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## Respected tax judge indicted for duping tax authorities

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Too many people deduct personal expenses as business expenses. There are many examples; (i) treating dinner out with family and friends as a business expense; (ii) traveling with the family to Hawaii, first class, staying in a fancy hotel suite, and deducting that as business travel; (iii) subscribing to periodicals, buying books and deducting them as business expenses; (iv) treating a portion of the home as an office, deducting a pro rata portion of the home's expenses as a business expenses, and taking depreciation on a portion of the home; and (v) deducting commuting and non-business travel mileage on a personal

automobile. These people think "What's the worst that will happen me? The IRS will disallow the deductions." Often that is the case. In the unlikely event of an audit, a CPA can end up getting the IRS to agree to some of the deductions, and can give up others without any significant repercussion. Or, if the disallowance is significant, the taxpayer might be hit with a 20 percent accuracy-related penalty. IRC Section 6662.

If the IRS agent is especially irritated, there is the IRC Section 6663 civil fraud penalty: 75 percent of the tax understatement. On the other hand, the taxpayer may mitigate both penalties by demonstrating that the underpayment was due to "reasonable cause" and that the taxpayer acted in "good faith." One element of "good faith" is the reliance on a professional's advice.

However, taxpayers labor under the illusion that deducting personal expenses can always be easily resolved. Tax fraud is not reserved for people who fail to report their income.

The basic elements of the felony of tax evasion are (i) a tax deficiency; (ii) an affirmative act constituting an evasion or attempted evasion of the tax law; and (iii) willfulness. IRC Section 7201. A tax deficiency can arise from an overstatement of expenses just as easily as from a failure to report income. The most frequently charged criminal tax violation, Section 7206, is for false returns: any person who willfully makes any document under the Internal Revenue laws that she or he does not believe to be true and correct. Conviction results in a fine of up to \$250,000 or imprisonment of up to three years, or both. Another crime is the attempt to interfere with the administration of the Internal Revenue laws. Section 7212. It is generally reserved for conduct occurring after a return has been filed, e.g., lying to the auditor. This is sometimes referred to as the "single-person conspiracy statute."

One excuse to willfulness, a required element of these felonies, is a good faith misunderstanding of the law. Imagine how unavailable that defense is when the party being charged is a U.S. Tax Court judge!

On Oct. 21, in the U.S. District Court for the District of Minnesota, a hearing was conducted into the guilty plea being entered by a former U.S. Tax Court judge. *United States v. Diane L. Kroupa*, 16-CR-84 (WMW/KMM). The former Tax Court judge was indicted on six counts, five of which were for the sections of the Internal Revenue Code discussed above. However, she agreed to plead guilty to a count not in the Internal Revenue Code: 18 U.S. Code Section 371: "If two or more persons conspire either to commit any offense against the United States, or to defraud the United States, or any agency ... in any manner or for any purpose, and one or more of such persons do any act to effect the object of the conspiracy, each shall be fined under this title or imprisoned." The potential sentence is imprisonment of up to a maximum of five years (there is no parole in the federal system), supervised release of up to a maximum of three years and a fine of up to \$250,000. The government requested restitution of the tax loss. The district judge may order the defendant to pay the costs of prosecution.

The former judge entered a plea agreement with the government. In exchange for pleading guilty to the first count, the government agreed to drop the remaining five charges. Of course, there is no guaranty that the district court judge will impose a lesser penalty due to the plea deal.

What did the former judge do? From 2004 to 2010, while she was a Tax Court judge, she filed returns jointly with her husband, who was a lobbyist. The two inflated the husband's consulting business's purported expenses by using personal expenses both incurred. For example, they fraudulently deducted personal travel and meals. Also, as part of her job as a Tax Court judge, she deducted the cost personal items, such as those at Barnes & Noble. Neither of them revealed to their tax return preparer that the expenses were inappropriate. During those seven years, the total false expenses were at least \$450,000. They also failed to report approximately \$45,000 from the sale of a parcel of land in South Dakota; they claimed that the income was from an inheritance. They falsely claimed that approximately \$33,000 of cancellation of debt income that they received from the Bank of America in 2008 was not taxable income because they were financially insolvent. Then, during one of the audits, they caused false and misleading representations to be made to the IRS agent (that the expenses were legitimate). Also, her husband cut-and-pasted credit card statements that purported to substantiate certain of the business expenses.

The government does not go after everyone. It does not have the resources. However, it does so often enough to remind everyone to be truthful and deduct only legitimate business expenses. Dinner out with the family is not a legitimate business expense. If you deduct it, you may miss years of family dinners.