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CRIMINAL LIABILITY FOR SUGGESTING THE IMPROPER PREPARATION OF A TAX RETURN

WIRT PETERS*

A generally excellent article by Fulton Oursler entitled *The Twilight of Honor*¹ began with the following situation:

During a recent election campaign, a newspaperman was asked by a well-known candidate what his fee would be to 'ghost-write' a speech.

'Five hundred dollars?' suggested the journalist.

'Okay! But actually you'll be getting much more. I have an expense fund that I don't have to account for and I can pay you in cash. Forget it on your income tax, and no one will ever know.'

Had the journalist accepted the proposal, he would have been committing the crime of tax evasion, for which many a man has gone to prison. *But the candidate, in urging him to cheat the Government, was apparently committing no crime at all.* (Emphasis added).

It is to the last sentence of this quotation that attention is specifically directed. Evidently it expresses the general belief of most laymen and, perhaps, of many tax practitioners. It presents an important proposition, however, which should be carefully reconsidered by every reader, for certainly Congress has not overlooked such an obvious possibility of an offense against the revenue laws of the country.

I

ANY PERSON WHO ADVISES THE PREPARATION OF A FALSE RETURN SHALL BE GUILTY OF A FELONY

Even the most superficial initial research will immediately disclose the following congressional enactment, in the Internal Revenue Code itself, providing penalties for advising the preparation of a false return:

Any person who willfully aids or assists in, or procures, counsels, or advises the preparation or presentation under, or in connection with any matter arising under, the internal revenue laws, of a false or fraudulent return, affidavit, claim, or document, shall (whether or not such falsity or fraud is with the knowledge or consent of the person authorized or required to present such return, affidavit, claim, or document) be guilty of a felony, and upon conviction thereof, be fined not more than \$10,000, or be imprisoned for not more than five years, or both, together with the costs of prosecution.²

Then, in addition, there are other statutes in the Criminal Code which provide penalties for presenting false claims,³ for conspiring to defraud,⁴

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1. Readers Digest, June, 1950, p.7.

2. INT. REV. CODE § 3793(b).

3. 18 U.S.C. § 80 *et seq.*

4. 18 U.S.C. § 550.

and for subscribing a return which is not believed to be true and correct as to every material matter.⁵

Parenthetically, when these statutes were brought to the attention of Mr. Oursler, his response was only to the effect that the candidate, if confronted, would simply deny everything and that would be an end to it. Now it is hardly necessary, of course, to point out to the legally trained audience to which this publication is directed, the impossible logical difficulty into which that statement forces its author. In the original article the author either assumed proof of the guilt of the journalist, or considered proof as an unnecessary element in the commission of the crime, inasmuch as it was stated dogmatically that if the journalist accepted the proposal he would be committing the crime. Suppose that he, too, when confronted, simply denied everything, would that have been an end to it and would he thereby have been innocent of any wrong? The commission of the act which constitutes the crime, and sufficient legal proof to secure a conviction and support a punishment, are two separate concepts, of which every law enforcement officer is painfully aware. But, we are entitled to the same assumptions when trying the candidate as were made in the case of the journalist. It is agreed that had the journalist accepted the proposal he would have been committing the act constituting the crime of tax evasion, whether he were ever convicted of it or not. The logical corollary, and the legal conclusion, is that the candidate, too, was committing an act defined as a felony.

Our interests here, however, are more fundamental and practical. We are more concerned with attempting to determine the liability of a practitioner who regularly gives advice and assists in the preparation of income tax returns. The above quoted section of the statute, it is to be noted, provides that the adviser can be separately and individually guilty of a felony without any evidence that the taxpayer had any knowledge that the return was improper.⁶ So, our discussion will be confined to a consideration of situations based on the assumption that the taxpayer lacked knowledge of the falsity of the return, for if we can support our contention under circumstances most unfavorable to our thesis, then there could be no argument in those cases of common knowledge.

II

ONE MAY BE GUILTY OF ADVISING A FALSE RETURN WITHOUT KNOWING THE RETURN IS FALSE

We can not proceed without first agreeing upon a generally applicable, workable definition of what constitutes a false return. It is proposed to define a false return as one which does *not* include all the reportable income,

5. U.S. Treas. Reg. 11 § 29.145-1 (1943).

6. *United States v. Kelley*, 105 F.2d 912, (2d Cir. 1939) is an extremely interesting case involving the tax adviser for the Greatest Show on Earth.

and/or, *does* include a deduction which is clearly not allowable. There can be no distinction, in principle, based on the quantity of the falsity. A return which omits one cent of income or claims one cent of a clearly unallowable deduction is a false return, just as false as though the amounts were one thousand or one million dollars. If this is a false return, then willfully advising its preparation is the act defined by the statute as a felony.

It is next necessary to anticipate any possible subsequent argument based upon the word "willfully." A re-reading of the statute will disclose that the word "willfully" is used as an adverb in connection with the verbs "aids," "advises," etc., and dictionaries define it as meaning "intentional" or "knowingly." Thus, if one intentionally advises a taxpayer knowing the advice will be used in the preparation of a tax return, he "willfully advises the preparation" of that return. If the advice results in a false return, he "willfully advises the preparation of a false return." That is, if the return is actually false, then the one who advised its preparation is guilty; he has advised the preparation of a false return, even though he might not have known that the return would be false if his advice were followed. Knowledge of the falsity is not required, merely lack of knowledge that the return is true. In the case of *Newton v. United States*⁷ the indictment charged that the accused "unlawfully and feloniously did wilfully aid in . . . the preparation . . . of a false and fraudulent claim." This indictment was attacked as invalid because it did not charge "that the accused knew the claims and return were false and fraudulent." Nevertheless, the court held the indictment to be sufficient.

No doubt one of the very purposes for which this statute was enacted was to deter individuals from indiscriminately giving advice, or assisting in the preparation of a tax return, unless the advice is correct and the adviser well qualified to prepare the return. Having a taxpayer prepare his own return improperly, and therefore falsely, is serious enough; but to have a person, particularly one who holds himself out to the public as qualified to assist with the preparation of returns, advising false returns, is even more serious. Congress had no desire to have the blind lead the blind in the maze of the internal revenue laws and thus compound confusion.

Returns may be false, with reference to deductions, in two different ways: First, the *amount* claimed as a deduction may be incorrect, and Second, the *item* claimed as a deduction, for which the amount may be known, may itself not be allowable. Some examples will serve to demonstrate how easily a tax practitioner may fall into difficulty.

A. \$150 Deduction for Contributions and One Year in the Penitentiary

Nearly all taxpayers, and most tax practitioners, erroneously believe that all amounts paid (up to the statutory limit of 15% of adjusted gross

7. 162 F.2d 795 (4th Cir. 1947).

income) to qualified organizations, are allowable as deductions for contributions. Probably not more than one percent of the individuals who become tax "experts" during the filing period, know the legal requirements for determining the allowable amount of such a common deduction. And, in the preparation of more than twenty-five thousand returns, I, personally, have not found even as many as a dozen taxpayers who knew the amount to which they were entitled. The code and regulations clearly set out the requirements:

in computing net income there shall be allowed as deductions: . . . in the case of an individual, contributions or gifts payment of which is made within the taxable year to or for the use of: . . . (certain specified organizations). Such contributions or gifts *shall be allowable as deductions only if verified* under rules and regulations prescribed by the Commissioner.⁸ (Emphasis added).

Claims for deductions under section 23 (o) must be substantiated . . . by a statement from the organization to which the contribution or gift was made showing whether the organization is a domestic organization, the name and address of the contributor or donor, the amount of the contribution or gift and the date of the actual payment thereof, . . .⁹

It is to be noted that the allowable deduction is not necessarily the amounts actually paid to authorized organizations, but only the amount which can be verified by a statement from the recipients. While it is the obligation of the practitioner to advise his client of these requirements, in practice the client may insist upon some deduction for amounts he knows he has paid. Accordingly, considerable questioning is usually required before arriving at an amount which the taxpayer believes to be a reasonably accurate computation of his actual payments and for which he is willing to assume sole responsibility for later substantiating. But suppose the adviser completes the return on this basis and then it is subsequently discovered that the taxpayer is unable to verify the deduction. The return is false, and the practitioner has aided in the preparation of a false return although he may have even advised against it.

In no event is it for the practitioner to propose or advise the deduction of a "reasonable" amount. This may probably have been what Tony Borgis did when he prepared the return for Pedro and Elina Martinez. It was testified at his trial that he inquired about the amount of the contributions, and that he finally used \$150 as the amount of the deduction. This is an average of approximately \$1.44 per week each for the taxpayer and his spouse, which does not seem to be unreasonable in amount per se, but Tony Borgis, the tax consultant, was convicted of aiding, assisting, and advising the preparation of a false and fraudulent income tax return and sentenced to be committed to the penitentiary for a year and a day.¹⁰

8. Int. Rev. Code § 23(o).

9. U.S. Treas. Reg. 111, § 29.23(o)-1 (1943).

10. United States v. Borgis, 182 F.2d 274 (7th Cir. 1950).

B. *One Does Not Need to be Sick to
Have a Deduction for Medical Care*

The task of the tax practitioner becomes even more dangerous when attempting to determine the deduction for medical expenses, principally because the term "medical care" is still largely undefined. The line between allowable and not allowable, between a true return and a false return, is exceedingly indefinite. The statute provides for the deduction in the following language:

In computing net income there shall be allowed as deductions: . . . Expenses paid during the taxable year, not compensated for by insurance, or otherwise, for medical care of the taxpayer, his spouse, or a dependant . . . (within limits). The term "medical care" as used in this subsection shall include amounts paid for the diagnosis, cure, mitigation, treatment, or prevention of disease, or for the purpose of affecting any structure or function of the body . . .¹¹

It is apparent that the allowable deduction is the net amount paid (within the statutory limits) for the purposes described, and not merely the amounts paid to authorized recipients for which verified supporting statements are available, as in the case of contributions. Of course, whenever the amount of the deduction is questioned, the burden of proving it rests with the taxpayer, and the Commissioner, by regulation,¹² has provided that it will have to be substantiated in much the same manner as provided for contributions.

However, the difficulty here is not only in establishing the amount paid, but also in determining whether it was paid for "medical care." There is nothing in the statute which says specifically that the effect on the body must be direct, immediate, or beneficial. What, then, assists in the prevention of disease, and affects the structure and function of the body, as much as our diet, the clothing we wear, the houses we live in and the conditions influencing our general mental outlook? Or, what affects the functioning of the body as directly and quickly as a few rounds of whiskey? There, naturally, has been a great deal of administrative and judicial "legislation" on this matter which is readily accessible, and there is, therefore, no intention of providing here a lesson in this deduction. But it seems apparent that no adviser can possibly skip lightly through this part of the return; rather, under even the most favorable conditions and fortuitous circumstances which can be anticipated, he feels like the proverbial boy whistling while passing the graveyard. The taxpayer seldom knows the amounts expended for items which the adviser seldom knows are allowable.

11. INT. REV. CODE § 23(x).

12. U.S. Treas. Reg. 111, § 29.23(x)-1 (1943).

C. *A Quick Summary of Other Simple
Methods for Committing a Felony*

1. *Other Deductions*

There are many other deductions provided by the statute which must be considered, and hurdled, by the practitioner in arriving at the net income of the taxpayer. For example, claiming hurricane damage as a deduction¹³ is a favorite pastime of many tax "experts" in southern Florida. It would be very interesting to compare the total of this deduction on income tax returns with other estimates of such damage. And, have you noticed how reports to the police of the theft of expensive jewelry and clothing increase toward the end of the year? Consider the deduction for taxes, particularly for Florida sales tax actually paid,¹⁴ not, it must be noted, for any estimated amount, either reasonable or unreasonable. If the taxpayer insists upon claiming an estimated amount, the practitioner must assure himself that the amount is capable of adequate proof inasmuch as he now is assisting in the preparation of a return which he does not definitely know is true and correct in every material respect. If the amount claimed is subsequently determined to be in excess of the actual amount paid—or in excess of the actual amount of loss by storm or theft—then the return is false and the practitioner assisted in the preparation of a false return.

2. *Omitted Income*

While in connection with deductions, the necessity for interpreting the law and applying it to a given set of circumstances may possibly permit of some reasonable difference of opinion, there can be very little defense against a charge of omitted income, assuming available proof of the receipt of the income. Nevertheless, a very large proportion of taxpayers and tax practitioners prepare false returns by omitting income. Again, personally, in the auditing of more than a hundred thousand income tax returns, I have found very few that included the interest earned on deposits placed with utility companies, and paid to the taxpayer by a credit against some current bill. This is an obviously omitted income which, if not included, results in a false return. The practitioner could not be heard to say that he did not willfully omit this income, that he merely forgot about it. Even though the taxpayer did not volunteer this information, the possibility of such income is so general (particularly if the adviser claims a deduction of municipal tax paid on such utility bills) that to forget about it is such gross negligence as to amount to wilfulness on the part of a practitioner who holds himself out to the public as an expert in the preparation of tax returns. The mere failure to report such income would be "inconsistent with a lack of guilty knowledge."¹⁵

13. INT. REV. CODE § 23(e).

14. INT. REV. CODE § 23(c).

15. MERTENS, 10 THE LAW OF FEDERAL INCOME TAXATION § 55.32 *et seq.*

3. *Bargaining Items*

Even some reputable practitioners have admitted to me that they have on occasion resorted to the use of a so-called bargaining item. This is an item, or the treatment of an item, which is not expected to be allowed by the revenue agent upon his audit of the return. It is used to draw the attention of the agent away from some more questionable item which has been less obviously reported by giving him a ready opportunity for adjusting the return and making a quick assessment of additional tax. Or, it may be used as a lever in bargaining with the agent in an effort to reach some compromise which may actually result in an advantage to the client to which he is not entitled. As over-burdened, practical agents have sometimes accepted such compromises instead of putting the government into an apparently unprofitable investigation, these bargaining items have sometimes accomplished their purpose. But, the return is false, the practitioner knows it, and he is guilty of an act defined as a felony, as well as of unethical conduct unbecoming to his profession.

4. *Credit for Dependents*

The provisions for ascertaining whether an individual may be a dependent of the taxpayer seem rather clearly stated in the statute;¹⁶ he must be within certain degrees of relationship, have a certain maximum taxable income, not join in any other return, and the taxpayer needs only provide more than half of his support. But in practice there seems to be considerable hesitancy on the part of the taxpayer in discussing with the possible dependent what is considered such a delicate matter and thus determining sufficient facts on which to predicate an accurate decision as to the propriety of the credit. When faced with the immediate preparation of the tax return, the taxpayer wants, at least, every possible deduction and credit, and at that moment the amounts of money sent to relatives during the year begin to loom larger and larger, even large enough to seem to constitute more than fifty percent of the relatives' income. Much of Tony Borgis' difficulty arose in connection with this claim for a credit for dependency.¹⁷

III

FAILURE TO PROSECUTE IS NOT AN INDICATION OF INNOCENCE

Many persons have completely misinterpreted the paucity of prosecutions in this area of offenses against the internal revenue laws, and have confused it either with an indication of a lack of guilt or an intention on the part of the government to ignore the more insignificant violations. Accordingly, many tax "experts" appear to practice their profession on the assumption that any single return can be made just a little false, that a de-

16. INT. REV. CODE § 25(b).

17. *United States v. Borgis*, *supra* note 10.

duction can be overstated just a little bit. They seem to operate on the theory that inasmuch as they apparently escaped detection in the use of some improper deduction on some prior return, that established a precedent which justifies the preparation of another false return. However, although in any particular case the government may have decided it was not practical, or politic, to press charges against the taxpayer or his counsel, that does not indicate its approval of the making of a false return, nor prevent the act from being criminal. Neither is there any comfort to be derived from the fact that the government may not as yet have instituted any action against the practitioner; perhaps evidence is merely being accumulated. As in the case of Tony Borgis,¹⁸ obviously no one return was very false, and it was probably made in accordance with a customary procedure which apparently had been accepted and passed in the past. However, the inaccurate, improperly prepared, and therefore false returns continued to accumulate until the Treasury Department considered it advisable to stop his practice.

IV

MANY TAX "EXPERTS" ARE NOT AWARE THEY ARE IN A HIGHLY HAZARDOUS OCCUPATION

1. *Responsibility Can Not be Avoided*

Another rather general belief among tax practitioners is that it is the taxpayer, for whom they have made the return, who must assume the responsibility for its accuracy. Some even attempt to secure this by neglecting to sign the return as the one who assisted in its preparation. But there is no refuge here, for that very failure to sign is itself a felony.¹⁹ And, you may be sure that when confronted by a revenue agent the taxpayer will have absolutely no knowledge about the matters on his return, but he will have a very definite recollection about the preparation of it. He will distinctly remember how he pleaded with the practitioner not to claim the deductions; he will recall how the adviser forced him to disclose the name, address, and relationship of a dependent whom he vehemently denied having assisted financially; and he will confess that the practitioner threatened him and compelled him to sign the return at the very moment he was protesting most vigorously that he did not want any reduction or refund of his taxes. Tony Borgis can, no doubt, verify this.

2. *Criminal or Civil Liability, or Both*

While cautiously attempting to avoid criminal liability, by conservatively preparing tax returns, the practitioner may discover that he has failed to perform his full duty to his client and thus to have become civilly liable for damages.²⁰ For the client is entitled to have his return prepared in such a

18. *Ibid.*

19. U.S. Treas. Reg. 111, § 29.145-1 (1943).

20. Peters, *Single-Standard Concept of Civil Liability in the Preparation of a Tax Return*. 4 MIAMI L.Q. 154 (1950).

manner that his tax is no larger than reasonably required. In order to accomplish this, the adviser is obliged to resort to an inquisition so as to be informed of all the possible facets of the particular factual situation being examined. Then he is obliged to interpret the provisions of the code, regulations, rulings, and decisions and apply them to the facts while resolving all reasonable doubts in favor of the taxpayer. He must thus push the deductions to the full limit allowable or be liable for any damage he may cause the taxpayer by failing to reasonably perform his employment, while at the same time he must not step across the line into the forbidden territory of false returns.

The tax practitioner is thus in a peculiarly hazardous occupation, dangers of which many (especially of the "drug-store expert" variety) are blithely unaware. He must tread a line as difficult as a tight wire across the Niagara Gorge. It is, no doubt, difficult enough to walk that wire when it is strong and visible, but when it is tenuous, obscured by darkness, and slippery from the mist, it must be impossible. The wire walker may wait for more favorable conditions; the practitioner has just such a tenuous and indefinite line to follow but he must follow it at his risk. To fall on one side makes him liable in civil damages to his client, while to fall off the other side makes him liable to the government for criminal penalties.