defraud and,

2. “Transmits or causes to be transmitted by means of wire, radio, or television communication in interstate or foreign commerce”

3. “For the purpose of executing such scheme”

b. 20-year felony

##### 3. Bank fraud – 18 USC §1344

a. Knowingly executes, or attempts to execute, a scheme to defraud a financial institution, or to obtain money from a financial institution by means of false or fraudulent pretenses

b. 30-year felony

##### 4. Bankruptcy fraud – 18 USC §157

a. Scheme to defraud, plus files a petition or document in a BK proceeding or makes a false or fraudulent representation in relation to a BK proceeding

b. 5-year felony

## F. Conspiracy vs. aiding and abetting

### 1. Conspiracy – 18 USC §371

a. Three elements:

1. Illegal agreement,

2. Criminal intent, and

3. An overt act in furtherance of the plan

b. Additional years in prison for an underlying felony and the maximum sentence for an underlying misdemeanor

### 2. Aiding and abetting – 18 USC §2

a. Aiding:

1. Assisting, supporting, or helping another to commit a crime

b. Abetting:

1. Encouraging, inciting, or inducing another to commit a crime

c. Elements:

1. The accused had specific intent to facilitate the commission of a crime by another;

2. The accused had the requisite intent of the underlying substantive offense;

3. The accused assisted or participated in the commission of the underlying substantive offense; and

4. Someone committed the underlying offense

3. Distinction between the two:

a. Conspiracy means you agreed to commit a crime, and someone took an overt action toward that goal. (Caution: your nod can be sufficient for your conspiracy conviction!)

a. Aid/abet means you actively did something to help commit a crime.

“The gist of conspiracy is the agreement; that of aiding, abetting or counseling is in consciously advising or assisting another to commit particular offenses, and thus becoming a party to them; that of substantive crime, going a step beyond mere aiding, abetting, counseling to completion of the offense.” *Pinkerton v. United States*, 328 U.S. 640, 66 S.Ct. 1180, 90 L.Ed. 1489 (1946)

#### IV. PART II: CIVIL LAW CONTEXT

##### A. Circular 230

1. §10.20 Information to be furnished

a. Bottom line: “A practitioner may not interfere, or attempt to interfere, with any proper and lawful effort by the Internal Revenue Service, its officers or employees, to obtain any record or information unless the practitioner believes in good faith and on reasonable grounds that the record or information is privileged.”

2. §10.21 Knowledge of client’s omission



a. Bottom line: If you know of problem, you “must advise the client promptly of the fact of such noncompliance, error, or omission. [You] must advise the client of the consequences as provided under the Code and regulations of such noncompliance, error, or omission.”

3. §10.22 Diligence as to accuracy

a. Bottom line: You “must exercise due diligence...[i]n preparing or assisting in the preparation of, approving, and filing tax returns, documents, affidavits, and other papers relating to Internal Revenue Service matters” as well as regarding advice you give.

4. §10.34 Standards with respect to tax returns and documents, affidavits and other papers

a. Know, reasonably should know, willful attempt, reckless or intentional disregard

b. Lacks reasonable basis, disregards the rules, delay or impede

c. Must advise of possible penalties

d. Must advise of opportunities to avoid penalties, including disclosure

5. §10.50 Sanctions

a. Censure, suspend or disbar from practice before IRS

b. Monetary penalty not to exceed gross income received (or to be received) from sanctioned conduct

B. Internal Revenue Code §6701

1. Elements

a. Aids or assists in, procures, or advises with respect to, the preparation or presentation of any portion of a return, affidavit, claim, or other document,

b. Knows (or has reason to believe) that such portion will be used in connection with any material matter arising under the internal revenue laws, and

c. Knows that such portion (if so used) would result in an understatement of the liability for tax of another person

2. Penalty:

a. \$1,000 or \$10,000 if respecting a corporate tax liability

3. “[T]he overriding interest in enacting Section 6701 was to deter the filing of fraudulent or false tax returns.” *Sansom v. United States*, 62 A.F.T.R.2d 88-5304, 88-5308 (N.D.Fla. 1988)

4. Applies to more than just return preparers; includes anyone supplying documents to IRS; civil liability mirrors §7206

a. “It appears that Congress specifically intended to create a provision to penalize aiding and abetting conduct similar to that conduct punished under 7206.” *Mattingly v. United States*, 924 F.2d 785, 788 (8th Cir. 1991)

b. Senate Report No. 97-494, §6701 applies to more than taxpayers and return preparers; International Money Market floor brokers engaged in trades designed to reduce clients’ taxes were charged with aiding and assisting under §7206(2). *United States v. Siegel*, 472 F. Supp. 440, 443 (N.D. Ill. 1979), cert. denied, 445 U.S. 989 (1982)

5. Omissions of gross income are always material

a. “[F]alse statements relating to gross income, irrespective of amount, constitute a material misstatement in violation of §7206(1).” *United States v. Hedman*, 630 F.2d 1184, 1196 (7th Cir.1980)

b. *United States v. Young*, 804 F.2d 116, 119 (8th Cir. 1986); False statements pertaining to gross receipts were material as a matter of law and could be the basis for a §7206(1) conviction; *United States*

*v. Holland*, 880 F.2d 1091, 1096 (9th Cir. 1989) (“any failure to report income is material”)

c. Bottom Line: ALWAYS be CERTAIN that ALL GROSS RECEIPTS are reported!

(1) Be sure to pull a wage/income transcript prior to filing the return

(2) Verify bank deposits – IRS will in an audit, whether civil or criminal

(3) Smell test: does the client’s lifestyle indicate higher gross receipts than reported by the client? (Rolls-Royce?)

6. Actual knowledge is required:

a. “§6701 requires that the actor have certain knowledge. The questions we must answer regard what type of knowledge is required...we believe actual knowledge, as opposed to the less stringent willful blindness, is required.” *Mattingly v. United States*, supra

b. Actual knowledge of the person charged, not the taxpayer; “Taxpayer not required to have knowledge,” §6701(d)

c. “A person’s knowledge or a state of mind can rarely be proven directly. Therefore direct proof of [defendant’s] knowledge is not necessary. Knowledge may be inferred from circumstantial evidence such as the conduct of [defendant], and such an inference as may arise from the combination of acts or statements, even though an act or statement standing alone may seem unimportant....” (*Mattingly*.)

C. *McElhanon v. Hing*, 151 Ariz. 386 (1985), aff’d 151 Ariz. 403 (1986)

1. Creditor sued debtor’s attorney

2. Alleged conspiracy to defraud creditor and conspiracy to prevent creditor from collecting

3. Debtor's attorney represented debtor in underlying case and assisted debtor in transferring assets so debtor would be insolvent

4. "A cause of action lies against a judgment debtor's attorney who conspires to defraud the judgment creditor."

5. "The proper measure of damages was the value of the property fraudulently conveyed or the amount of the debt, whichever was less."

#### D. Bar RPC

a. ABA Model Rule 1.2(d) and CA Bar RPC Rule 1.2.1(a)

A lawyer shall not counsel a client to engage, or assist a client in conduct that the lawyer knows\* is criminal, fraudulent,\* or a violation of any law, rule, or ruling of a tribunal.\*

b. ABA Model Rule 8.4 and CA Bar RPC Rule 8.4

It is professional misconduct for a lawyer to:

(a) [Not relevant here]

(b) commit a criminal act that reflects adversely on the lawyer's honesty, trustworthiness or fitness as a lawyer in other respects;

(c) engage in conduct involving dishonesty, fraud, deceit or misrepresentation;

(d) engage in conduct that is prejudicial to the administration of justice;

(e) [Not relevant here]

#### E. CPA RPC

1. AICPA Code of Professional Conduct

a. 1.100.001 Integrity and Objectivity Rule

b. 1.400.040 Negligence in the Preparation of Financial Statements or Records

2. California Society of CPAs Code of Professional Conduct

a. Art. III – Integrity

(1) “Integrity is measured in terms of what is right and just.”

(2) “[A] member should test decisions and deeds by asking: ‘Am I doing what a person of integrity would do? Have I retained my integrity?’ Integrity requires a member to observe both the form and the spirit of technical and ethical standards; circumvention of those standards constitutes subordination of judgment. Integrity also requires a member to observe the principles of objectivity and independence and of due care.”

b. Article IV – Objectivity and Independence

(1) “For a member in public practice, the maintenance of objectivity and independence requires a continuing assessment of client relationships and public responsibility.”

(2) “Members employed by others to prepare financial statements or to perform auditing, tax or consulting services are charged with the same responsibility for objectivity as members in public practice and must be scrupulous in their application of generally accepted accounting principles and candid in all their dealings with members in public practice.”

c. Article V – Due Care

(1) Due care “imposes the obligation to perform professional services to the best of a member’s ability with concern for the best interest of those for whom the services are performed and consistent with the profession’s responsibility to the public.”

d. RULE 201. A member shall comply with the following standards and with any interpretations thereof by bodies designated by CalCPA.

(1) A. Professional competence. Undertake only those professional services that the member or the member's firm can reasonably expect to be completed with professional competence.

(2) B. Due professional care. Exercise due professional care in the performance of professional services.

(3) C. Planning and supervision. Adequately plan and supervise performance of professional services.

(4) D. Sufficient relevant data. Obtain sufficient relevant data to afford a reasonable basis for conclusions or recommendations in relation to any professional services performed.

#### F. Ethics vs. Morality: Do the Right Thing

1. Duty to both the client and the public, including public agencies such as IRS. E.g., the modern notion of “stakeholders” vs. “shareholders”

2. “Observe both the form and the spirit” of the law. (CSCPA CPC, *infra*)

3. “He who lives by the sword [technical adherence to the letter of the law] will die by the sword [fail to keep a technicality].” Matthew 26:52

4. “Form cannot be exalted over substance”

a. “Held: while the plan conformed to the terms of the statute, there was no reorganization within the intent of the statute.” *Gregory v. Helvering*, 293 U.S. 465 (1935)

b. “The rule which excludes from consideration the motive of tax avoidance is not pertinent to the situation here, because the

transaction upon its face lies outside the plain intent of the statute.” *Gregory v. Helvering*, supra

c. But see *Summa Holdings, Inc., v. C.I.R.*, 848 F.3d 779 (6th Cir. 2017), “‘Form’ is ‘substance’ when it comes to law. The words of law (its form) determine content (its substance). How odd, then, to permit the tax collector to reverse the sequence—to allow him to determine the substance of a law and to make it govern ‘over’ the written form of the law—and to call it a “doctrine” no less.

## V. PART III: COLLECTION REPRESENTATIVE CONTEXT

### A. *United States v. Cohen*, 544 F.2d 781 (1977)

1. Signed form 433-A on 2/13/1970, claiming “as of 1/30/1970” assets were less than \$2k, whereas he was in possession of Federal Reserve checks dated 2/5/1970 amounting to \$30k

2. Convicted of violating §7206(1) (materially false statement)

### B. *United States v. Greene*, 04-cr-09-001-HDC (N.D. Oklahoma) (aff’d 2012 WL 1965620)

1. Charged with §7201 evasion and §7206(1) false declaration

2. Tried OIC to compromise \$641,000

3. Left three bank accounts off 433-A, held in other names, \$300k in balances, and a note with face value of \$85k. (Per the indictment: “concealing and attempting to conceal from IRS the nature and extent of assets, by placing in the names of nominees, and by filing a false and fraudulent offer in compromise (supported by a false declaration under oath on Form 433-A).”

4. Rather than accepted OIC, he got 60 months for evasion 10 months for false statements on the 433-A, and a \$500k fine (in addition to still owing the underlying taxes).

5. Query: did he “win”?

C. How much verification? How much inquiry?

D. You may not be “willfully blind”

1. What you don’t know can hurt you

2. Does it pass the smell test?

3. Elements of willful blindness in criminal context:

a. Subjectively believe that there is a high probability that a fact exists

b. Take deliberate actions to avoid learning of that fact, and

c. Some Circuits (not 7th or 9th) deliberate avoidance motivated by a desire to avoid criminal responsibility

d. Willful blindness must extend well beyond negligence and even recklessness

## VI. PART IV: RETURN PREPARER CONTEXT

A. *Goodmansen* case – *United States. v. Allen, et al*, 2:09-cr-01148-ROS-2

1. Attorney and CPA charged with conspiracy, §7206(1) filing false return, and §7206(2) aiding & assisting

2. Mac, as defense attorney, called attorney Steve Allen as witness in offshore triple trust case in which promoters and return preparers were indicted; 25 years later Allen is defendant

3. CPA Goodmansen pled to conspiracy to defraud in connection with fraudulent offshore triple trust scheme sold by attorney Steve Allen

4. CPA Goodmansen prepared many of the 1040NR tax returns

5. Sentenced to 18 months prison



B. Preparers we represented

1. Usually caught by sting
2. Preparing false returns to both underreport income and get clients bogus deductions

C. What conduct rises to the level of §6701 penalties?

1. “§6701 penalties will not be imposed as to a particular tax document if other return preparer penalties also apply to that document. 1982 U.S.Code Cong. and Adm.News, Vol. 2, at 1023. Therefore, the penalty does not apply in situations where the preparer could also be charged with negligence – Code §6694(a), or willful understatement of tax liability, §6694(b).” (*Warner v. United States*, 700 F.Supp. 532, 882 (S.D. Fla. 1988))
2. “§6701(a) is more closely akin to §7206(2) which clearly requires falsity or fraudulence as an element of proof.” (*Id.*)
3. “If the preparer knows that use of the tax document as prepared will result in an understatement of tax liability, must not the document necessarily be false or fraudulent?” (*Id.*)

D. How much verification? How much inquiry?

1. “What this [civil penalty] structure appears to demonstrate is that, as a taxpayer’s or tax preparer’s conduct becomes more culpable and relates more directly to a tax filing, payment or disclosure under the internal revenue laws, the civil penalty increases.” *Mattingly v. United States*, supra

E. You may not be “willfully blind”

1. What you don’t know can hurt you
2. Does it pass the smell test?
3. Facebook, Instagram?
4. Elements of willful blindness in civil context:

- a. Aware of a high probability of unreported income or improper deductions, and
- b. Deliberately avoided steps to confirm this awareness
- c. *Fiore v. Commissioner*, T.C. Memo. 2013-21

## VII. Conclusion

A. Don't be so eager to "win" that you cross the line

1. Don't make the client's problem YOUR problem

B. Don't be willfully blind

C. What does true service to client look like?

1. Crossing the line and later getting into trouble makes both you and your client worse off
2. Instead, show your client the right way; win by following the law
3. Peace of mind is valuable and is what most clients want