

IRS Announces New Initiative Targeting High-Income Individuals Who Did Not File A Tax Return – A Risk of Criminal Liability

By Steve Toscher, Sandra Brown, Evan Davis and Luke Ryan

On February 29, 2024, the IRS announced a new initiative targeting approximately 125,000 high-income taxpayers who have failed to file federal income tax returns since 2017. With funding from the 2022 Inflation Reduction Act, the IRS will send compliance letters to these individuals, including over 25,000 letters to individuals with incomes above \$1 million and over 100,000 letters to those earning between \$400,000 and \$1 million. The new initiative aims to address tax non-compliance, with penalties for failure to file ranging up to 25% of the non-filer's tax bill, potentially a 75% penalty for willful failures, and potential criminal liability. The IRS believes that hundreds of millions of dollars in unpaid taxes are involved.

The IRS's announcement explained that a non-filer's failure to respond to the compliance letter may lead to additional enforcement actions, including audits, collection activities, and potential criminal prosecution. If non-filers continue to ignore IRS communications, the Service may file substitute tax returns on the non-filer's behalf, potentially resulting in tax bills, collection actions, and other penalties. Accordingly, the IRS strongly encourages any non-filer to consult with a qualified tax professional as soon as possible to avoid further penalties and/or potential criminal prosecution.

I. Background

Since at least 2012, cuts to the IRS's budget significantly impacted the Service's ability to pursue non-filing taxpayers, and, beginning in 2020, the COVID-19 pandemic exacerbated the challenge due to a large volume of paper tax returns and unopened mail that overwhelmed the Service. Beginning in July 2023, however, the IRS announced that it was using some of the nearly \$60 billion of newly allocated Inflation Reduction Act (IRA) funding to upgrade the Service's outdated scanners and improve its processing efficiency. In the same announcement, the IRS explained that it was focusing on reducing the gap between taxes owed and what the Service actually collects, particularly from high-income individuals. The IRS announced that it had already closed 175 cases involving tax-delinquent millionaires, generating \$38 million in revenue, and IRS Commissioner Danny Werfel emphasized his intention to grow the IRS's workforce to "crack[] down on millionaire non-filers."

Approximately two months later, in September 2023, the IRS announced a comprehensive effort to "restore fairness to the tax system" by utilizing funding from the IRA. The announcement explained that the Service intended to shift its focus to high-income earners, partnerships, large corporations, and promoters who abuse tax laws. Key changes included using artificial intelligence and advanced technology to detect tax evasion schemes; a greater focus on addressing discrepancies in the balance sheets of large partnerships; and targeting various compliance issues such as digital assets, FBAR violations, and labor broker schemes. The IRS's announcement emphasized the Service's commitment to enhancing tax compliance, particularly among high-income individuals and entities, while also protecting the interests of working-class taxpayers by ensuring that audit rates remain unchanged for taxpayers earning less than \$400,000 annually.

Later that month, Senator Ron Wyden, the Chairman of the Senate Finance Committee, sent a letter to Commissioner Werfel urging the IRS to "significantly increase enforcement action against wealthy tax cheats who refuse to file tax returns." Sen. Wyden's letter explained that new data that was provided to

the Senate Finance Committee by the IRS had identified “staggering levels of noncompliance and criminality by high-income non-filers.” “While I commend the new IRS enforcement initiative focusing on high-income earners and large corporations,” Sen. Wyden wrote, “I believe resources from the Inflation Reduction Act should also be used to crack down on this particularly brazen form of tax evasion.”

According to Sen. Wyden, the IRS’s data indicated that, from 2017 to 2020, over 1.4 million high-income taxpayers had not filed a tax return, potentially resulting in \$65.7 billion in unpaid taxes; many of the non-filers were repeat offenders, with over 10,000 taxpayers having multiple years of unfiled returns and large outstanding tax balances; and, despite this, only a small fraction of cases were referred for criminal prosecution due to resource constraints and prosecutorial discretion. Particularly concerning to Sen. Wyden was a subset of more than 8,700 ultra-wealthy non-filers who owed over \$500,000 each in unpaid taxes. Sen. Wyden explained that, even among the top 500 high-income non-filers for each year (totaling 2,000 taxpayers) enforcement actions such as liens and levies were rare, with only a few cases under criminal investigation or subjected to examinations.

II. The IRS’s New Non-Filer Initiative

On February 29, 2024, the IRS indicated that it is acting on Sen. Wyden’s request by announcing a new initiative targeting high-income taxpayers who have failed to file federal income tax returns since 2017. The announcement explained that the Service has received third-party information such as Forms W-2 and 1099s that indicate that approximately 125,000 individuals with incomes ranging from \$400,000 to over \$1 million failed to file tax returns. Compliance letters will be mailed to these taxpayers, and the IRS plans to send out approximately 20,000 to 40,000 letters weekly, starting with those in the highest income brackets.

The IRS’s announcement explained that, while the exact amount of recoverable revenue is uncertain, there are potentially hundreds of millions of dollars in unpaid taxes among these cases. The announcement emphasized the importance of voluntary compliance, warning that failure to file could result in IRS enforcement actions, including audits and criminal prosecution. In addition, the IRS is aiming to inform non-filers who may be entitled to refunds, particularly those with lower incomes who missed out on refunds in previous years. “If someone hasn’t filed a tax return for previous years, this is the time to review their situation and make it right,” Commissioner Werfel said. “For those who owe, the risk will just grow over time as will the potential for penalties and interest. These non-filers should review information on IRS.gov that can help and consider talking to a trusted tax professional as soon as possible.”

In response to the announcement, Sen. Wyden applauded the IRS’s new initiative. “As somebody who’s been sounding the alarm about this issue for years,” Sen. Wyden said, “it’s great to hear that the IRS is finally telling the wealthy scofflaws that it’s time to get right and pay what they owe.” Sen. Wyden attributed the IRS’s new initiative to the Inflation Reduction Act, stating that it aligns with Democrats’ goals for stronger enforcement actions.

III. Willful Failure to File a Tax Return is a Crime

Section 7203 of Title 26 of the United States Code (the Internal Revenue Code) makes it a crime to intentionally fail to file a federal tax return, pay a tax, keep necessary records, or provide information

that is required by the IRS. While normally a misdemeanor, failure to file a return can be a felony if it amounts to “evasion.”

In order to establish a violation of section 7203 for failing to file a tax return, the government must establish the following elements: (1) the individual was required to file a return for the taxable period; (2) the individual failed to file a return at the time required; and (3) the individual acted willfully. Willfulness may be inferred from a variety of circumstances, including failure to file a return during multiple years; the fact that a taxpayer timely filed returns in prior years, which indicates that the taxpayer knew of the filing obligation; a taxpayer’s failure to file state tax returns; and the receipt of a form W-2, which may be treated as a reminder of the obligation to file.

A misdemeanor willful failure to file a return under section 7203 may rise to the felony level of a willful attempt to evade or defeat tax under section 7201 if the government can demonstrate an affirmative act proving evasion. The general rule, however, is that an omission to act will not satisfy the affirmative act requirement: for example, a mere failure to file a return, standing alone, cannot constitute an attempt to evade assessment of taxes. But, the following have been found to be affirmative acts supporting charges under 7201: (1) providing false information about assets or income to the IRS; (2) placing assets in the names of others; (3) dealing in cash; (4) using nominees to conduct business, buy and sell assets, or conduct other financial transactions; and (5) in the case of evading *payment* of taxes, running personal expenses through a business account to make it harder for the IRS to levy the taxpayer’s personal funds.

IV. Civil and Criminal Consequences for Failing to File a Federal Tax Return

A. Civil Penalties

Failure to file a federal tax return will, more than likely, result in civil penalties imposed by the IRS. The amount of the penalties depends on a variety of factors, such as the amount of tax owed, the reason for the non-filing, and the taxpayer’s history of compliance. Commonly imposed civil penalties for failing to file a tax return are the following:

- **Failure-to-File Penalty:** This penalty is assessed when a taxpayer does not file their tax return by the due date or extended due date. The penalty typically accrues monthly and is usually a percentage of the unpaid taxes owed. The IRS’s recent announcement explained that the penalty for a failure to file can be as much as 5% of the amount owed every month, up to 25% of the non-filer’s tax bill.
- **Failure-to-Pay Penalty:** In addition to the failure-to-file penalty, the IRS may impose a failure-to-pay penalty when a taxpayer fails to pay the taxes owed by the due date. This penalty is usually a percentage of the unpaid taxes and accrues monthly until the taxes are fully paid or the statutory maximum is reached.
- **Interest Charges:** Taxpayers who have unpaid taxes are also subject to interest charges on the unpaid tax amount. The interest accrues daily and is compounded, meaning the interest is charged on both the original tax amount and any previously accrued interest. Penalties also incur interest.

- **Civil Fraud Penalty:** If the failure to file a tax return is due to a fraudulent intent to evade taxes, the taxpayer may be subject to a civil fraud penalty. This penalty can be as high as 75% of the underpayment of tax if the IRS is able to prove that the underpayment was intentional.

B. Criminal Penalties

Section 2T1.1 of the U.S. Sentencing Commission’s Guidelines Manual provides the discretionary framework that federal judges use to determine the appropriate criminal penalty for an individual who has pleaded guilty to or been convicted of willfully failing to file a federal tax return. The Guidelines allow for adjustments to the recommended sentence based on specific factors, such as the defendant’s acceptance of responsibility or cooperation with authorities. The purpose of the Guidelines is to provide consistency and fairness across the 94 federal district courts that make up the United States federal court system.

The Guidelines analysis begins by categorizing the defendant’s crime of conviction based on the severity of the offense and assigns each crime of conviction a numerical “offense level.” At the same time, the defendant’s “criminal history category” is assessed and assigned a score based on the defendant’s prior criminal activity (if any). The Guidelines then provide a sentencing table that cross-references the offense level with the defendant’s criminal history category to determine the recommended range of imprisonment. The Guidelines also include recommended ranges for fines, probation, and supervised release.

While every sentencing and individual defendant is unique, the Guidelines are the starting point and the general application of the Guidelines to a willful failure to file offense is as follows:

- **Calculation of Offense Level:** The offense level is determined based on the amount of tax that should have been reported on the unfiled return and paid. The following chart determines the starting or “base” offense level:

§2T4.1. Tax Table	
TAX LOSS (APPLY THE GREATEST)	OFFENSE LEVEL
(A) \$2,500 or less	6
(B) More than \$2,500	8
(C) More than \$6,500	10
(D) More than \$15,000	12
(E) More than \$40,000	14
(F) More than \$100,000	16
(G) More than \$250,000	18
(H) More than \$550,000	20
(I) More than \$1,500,000	22
(J) More than \$3,500,000	24
(K) More than \$9,500,000	26
(L) More than \$25,000,000	28
(M) More than \$65,000,000	30
(N) More than \$150,000,000	32
(O) More than \$250,000,000	34
(P) More than \$550,000,000	36

- Adjustments to Offense Level: Next, the base offense level may be increased or decreased depending on certain characteristics of the offense, such as obstruction of justice, use of sophisticated means, or the defendant's acceptance of responsibility. Notably, in 2023, the Guidelines were revised to allow a two-point decrease to a defendant's base offense level for defendants with minimal or no prior criminal history.
- Determination of Criminal History Category: Once the offense level is calculated, the defendant's criminal history category is determined based on his/her prior convictions. Defendants with no prior convictions fall into Category I. The greater the defendant's prior criminal activity, the greater the criminal history category that he/she is assigned.
- Determination of Recommended Sentencing Range: Once the base offense level and any relevant adjustments are made, the Guidelines provide a sentencing range based on the offense level and the defendant's criminal history category according to the following chart. The chart indicates the minimum and maximum terms of imprisonment recommended under the Guidelines. Importantly, sentencing judges have discretion to depart from the Guidelines if they determine that a variance is warranted based on the nature and circumstances of the offense and the history and characteristics of the defendant. Importantly where only a misdemeanor is charged, it is likely that this lesser offense would and should be taken into account by the sentencing court when imposing the sentence.

SENTENCING TABLE (in months of imprisonment)						
Offense Level	Criminal History Category (Criminal History Points)					
	I (0 or 1)	II (2 or 3)	III (4, 5, 6)	IV (7, 8, 9)	V (10, 11, 12)	VI (13 or more)
Zone A	1	0-6	0-6	0-6	0-6	0-6
	2	0-6	0-6	0-6	0-6	1-7
	3	0-6	0-6	0-6	0-6	2-8
	4	0-6	0-6	0-6	2-8	4-10
	5	0-6	0-6	1-7	4-10	6-12
	6	0-6	1-7	2-8	6-12	9-15
	7	0-6	2-8	4-10	8-14	12-18
	8	0-6	4-10	6-12	10-16	15-21
Zone B	9	4-10	6-12	8-14	12-18	18-24
	10	6-12	8-14	10-16	15-21	21-27
	11	8-14	10-16	12-18	18-24	24-30
Zone C	12	10-16	12-18	15-21	21-27	27-33
	13	12-18	15-21	18-24	24-30	30-37
Zone D	14	15-21	18-24	21-27	27-33	33-41
	15	18-24	21-27	24-30	30-37	37-46
	16	21-27	24-30	27-33	33-41	41-51
	17	24-30	27-33	30-37	37-46	46-57
	18	27-33	30-37	33-41	41-51	51-63
	19	30-37	33-41	37-46	46-57	57-71
	20	33-41	37-46	41-51	51-63	63-78
	21	37-46	41-51	46-57	57-71	70-87
	22	41-51	46-57	51-63	63-78	77-96
	23	46-57	51-63	57-71	70-87	84-105
	24	51-63	57-71	63-78	77-96	92-115
	25	57-71	63-78	70-87	84-105	100-125
	26	63-78	70-87	78-97	92-115	110-137
	27	70-87	78-97	87-108	100-125	120-150
	28	78-97	87-108	97-121	110-137	130-162
	29	87-108	97-121	108-135	121-151	140-175
	30	97-121	108-135	121-151	135-168	151-188
	31	108-135	121-151	135-168	151-188	168-210
	32	121-151	135-168	151-188	168-210	188-235
	33	135-168	151-188	168-210	188-235	210-262
	34	151-188	168-210	188-235	210-262	235-293
	35	168-210	188-235	210-262	235-293	262-327
	36	188-235	210-262	235-293	262-327	292-365
	37	210-262	235-293	262-327	292-365	324-405
	38	235-293	262-327	292-365	324-405	360-life
	39	262-327	292-365	324-405	360-life	360-life
	40	292-365	324-405	360-life	360-life	360-life
	41	324-405	360-life	360-life	360-life	360-life
	42	360-life	360-life	360-life	360-life	360-life
	43	life	life	life	life	life

As an example, if the charge is a felony tax loss of \$300,000, and the defendant is a first-time offender who pleaded guilty and otherwise cooperated, the Guideline sentence would be 12 to 18 months' incarceration. This is calculated as follows:

- Base Offense level = 18 (per the Tax Table because the tax loss is more than \$250,000 but less than \$550,000).
- Decrease of 2 points for first-time offender; and decrease of 3 points for acceptance of responsibility and cooperation with the government.
- Resulting offense level = 13.

- Criminal History Category = I (because the defendant has no prior criminal convictions).
- Per the Sentencing Table, the defendant's Offense Level of 13 and Criminal History Category of I results in a recommended sentence of 12-18 months of imprisonment.

Where the charge is a misdemeanor violation of section 7203, the maximum sentence cannot exceed one year of incarceration. Misdemeanor violations of federal law are classified as follows: Class A misdemeanors are punishable by more than six months but not more than twelve months of imprisonment; Class B misdemeanors are punishable by more than thirty days but not more than six months of imprisonment; Class C misdemeanors are punishable by more than five days but not more than thirty days of imprisonment; and infractions are punishable by more than five days or for which no imprisonment is authorized. See 18 U.S.C. § 3559. The Guidelines do not apply to Class B or C misdemeanors or to infractions. See Guidelines § 1B1.9.

In the case of a misdemeanor conviction, a sentencing court would strongly consider imposing a sentence substantially below the Guidelines as the offense of conviction is a less severe offense than a felony conviction normally contemplated by the Guidelines. For example, in 2013, singer and actress Lauryn Hill was sentenced to three months of imprisonment and three months of home confinement for intentionally failing to file five years of tax returns and not reporting more than \$2.3 million in income. Under the Guidelines, her recommended sentence as a first-time offender would have been 18-24 months' incarceration (the tax loss was approximately \$1 million). However, because she pleaded guilty to misdemeanor violations of section 7203, she likely received a substantially less severe sentence than if she had been convicted of felony violations of section 7203.

V. Conclusion

The IRS's new initiative targeting high-income non-filers is a strong message from the Service about the consequences of non-compliance with the federal tax laws. The announcement underscores the seriousness of non-compliance, with potential enforcement actions including audits, collection activities, and even criminal prosecution, which could include incarceration. Accordingly, non-filers should seek guidance from a qualified tax professional as soon as possible as prompt corrective action can avoid some of the more dire consequences of the non-filing.

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Additional information on the firm is available at <http://www.taxlitigator.com>.