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IRS Forgives Tax Mistakes, Not Evasion Or Fraud, But Which Is Which?

Taxes are complex, so you might assume just about *anything* can be called an innocent mistake. Actually, the tax law draws a line between non-willful and willful, and steep penalties or even prosecution can hang in the balance. ‘Gee, I didn’t know,’ doesn’t always cut it. Ignorance of even complex tax laws isn’t always a viable defense. It is one reason to get professional advice about what is income, what you can deduct, etc. If the opinion turns out to be wrong, relying on a professional can often get you out of penalties.

With most tax mistakes, the question is just whether you pay penalties on top of taxes and interest when they catch your mistake. The size of penalties varies but often, 25% is at stake. Civil fraud is 75%, but that’s not often asserted. Criminal violations are asserted even less frequently. Still, most criminal tax cases start with civil audits. Even a smidgen of fraud or intentional misstatements can land you in jail. The burden can be placed on you to prove you are right or that your mistakes were innocent.



Even *stupid* mistakes can often be forgiven, but intentional wrongdoing is different. Remember the [Twinkie defense](#)? It said lots of junk food can mess up your brain, diminishing your capacity to

commit crimes. Eventually, California abolished diminished capacity in [California Code Section 25](#) and [Proposition 8](#), a Victim's Bill of Rights. If there is a corollary to this in the tax world it would be the [TurboTax defense](#). It was borne when [Treasury Secretary hopeful Tim Geithner](#) was accused of not paying about \$35,000 of self-employment/FICA tax.

TurboTax didn't tell me I owed it, he famously said. He was then confirmed as Treasury Secretary. Many observers [find it odd](#), but most [Congressman don't do their own returns](#), and Mr. Geithner got a pass. Since then, many regular taxpayers tried to use it. The courts said no in [Hopson v. Commissioner](#), [Parker v. Commissioner](#), [Lam and Chang v. Commissioner](#), and [Au v. Commissioner](#). Finally, the Tax Court embraced the TurboTax defense in [Olsen v. Commissioner](#). A patent attorney blamed his tax mistakes on the software, saying it should excuse penalties the IRS imposed. Over IRS objections, the Tax Court agreed.

If your mistakes are serious, the IRS can say you are willful. According to the IRS, willfulness involves a voluntary, intentional violation of a known legal duty. Willfulness is shown by your knowledge of reporting requirements and your conscious choice not to comply. Willfulness means you acted with knowledge that your conduct was unlawful—a voluntary, intentional, violation of a known legal duty.

Examples might include reporting \$10,000 when you actually received \$20,000, failing to declare an offshore account, or deducting your family vacation. You may not have meant any harm or to cheat anyone, but that may not be enough. The failure to learn of filing requirements, coupled with efforts to conceal the income or the true facts, can mean a violation was willful. Your conduct is relevant too.

Some courts say willfulness is a purpose to disobey the law, but watch out for conduct meant to conceal. Setting up trusts or corporations, or filing some forms and not others, can look bad. Using cash, keeping deposits below \$10,000, using travelers checks, under-reporting business income, and inflating your expenses can all spell trouble. Perhaps you can explain one failure, but repeated failures can morph conduct from inadvertent neglect into reckless or deliberate disregard. 'Willful blindness' is a kind of conscious effort to *avoid* learning about reporting requirements, and that too can be enough to land you in jail.

In one recent case, the IRS argued that big spending alone—in the face of unpaid taxes—was willful. The court in [Hawkins v. Franchise Tax Board](#) said spending alone isn't willful. However, the fact that such arguments reach the courts should tell you that willfulness can be a matter of opinion. clear. Big dollars and even one's freedom can turn on what's willful.

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