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Will your audit lead to prosecution?

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One of the fears of any of any taxpayer under tax audit is that the auditor will “refer” the case for prosecution. There are less than 2,500 federal criminal tax cases prosecuted annually out of 100 million returns filed, so the odds in a pure sense of prosecution are relatively slim. However, most taxpayers know when they have undisclosed source of income, hidden assets or taken improper deductions and for them the perceived odds are 100%. In some cases, the source of unreported income is illegal activities. In some cases the source of the improper deductions is a fictitious or overstated item. These are all considered “eggshell” audits.

Eggshell audits require counsel at the beginning of the audit process. No communication or statements should be made to the auditor without counsel’s advice. While it is normal for clients to go their accountants upon receipt of an audit letter, taxpayers need to understand that there is no privileged communication with their accountants involving criminal tax matters. Statements made to an accountant that disclose illegal activity simply are not privileged. If a taxpayer knows or has reason that he or she has filed a “false return” the client needs to speak with an attorney who is skilled in handling “eggshell” audits. That attorney can then gather all the facts and advise the client.

It is also important to speak to tax counsel prior to an audit if there is a life cycle event, such as a divorce, or business breakup where “eggshell” issues may be discovered or a “whistleblower” claim (a reward claim) could be filed. Soon to be ex-spouses, business partners and disgruntled employees are major sources of information and often file whistleblower claims. There are strategies that skilled counsel can discuss to minimize the potential damage in such cases.

The very worst thing for a taxpayer to do is provide false or misleading information to an auditor or investigator and yet taxpayers continue to do so rather than make contact with counsel.

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