IRM Section 25.1.6.3 (11-05-2014)

Evidence of Fraud

1. Since direct proof of fraudulent intent is rarely available, fraud must be proven by circumstantial evidence and
    - Deception
    - Misrepresentation of material facts
    - False or altered documents
    - Evasion (i.e., diversion or omission)
2. The courts focus on key badges of fraud in determining whether there was an "intent to evade" tax. A determination of fraud is based on the taxpayer's entire course of conduct, with each badge of fraud given the weight appropriate to a particular case. An evaluation of fraud is based on the weight of the evidence rather than the quantity of the factors. Some of the common "first indicators (or badges) of fraud" include:
    - Understatement of income (e.g., omissions of specific items or entire sources of income, failure to report substantial amounts of income received)
    - Fictitious or improper deductions (e.g., overstatement of deductions, personal items deducted as business expenses)
    - Accounting irregularities (e.g., two sets of books, false entries on documents)
    - Obstructive actions of the taxpayer (e.g., false statements, destruction of records, transfer of assets, failure to cooperate with the examiner, concealment of assets)
    - A consistent pattern over several years of underreporting taxable income
    - Implausible or inconsistent explanations of behavior
    - Engaging in illegal activities (e.g., drug dealing), or attempting to conceal illegal activities
    - Inadequate records
    - Dealing in cash
    - Failure to file returns, and
    - Education and experience
3. The Facts section of the penalty narrative should include a detailed description of all applicable badges of fraud. Additionally the examiner should include other items of deception or instances where the taxpayer may have misled or misrepresented facts to the government.