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‘Aggressive’ Tax Returns Can Mean Fraud

Image via allbusiness.com

Gift tax returns are notoriously overlooked. Many fail to report gifts to family members larger than the $13,000 allowed to each person annually. Curiously, gift tax returns are also among the most under-audited by the IRS. See Avoid IRS Audit Triggers.

Perhaps that should make more people file them! But as with all tax returns, be truthful and accurate. Where judgment is required—including the fair market value of property—be realistic and have some ammunition to back yourself up. See Simple Rules For Tax Disputes.

These simple and common sense thoughts were on my mind as I read the tax disaster of *Gaughen v. United States*. On December 31, 2004, Thomas Gaughen transferred seven parcels of real estate to family members and filed a gift tax return. Gaughen claimed three parcels covering 205 acres were worth $857,000. The IRS said they were worth $5.73 million.

The tax due was over $1 million. Given the huge dispartiy, the IRS also imposed a 75% civil fraud penalty of $781,429.59. With $493,676.67 of interest, the IRS wanted $2,340,327.04. Gaughen paid it and sued for a refund.

His first fight was attempting to remove the fraud penalty from the case. To collect the 75% fraud penalty, the IRS must prove (by clear and convincing evidence) he ***intentionally*** underpaid his taxes. Gaughen argued this was a mere difference in valuation. Maybe, but the court said the difference was so ***huge*** that the jury should decide.

Besides, even local tax assessments for the parcels totaled $1.53 million, far beyond the $857,000 Gaughen claimed they were worth. Gaughen argued these property tax assessments were not controlling, but the court said they were for the jury to consider. In any event, there were also two sale contracts.

One contract signed May 21, 2004 was for $5 million. A second signed four months after the gifts was for another $2 million. $7 million for the parcels was far beyond the $857,000 Gaughen claimed they were worth. In fact, the contracts totalled about 10 times the value he reported on his gift tax return!

That showed his intent to commit fraud, said the IRS. Gaughen pointed out that both contracts had multiple real estate contingencies. Maybe, said the court, but all of that would have to go to the jury.

Last Laugh? Gaughen's final argument was that he relied on an "independent" appraiser who came up with those numbers. Oops. The court said the record included letters Gaughen ***wrote to*** the appraiser ***directing him*** to set the value at specific ***low*** numbers. The independence of the appraiser should be evaluated by the jury, said the court.

There's nothing wrong with appraisals, and in fact sometimes fancy appraisals can defeat the IRS. However, don't get too aggressive.

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Proprietors: To Avoid Audit, Avoid Schedule C

IRS Criminal Investigations On Rise

More IRS Audits Coming Your Way

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Supreme Court To Rule On IRS 6 Year Audit Push

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