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The Civil Fraud Penalty

Where an underpayment of tax, or a failure to file a tax return is due to fraud, the taxpayer is liable for the civil fraud penalty. The civil fraud penalty is the 800-pound gorilla of civil penalties because it is "the largest civil tax penalty in dollar magnitude."[i] It applies not only to cases where the taxpayer files a false return but also to cases where the taxpayer refrains from filing a return altogether. The former applies only to filed returns and is penalized under section 6663. The latter includes both a failure to file and a late filing. It is penalized under section 6651.

Section 6663(a) imposes a penalty equal to 75% of the portion of the underpayment which is attributable to fraud.[ii] Under section 6651(a)(1), the normal delinquency penalty is five percent per month (or part of a month) capped at 25%. However, when the failure to file is due to *fraud*, section 6651(f) raises the delinquency penalty to 15% per month (or part of a month) capped at 75%.[iii]

The IRS bears the burden of proving civil fraud by clear and convincing evidence.[iv] Civil fraud is defined as follows:

> The intentional commission of an act or acts for the specific purpose of evading a tax believed to be owing. Fraud implies bad faith, intentional wrongdoing, and a sinister motive. It is never imputed or presumed. Whether fraud has been committed is a question of fact to be determined from the entire record.[v]

Since direct proof of fraudulent intent is seldomly available, this element is typically inferred from "objective facts (i.e., the existence of one or more of the so-called "badges of fraud")."[vi] They include, among others:

- "A multi-year pattern of understating income;"[vii]
- "Failing to maintain adequate books and records;"[viii]
- "Failing to file returns;"[ix]
- "Concealing assets;"[x]
- "Lying to or failing to cooperate with IRS agents;"[xi]
- "Receiving illegal source income;"[xii]

- "Giving implausible or inconsistent explanations;"[xiii]
- "Dealing in cash;"[xiv]
- "Consistently and substantially overstating deductions;"[xv]
- "Keeping multiple sets of books;"[xvi]
- "Creating false documents or entries;"[xvii]
- "Destroying information;"[xviii] and
- "Deceptively structuring transactions."[xix]

Two important points should be kept in mind when it comes to the civil fraud penalty. First, reasonable cause is a defense.[xx] And second, "when fraud is established, there is no statute of limitations impediment to the assessment of civil liabilities."[xxi]

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[i] Tax Crimes, Townsend, John, Campagna, Larry, Johnson, Steve, LexisNexis, 2008 at p. 379.
[ii] Id.
[iii] Id.
[iv] IRC Section 7454; Tax Ct. R. 142(b).
[v] Estate of Spruill v. Commissioner, 88 T.C. 1197, 1241-42 (1987).
[vi] Id., supra, note (i), citing Spies v. United States, 317 U.S. 492, 499 (1943); Rowlee v. Commissioner, 80 T.C. 1111, 1123 (1983).
[vii] Id., supra, note (i), at 380.
[viii] Id.
[ix] Id.
[x] Id.
[xi] Id.
[xii] Id.
[xiii] Id.
[xiv] Id.
[xv] Id.
[xvi] Id.
[xvii] Id.
[xviii] Id.

[xix] Id.
[xx] Id.
[xxi] Id.