News Release

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IRS and State Department of Taxation Alert Hawaii Taxpayers to Abusive Tax Schemes

HONOLULU/SEATTLE – The Internal Revenue Service and the State of Hawaii Department of Taxation advise taxpayers not to fall victim to one of the tax scams that surface each year during the filing season. Victims of these abusive schemes often pay promoters or unscrupulous tax preparers large fees, then end up facing a staggering amount of back taxes, interest and penalties.

"At the IRS, we're augmenting our enforcement resources to attack schemes and scams. While we're actively targeting promoters, taxpayers themselves should be wary of anyone who promises to eliminate their taxes", said IRS Commissioner Mark W. Everson. "Don't be fooled by these outrageous claims. There is no secret way to escape paying taxes."

"It's not just the wealthy who are targeted," said State Tax Director, Kurt Kawafuchi. "In Hawaii, some of our most vulnerable taxpayers have fallen victim, and we have proposed legislation to prevent this from continuing."

House Bill 2514 and Senate Bill 2989 are currently before the State Legislature. If passed, they would allow the Department of Taxation to impose civil penalties and injunctions on individuals who promote abusive tax shelters and on tax preparers who support unrealistic positions on their clients' tax returns.

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The IRS and State Department of Taxation urge people to avoid these common schemes:

- **RETURN PREPARER FRAUD**. Most tax return preparers are honest, but taxpayers should choose a tax preparer carefully. Unscrupulous tax preparers cause problems for those who use their services while enriching themselves. Here are some tips:
    - Avoid tax preparers who guarantee large refunds before seeing your tax records or who want a portion of your refund as payment.
    - If your refund is considerably higher this year than last year and your situation hasn't changed very much, you may want to get a second opinion. It could be because your current tax preparer claimed false deductions.
    - Make sure your tax preparer goes over your tax return with you line-by-line, and explains everything thoroughly. Even if you don't know much about completing your tax return, you will know what your wages were, how much you donated to charitable organizations, and other basic information reported on your tax return.
    - Do not sign a tax return before you review it and are sure that the information is correct. No matter who prepares the return, the taxpayer is ultimately responsible for all of the information on that return and for the payment of any tax, penalty, and interest charges that may be assessed.
    - Do not accept a return if the preparer does not sign it. If the tax preparer doesn't want to take responsibility for the information on your return, neither do you.
- **EMPLOYMENT TAX EVASION**. The IRS and the State Department of Taxation have seen a number of illegal schemes in which promoters tell employees to claim to be exempt from the withholding of taxes from their wages when they are not exempt, or to claim incorrectly an excessive number of withholding exemptions so that no taxes are withheld. If you did

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not pay enough tax, either through withholding or by making estimated tax payments, you may have to pay penalties.

- **IMPROPER HOME-BASED BUSINESS.** This scheme purports to offer tax "relief" but is an illegal tax avoidance scheme in reality. Its promoters claim that individual taxpayers can deduct most, or all, of their personal expenses as business expenses by setting up a bogus home-based business. The tax code firmly establishes that a clear business purpose and profit motive must exist before a taxpayer can deduct anything as a business expense. This scam has been around for years, but the IRS and State Department of Taxation continue to see activity in this area.
- **MISUSE OF TRUSTS**. Promoters of abusive tax avoidance transactions are increasingly urging taxpayers to transfer assets into trusts. The promoters promise a variety of benefits, such as the reduction of income subject to tax, deductions for personal expenses paid by the trust, and reduction of gift or estate taxes. Taxpayers should be aware that abusive trust arrangements will not produce the tax benefits advertised by their promoters, and that the IRS and the State Department of Taxation are actively examining these types of trust arrangements. More than a dozen injunctions have been obtained by the IRS against promoters, and numerous promoters and their clients have been criminally prosecuted. Before entering any trust arrangements, taxpayers should seek the advice of a trusted tax professional.
- **SHARE/BORROW EITC DEPENDENTS**. Unscrupulous tax preparers "share" one client's qualifying children with another client in order to allow both clients to claim the federal Earned Income Tax Credit. For example, one client may have four children, but only needs to list two to get the maximum EITC. The preparer will list two children on the first client's tax return and the other two on another client's return. The preparer and the client "selling" the dependents split a fee. The IRS prosecutes the preparers of such fraudulent claims, and participating taxpayers could be subject to civil penalties.

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Persons who suspect tax fraud can report it to the State Department of Taxation by calling the Taxpayer Services Branch at 587-4242 (toll-free at 800-222-3229) or by e-mailing them at Taxpayer.Services@hawaii.gov. Tax fraud also can be reported to the IRS at 800-829-0433. More information on tax scams and schemes is available by visiting “The Newsroom” section of the IRS website at www.irs.gov.

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