

Beware 'Taking The Fifth' On Your Returns This Year

By Robert W. Wood and Scott B. Weese

Lawyers are probably more tax savvy than non-lawyers when it comes to the frivolous label. In a legal setting, it is *never* good to have an argument called “frivolous.” That is even truer with taxes, where being called “frivolous” is one of the last things you ever want to happen.

It is a sore subject with the Internal Revenue Service. The IRS hears many frivolous arguments. They do not like them, not one little bit. They even have an alphabetical list of the silliest ones that pop up regularly. (Hint: Taxes are constitutional, and you owe them. See <https://www.irs.gov/Tax-Professionals/The-Truth-About-Frivolous-Tax-Arguments-Introduction>.)

One of the oldest and yet facially somehow attractive of these best-avoided bad tax arguments is that filling out a tax return may require you to admit a crime. Do not make this — or really, any frivolous — argument. Sure, you might think you are being careful or clever, but if you make one of these frivolous arguments, you pay the price.

First, you would be calling attention to yourself. Second, the IRS can slap on a special frivolous position penalty imposed by Section 6702 of the tax code. That was the situation one taxpayer found himself in in a recent U.S. Tax Court case, *Youssefzadeh v. Commissioner*, 014868-14. This case involved a curious mix of FBAR reporting and the Fifth Amendment protection from self-incrimination.

The big question was whether the frivolous position penalty could be imposed. The U.S. government takes FBAR reporting *very* seriously. So seriously, in fact, that willful failure to file an FBAR is a crime. The IRS also takes FBAR reporting very seriously, even though FBARs are not, strictly speaking, tax forms.

Right on Schedule B of your tax return (where you report interest income, including interest from foreign bank accounts), the IRS asks whether you were supposed to file an FBAR for the year. Youssefzadeh was apparently worried about answering that question, since the wrong answer might be or imply a criminal offense. So he took the Fifth.

Now, before anyone thinks this is a good idea, keep in mind that generally refusing to provide information on a tax return because it may incriminate you is one of those frivolous positions the IRS hates. The U.S. Supreme Court even weighed in on this in *United States v. Sullivan*, 274 U.S. 259 (1927). In that case, the Supreme Court waxed poetic: “He could not draw a conjurer’s circle around the whole matter by his declaration that to write any word upon the government blank would bring him into danger in the law.”

Translation? Everybody has to file taxes. So in Youssefzadeh’s case, the IRS imposed the frivolous position penalty. Rather than just paying it, Youssefzadeh challenged it through a collection due process hearing. Eventually, Youssefzadeh got his ticket to Tax Court. Shockingly, he won — sort of.

As it happened, Youssefzadeh actually *did* provide the information required by his tax return. On Schedule B, he gave the total amount of interest income, accounting for every penny he earned worldwide. Only *after* providing that truthful, accurate and legally required information, did he assert his Fifth Amendment privilege. That is, he just left off some of the bank information.

He refused to answer whether he had to file an FBAR. The Tax Court reviewed the requirements of the frivolous position penalty. First, the document containing the “frivolous” position must purport to

be a tax return. Here, that was clear: The filing was on a standard tax return form, and had all the information needed to calculate tax.

Second, the return has to omit enough information to prevent the IRS from judging the “substantial correctness” of the return, or the position is clearly substantially incorrect (geared at returns that list all zeroes and their ilk). The court noted that this factor requires that the return be merely “substantially correct” rather than “completely correct.” The court wrestled with this one, but found that the tax return was substantially complete precisely because the proper numerical information was present.

Finally, the position itself must be frivolous, and it must demonstrate a desire to *impede* administration of the tax code. Baseless positions and positions on the IRS’s naughty list will usually satisfy this prong. And one of those naughty list items is asserting the Fifth Amendment. But Youssefzadeh triumphed.

How? Because there are times when even the IRS recognizes that the Fifth Amendment has a place on a Form 1040. Clearly, a *blanket* “take the Fifth” assertion will draw the penalty, but Youssefzadeh did not make a blanket assertion. He made a specific, limited assertion based on a reasonable fear of prosecution for a specific answer.

The Tax Court said that as long as the taxpayer has “reasonable cause” to fear that answering a question could lead to a prosecution, even if it merely provides a clue or tendency to incriminate, it is not necessarily frivolous to assert the right against self-incrimination. Even the IRS guidance agrees with that. See IRM Section 4.10.12.1.1.(1.)(J). Having found the IRS lacking on all three prongs of the test, the Tax Court struck down the penalty.

Despite the taxpayer victory, it is important not to take the lessons of this case too far. For one thing, this case technically cannot be relied on as precedent. It is an order of the court under Tax Court Rule 50(f), having a kind of non-published status. Besides, Youssefzadeh may have actually created more problems for himself.

He recognized that lying on his returns would have been a separate crime, and was never an option. The better course, as with so many things in life and in taxes, would have been to tell the whole truth on the tax returns, and fix any errors. Whatever the (dubious) wisdom of the Youssefzadeh’s Fifth Amendment middle way, he only escaped the frivolous return penalty. And that is surely a pyrrhic victory. After all, the IRS was probably clued in that he was *supposed* to file FBARs, and did not. That sounds an awful lot like willful conduct, whether it is frivolous or not. And willful failure to file FBARs comes with a heavy price.

Robert W. Wood is a tax lawyer with Wood LLP, and is the author of numerous tax books including "Taxation of Damage Awards & Settlement Payments" (www.TaxInstitute.com). This discussion is not intended as legal advice.

Scott B. Weese is an associate with Wood LLP.