

# S&W Defense and Investigations Report

November 2007



Barry S. Pollack



David J. Nagle<sup>1</sup>

## WHY AMENDED TAX RETURNS ARE NOT SUCH AN EASY FIX

Tax lawyers and accountants may routinely advise clients to file amended tax returns whenever an error is uncovered in a previously filed return. With traditional tax evasion prosecutions seemingly on the rise, the concept of amended tax returns can generate several important questions. What if a "mistake" in a tax return arose from an intentional act of tax evasion? What if an amended return could serve as Exhibit 1 at a criminal prosecution for tax evasion? What if the government would find it difficult to prove a tax deficiency beyond a reasonable doubt in the absence of an amended return? On the other hand, what if the client does not file an amended return, and ultimately the government views the matter as potentially criminal simply because a tax deficiency was not fixed promptly? Tax advisors and taxpayers can struggle with the answers to these questions, at least with regard to individual returns.

### Recent Court Decisions

A significant concern arises from the possibility that a criminal prosecution could arise from or receive support from either an amended tax return or the lack of an amended tax return. On October 29, 2007, the United States Court of Appeals for the Fifth Circuit affirmed a taxpayer's conviction for filing a false *amended* return in *United States v. Clayton*. Earlier in the month, the Third Circuit affirmed, in *United States v. Havey*, the denial of a new trial where the record was "replete with overwhelming evidence that [the defendant] filed false income tax returns ... and that he *failed to file any amended returns* during the ten months leading up to the audit ..., contrary to his claim that he intended to do so." In September, in *United States v. Bland*, the Sixth Circuit affirmed a tax offense conviction obtained by a prosecutor who emphasized the belated timing of an amended tax return.

### Relevant Factors

When assessing risks associated with filing an amended tax return, several factors should be considered. First, the size of a potential deficiency can be relevant.

Second, the complexity of the underlying tax issue can affect whether an error is perceived as an innocent mistake. Third, the length of time that has passed since filing an incorrect return and the number of incorrect returns can affect whether errors would suggest a mistake rather than fraud. Fourth, if an audit or criminal investigation has already begun, then the filing of an amended return or other voluntary disclosure to the government will not likely prevent an imminent criminal prosecution, though some form of leniency may be possible. Fifth, a taxpayer may have a Fifth Amendment right against self-incrimination that permits her to avoid disclosing specific incriminating information on an amended tax return. On the other hand, a taxpayer who waits too long to file an amended return or to make a voluntary disclosure may lose an opportunity to avoid penalties or find herself a subject or target of a criminal investigation.

A tax lawyer or advisor cannot force a taxpayer to file an amended return. The ultimate decision remains with the taxpayer. If a taxpayer were providing misleading information in a pending audit or proceeding, however, a lawyer or advisor may have to withdraw from the representation. While informing a client of the possible consequences of amending can be extremely important, a government agent or attorney could take the position that a tax lawyer or advisor should not discourage a taxpayer from filing a correct amended return. Also, without an amended return, substantial civil penalties and interest may continue to accrue.

### Is There a Duty to Amend?

A review of federal case law sheds light on the scope of any potential duty of a taxpayer to file an amended return. The United States Tax Court has stated, on multiple occasions, that a taxpayer should file "a timely tax return based on the best information available and later fil[e] an amended return if necessary." In 1984, however, the United States Supreme Court explained, in *Badaracco v. C.I.R.*, that "the Internal Revenue Code does not explicitly provide either for a taxpayer's filing, or for the Commissioner's acceptance, of an amended return; instead, an amended return is a creature of administrative origin and grace." While there may exist no statutory basis for filing amended returns, doing so has become a regular practice at the IRS. Even if a taxpayer does not have a statutory obligation to file an amended tax return, circumstances could require a lawyer to consider any applicable ethical obligations, particularly if an audit or other proceeding involving the IRS is pending.

### Taxpayer's Fifth Amendment Rights

The Supreme Court has recognized certain Fifth Amendment rights held by taxpayers. In a landmark 1927 case, *United States v. Sullivan*, the Supreme Court held that a taxpayer did not possess a Fifth Amendment right to avoid filing a tax return merely because he earned taxable income from an illegal

<sup>1</sup> Barry S. Pollack is a partner in the S&W Litigation Department and a former federal prosecutor. David J. Nagle is a partner in the S&W Tax Department. Attorney Pollack was honored as a 2005 Lawyer of the Year by the *Massachusetts Lawyers Weekly* and a Superlawyer in Criminal Law by *Boston Magazine*. Attorney Nagle has an LLM in Taxation and has been honored as a Rising Star by *Boston Magazine*.

# S&W Defense and Investigations Report

activity. The *Sullivan* Court reinstated a criminal conviction, but explained that a taxpayer may possess certain Fifth Amendment rights to withhold specific incriminating information:

If the form of return provided called for answers that the defendant was privileged from making he could have raised the objection in the return, but could not on that account refuse to make any return at all. We are not called on to decide what, if anything, he might have withheld. Most of the items warranted no complaint. It would be an extreme if not an extravagant application of the Fifth Amendment to say that it authorized a man to refuse to state the amount of his income because it had been made in crime. But if the defendant desired to test that or any other point he should have tested it in the return so that it could be passed upon. He could not draw a conjurer's circle around the whole matter by his own declaration that to write any word upon the government blank would bring him into danger of the law.

The *Sullivan* Court did not address, however, a taxpayer's claim that Fifth Amendment rights excuse any duty to file an amended tax return because doing so could provide the requisite proof of two of the three essential elements of the crime: (1) an attempt to evade, and (2) a substantial deficiency, leaving at issue only (3) willfulness.

In 1976, the Supreme Court rejected a taxpayer's Fifth Amendment argument while affirming the conviction in *Garner v. United States*. The *Garner* case involved a "nontax criminal prosecution" for gambling offenses based on the defendant's admissions in a tax return of certain incriminating activities. In *Garner*, the Court suggested that the defendant could have invoked "the privilege against compulsory self-incrimination on his tax returns in lieu of supplying the information used against him." In so holding, the *Garner* Court carefully

limited its holding. First, the Court explained it had "no occasion in this case to decide what types of information are so neutral that the privilege could rarely, if ever, be asserted to prevent their disclosure." Second, the claims of Fifth Amendment privilege it considered were "only those justified by a fear of self-incrimination other than under the tax laws." Third, the Court warned that nothing it said "questions the continuing validity of *Sullivan's* holding that returns must be filed." As with *Sullivan*, the *Garner* decision did not address the Fifth Amendment implications of filing amended tax returns in the face of a potential tax evasion prosecution.

## Voluntary Disclosure

Prior to 1952, the IRS maintained a formal voluntary disclosure policy through which a taxpayer could avoid prosecution by proactively correcting past deficiencies. Now the IRS merely considers voluntary disclosure as one of the many factors that determine whether to recommend a criminal tax prosecution. A voluntary disclosure, through amended tax returns or otherwise, may not serve as a controlling factor if the government perceives that the cooperation arises merely because of an imminent investigation. Organizational taxpayers have other incentives and requirements to consider that are beyond the scope of this advisory.

## Conclusion

When mistakes in tax returns are significant in amount and not clearly inadvertent, amended tax returns may be far from an easy fix. Criminal consequences could ensue. An individual taxpayer can be made aware of possible consequences, without discouraging the filing of correct amended returns. Fifth Amendment rights and voluntary disclosures should also be considered. Each case may present a different balance of factors that will help inform the taxpayer's choice.

The S&W Defense and Investigations Report is published by S&W's **Government Investigations & White Collar Defense Group**. At the core of the Group is a team of seasoned investigative, trial and tax attorneys, including former federal prosecutors and other former government attorneys, who offer skills and experience derived collectively from hundreds of investigations and prosecutions. Members of the Government Investigations & White Collar Defense Group not only span the Firm's three offices in Boston, New York, and D.C., but also provide access to numerous other jurisdictions in which they have appeared and thousands of pertinent contacts throughout the country. For more information, you may review biographies on the firm's Web site ([www.sandw.com](http://www.sandw.com)) of the members of the Government Investigations & White Collar Defense Group, or contact any of them directly:

Lindsay Barna	<a href="mailto:lbarna@sandw.com">lbarna@sandw.com</a>	202 775 1224
Kevin M. Colmery	<a href="mailto:kcolmey@sandw.com">kcolmey@sandw.com</a>	617 338 2851
William E. Halmkin+	<a href="mailto:whalmkin@sandw.com">whalmkin@sandw.com</a>	617 338 2436
Jeffrey M. Karp++	<a href="mailto:jkarp@sandw.com">jkarp@sandw.com</a>	202 370 3921
Jonathan G. Kortmansky	<a href="mailto:jkortmansky@sandw.com">jkortmansky@sandw.com</a>	212 660 3044
David C. Mahaffey**	<a href="mailto:dmahaffey@sandw.com">dmahaffey@sandw.com</a>	202 775 1207
Jerome C. Muys++	<a href="mailto:jmuys@sandw.com">jmuys@sandw.com</a>	202 370 3920
David J. Nagle	<a href="mailto:dnagle@sandw.com">dnagle@sandw.com</a>	617 338 2873
Barry S. Pollack*	<a href="mailto:bpollack@sandw.com">bpollack@sandw.com</a>	617 338 2910
Joshua L. Solomon	<a href="mailto:jsolomon@sandw.com">jsolomon@sandw.com</a>	617 338 2408
Laura Steinberg	<a href="mailto:lsteinberg@sandw.com">lsteinberg@sandw.com</a>	617 338 2867
Paul E. Summit*	<a href="mailto:psummit@sandw.com">psummit@sandw.com</a>	617 338 2488
Frank B. Velie*	<a href="mailto:fvelie@sandw.com">fvelie@sandw.com</a>	212 660 3037
Julie A. Weisman++	<a href="mailto:jweisman@sandw.com">jweisman@sandw.com</a>	202 775 1221

\* former Assistant United States Attorney; \*\* former SEC attorney; \*\*\* former Assistant Attorney General, Massachusetts;  
+ former Deputy Commissioner of the Massachusetts Department of Revenue ++ former Justice Department attorneys

© 2007, **Sullivan & Worcester LLP**. All rights reserved. This Report is not intended to constitute legal advice or a general solution to similar issues or problems. The reader should not rely on this Report as legal advice because even a slight change in the circumstances faced by parties can change the appropriate legal advice for the situation. An attorney-client relationship is not established by the dissemination or review of this Report.