

What Are the Objectives and Possible Outcomes of an Eggshell Audit?

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What are the objectives and possible outcomes of an eggshell audit?

Once an IRS revenue agent becomes aware that a taxpayer may have filed one or more fraudulent tax returns the criminal defense counsel must weigh the benefit of continuing to cooperate with the agent in an effort to quell the agent's suspicion or choosing to advise his client to remain silent to protect the taxpayer from self-incriminating themselves by admitting to the fraud or in making statements that the auditor later proves to be lies which amounts to a felony in and of itself as it is a felony to lie to a federal agent.

The Criminal Tax Defense Attorney's largest concern in an eggshell audit is to dissuade the examining agent from referring the case to the criminal investigation unit of the IRS because CID's primary mission is to deter the general public from committing tax crimes by criminally prosecuting a sample of taxpayers caught cheating to make an example out of them.

Taxpayers facing an eggshell audit should only be represented by experienced criminal tax defense counsel and the CPAs who perform via a Kovel agreement (United States v. Kovel, 296 F.2d 918 (2nd Cir. 1961)) effectively subordinating them to the attorney's supervision and rendering communication between the CPA and the client subject to the attorney client privilege. The original return preparer should never provide representation in an eggshell audit as they do not have attorney client privilege and are often subpoenaed to help make the government's case in chief against the taxpayer. Also, they cannot be trusted to be more concerned with protecting their own reputation than in helping the client avoid criminal prosecution.

Criminal tax defense attorneys representing a client in an eggshell audit commonly seek to achieve three overarching objectives.

1. To prevent a criminal investigation from beginning by attempting to keep a matter purely a civil examination.
2. Avoid the imposition of civil fraud penalties that are possible under IRC § 6663 which imposes a 75% penalty on any portion of an underpayment that is attributable to fraud.
3. Minimize additional tax, penalties and interest.

There are generally three possible outcomes for eggshell audits:

1. The Revenue Agent does not consider the misstatements found and adjustments made during the audit to be caused by fraud and thus do not discover criminal tax issues.
2. The Revenue Agent discovers misstatements that they suspect might have been caused by fraud but because of effective lawyering the agent is inclined to keep the matter purely a civil examination because of lack of proof as to criminal intent.
3. The Revenue Agent makes a referral a technical fraud specialist so that the case will be possibly worked up for a referral to the Criminal Investigation function of the IRS (CI).

Once a revenue agent discovers significant and affirmative indications of fraud during a civil audit, he will first consult with his manager and upon receiving his managers approval he then consults with a “fraud referral specialist” that works directly with the auditor to develop a “fraud development plan,” for the sole purpose of documenting the affirmative acts and firm indicators of fraud in order to refer the case to the criminal investigation function of the IRS.

Revenue agents commonly continue to collect information after the discovery of firm indications of fraud, and thus procedurally go off the reservation by effectively conducting their own personal reverse eggshell audit.

The continued investigation by the revenue agent without proper notice to the taxpayer and their representative that subsequent statements made and information provided will likely be used in a subsequent criminal investigation and prosecution violates the taxpayer’s constitutional rights that would exist if they were approached by the criminal investigation division directly and received a Miranda like reading of their rights.

An argument can be made that all subsequent information and the taxpayer’s statements collected after the revenue agent’s original discovery of badges of fraud is inadmissible under Toussaint and thus can be suppressed. However contrary hair-splitting case law holds that if the auditor’s conduct is merely a deception that violates IRS procedure but falls short of violating the U.S. Constitution or applicable federal statutes, the evidence collected by the auditor will not be held to be inadmissible in a subsequent criminal prosecution under Caceres and thus will not be suppressed. This split in federal case law creates a continuum of auditor behavior that requires measuring actions taken by an auditor that are often

clandestine and thus hard to analyze and therefore makes the reverse eggshell audit extremely risky to the effected taxpayer.

How are the objectives obtained?

Taxpayers faced with an eggshell audit are in dire need of an experienced tax attorney who can advise the taxpayer on how exactly to comply with the auditor's data requests, questioning, summoning of records and all other investigatory techniques while simultaneously preventing the client from making criminal admissions or providing false information that effectively waive the client's 5th Amendment privilege against self-incrimination. One of the strongest protections available to criminal tax defense counsel is found under *Tweel*, which held that any auditor deception in a reverse eggshell audit must be tacit rather than affirmative otherwise subsequently procured information will be suppressible. Thus, when a revenue agent lies when he or she states that there is no parallel criminal investigation underway, a technical fraud advisor has not been associated with the audit, or if they continue their civil investigation after badges of fraud have been detected which are sufficient to trigger a halt to the civil examination and a criminal referral, any subsequently procured documents and statements are suppressible in a subsequent criminal prosecution.

A taxpayer representative's failure to ask the right questions at the sensitive juncture between an eggshell audit and its progression into a reverse eggshell, or failure to recognize the approaching juncture altogether, may result in a permanent loss of a taxpayer's constitutional rights and privileges.

Procedures that this office follows to minimize the risks of an eggshell audit are to prevent the taxpayer from making criminal admissions by limiting their involvement in the audit, preventing or where necessary closely controlling a client interview, only having first thoroughly prepared our client for the expected questioning they will receive. We will attempt to relocate any interview originally scheduled to take place in the personal residence or the business establishment of the taxpayer because of the potential for an economic lifestyle analysis in their home and hard to control auditor access to the client's business records and employees at their business premises. We also do not want to have the client or his or her employees present at any required business tour. We will create thorough records of any damaging positions taken or alluded to by the agent. After the examination we may submit a FOIA request (Freedom of Information Act) to obtain a copy of the record created by the agent including his or her notes. We only provide copies of information requested during the audit

where required by the auditor and we keep a detailed record of what was provided. Our clients are thoroughly advised of the importance of not making false statements, as they can lead to obstruction charges in a criminal investigation and can constitute a felony in their own right even in a straight civil audit scenario. We always remain calm and professional and establish a rapport with the Agent from the outset that combined with our firm's excellent reputation with the taxing authorities that we have found to consistently be the difference between the audit proceeding as a straight civil matter rather than the matter turning into a criminal referral.

Our office is not afraid to have the client take the fifth in appropriate circumstances. Where a civil investigation has clear and definite indications of a clandestine criminal investigation the taxpayer can refuse to answer an auditor or subsequent criminal investigator's questions on the grounds that the answers they provide may incriminate them. This action is sure to raise concrete suspicion on the part of the auditor but the failure of counsel to invoke the taxpayer's Fifth Amendment privileges where appropriate can be far more damaging to a taxpayer in a parallel of subsequent criminal investigation as information gathered by the auditor indicative of fraud will certainly be used against them. Moreover, incriminating statements or information provided to an auditor may fully or partially waive the constitutional protections of the 4th and 5th amendments.

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