PERSPECTIVE

Tax avoidance dos and don'ts (mostly don'ts)

By Robert W. Wood

It is hard not to revel in celebrity tax gaffes. In part, perhaps they make us all feel a little better. And as many a lawyer knows, having high income does not mean happiness or even orderly financial affairs. So we read TMZ, follow Perez Hilton, watch E! and shake our heads (but we smile a little too).

Even so, there are both professional and personal lessons we can glean, and some are important. One is about the sometimes arbitrary-seeming enforcement that means many taxpayers will transgress and few will be caught. Don't count on this. It is no comfort if you are the one that is caught. And having a good accountant and lawyer doesn't make you immune from prosecution or even high taxes (though it can help).

Stephen Baldwin, perhaps the strangest of acting's Baldwin Brothers, recently pleaded guilty to tax charges as part of a plea deal in New York state. He admitted that he failed to pay New York state income taxes for 2008, 2009 and 2010. Baldwin made a $100,000 down payment upon his arraignment.

His plea bargain calls for no jail time and even allows that his record may be wiped clean if he pays New York the approximately $400,000 he owes within one year. If he fails to pay all he owes within a year, the plea bargain provides for a five-year sentence of probation and repayment within that time. In all, it sounds like an unusually good deal.

Most states don't resort to criminal tax prosecutions. Most tax prosecutions are federal, and the federal government means business. Tax prosecutions get people's attention, especially around tax time. Observers may well compare this seemingly cushy deal with the harsher treatment fellow actor Wesley Snipes received.

Both men evidently relied on others, as is common in the entertainment world, yet both failed to prevail based solely on reliance on others. Both were facing serious charges and both ended up with charges that stuck. Baldwin made a deal and entered a guilty plea, while Snipes went to trial, where prosecutors and judges can be harsher.

Snipes was tried on felony as well as misdemeanor tax charges, but was only convicted of misdemeanors. In fact, most observers thought the government largely failed in the case since Snipes was acquitted on the more serious felony charges. Failure to file a tax return is a misdemeanor, while filing falsely is a felony.

Any criminal charge is serious, but the latter is more serious and the penalties are more frightening. When Snipes was convicted in 2008 of three misdemeanor counts of failing to file tax returns, he received a hefty three-year sentence. He reported to prison on Dec. 9, 2010. The Federal Bureau of Prisons quietly released him on April 2, transferring him to the New York Community Corrections Office for home confinement until July 19, 2013.

Snipes is a well-known figure and earned approximately $40 million from 1999 to 2004. He avoided paying $7 million in taxes between 1999 and 2001, but it seems clear he was led astray. He followed an accountant and an anti-tax advocate down a dangerous path, but the court found that it was still his responsibility.

His advisers, Eddie Ray Kahn and Douglas P. Rosile, claimed they did not legally have to pay taxes. Snipes claimed that he relied upon them. Unfortunately, they were convicted by the same jury of tax fraud and conspiracy. Both drew longer prison terms than Snipes.

Snipes appealed, argued his sentence was unreasonable, and even claimed he couldn't get a fair trial in Ocala, Fla., because of his race. Even the U.S. Supreme Court turned him down. If Snipes is dispensing tax advice — and I doubt that he is — I imagine that today he might be more likely to give some stern warnings like these:

Don't argue our tax system is voluntary. This is self-explanatory. Forget it. You must file a tax return each year with the IRS if your income is over the requisite level. The U.S. taxes all income wherever you earn it. Stay away from crazy arguments.

Don't use off-beat definitions of income. Don't argue that wages, tips and other compensation received for personal services are not income. Avoid saying that Federal Reserve Notes are not income or that only foreign-source income is taxable, making domestic income exempt. This has variations, but this is what ensnared Snipes.

Don't argue over terms in the tax code. Avoid arguing that a taxpayer is not a "citizen" of the U.S. and thus not subject to tax laws. Avoid claiming the U.S. consists only of the District of Columbia, federal territories and federal enclaves. Don't argue that only employees of the federal government are subject to federal income tax.

Steer clear of constitutional claims. Arguments based on the First, Fifth, 13th and 16th Amendments to our Constitution include such "nice try" claims as: Taxpayers can refuse to pay income taxes on religious or moral grounds by invoking the First Amendment; Federal income taxes constitute a "taking" without due process; and compelled compliance with federal income tax laws is servitude violating the 13th Amendment.

Don't assert fictional legal theories. Avoid these "fictional" claims: The IRS is not an agency of the U.S. (You will lose.) Taxpayers are not required to file a federal income tax return because the instructions to Form 1040 and tax regulations don't display an OMB control number as required by the Paperwork Reduction Act. (No again.) Don't claim you're a church. Don't buy "untaxing" trusts or other deals that sound like infomercials.

Be careful with amended returns, too. Once you've filed your return, you can't be prosecuted for failing to file an amended return, even though something may happen after you file that makes it clear your original return contained mistakes. Yet if you knew the return was inaccurate when you filed it you should amend it to make it accurate without delay.

The IRS rarely brings up an originally filed return in audits or criminal prosecutions once the taxpayer comes forward and attempts to correct it by filing an amended return. But to take advantage of this rule you need to be proactive. You need to make the correction before the IRS finds your error.

Be careful relying on others. This may be the most important lesson of all. If something sounds too good to be true, it probably is.

Robert W. Wood *is a tax lawyer with a nationwide practice (www.WoodLLP.com). The author of more than 30 books including "Taxation of Damage Awards & Settlement Payments" (4th Ed. 2009 With 2012 Supplement www.taxinstitute.com), he can be reached at Wood@WoodLLP.com. This discussion is not intended as legal advice, and cannot be relied upon for any purpose without the services of a qualified professional.*