

You Suspect Your Client Committed Tax Fraud: Now What?

By Stephen A. Josey and Brie Barry*



What is a tax practitioner to do when they suspect—or worse, know—that their client committed tax fraud? In the first and second parts of this three-part series, we discussed the basic elements of civil tax fraud and previewed the consequences that can result from a fraud determination.¹ Those include civil fraud penalties under Code Sec. 6663(a), additions to tax for fraudulent failure to file under Code Sec. 6651(f), criminal sanctions under Code Secs. 7201–7207, and an unlimited period of limitations on assessment under Code Sec. 6501(c)(1). Having identified what constitutes fraud and discussed its potential consequences, we now turn to the practical advice tax professionals can offer clients when fraud is detected or suspected.

Identify the Problem

Most tax practitioners will likely never have a client burst through their office doors confessing to tax fraud. More often, a client tiptoes around the subject when pressed about potential inaccuracies on a filed return. Even so, most clients who have misrepresented something on a tax return understand that our federal tax system runs on voluntary compliance—and that failing to comply can carry consequences.

When a practitioner suspects that a past filing may be tainted by fraud, two things are critical: establishing a baseline of trust with the client and explaining the consequences in plain terms. If the government has not yet flagged the issue, the practitioner should also promptly advise the client of available remedial options. As discussed below, those options narrow considerably if the Internal Revenue Service (“IRS”) already has opened an investigation by the time the taxpayer retains representation.

Understand That Combating Tax Fraud is a Government Priority

The IRS and the U.S. Department of Justice (“DOJ”) have strongly signaled that criminal and civil fraud enforcement will be a priority in the coming years.

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Both the IRS Office of Fraud Enforcement (“OFE”) and IRS Criminal Investigation (“CI”) have voiced a commitment to identifying and investigating tax fraud.² The IRS OFE serves as “the champion for fraud on the civil side,” referring cases that may warrant investigation for criminal prosecution to IRS CI.³ The new IRS Chief Executive Officer has indicated that the IRS OFE will play an outsized role in shrinking the tax gap.⁴ Consistent with this promise, the IRS recently launched a new webpage that will enable taxpayers to confidentially report fraud.⁵

Once IRS CI builds a case, it may refer the matter to the DOJ for prosecution.⁶ IRS CI recently reported that in fiscal year 2025 it identified \$4.5 billion attributable to tax fraud, more than double the amount from fiscal year 2024.⁷ This figure confirms that tax fraud is both pervasive and a high priority for the agency. It also suggests that tax fraud is on the rise, that IRS CI is becoming more sophisticated at detecting it, that those committing fraud are growing more ambitious in their scope, or some combination of the three.

Of course, the DOJ does not have unlimited resources to pursue every criminal tax fraud case, and in the cases that it does bring, it must prove guilt beyond a reasonable doubt—no small task. As a result, it is highly selective in the cases that it chooses to bring. According to the U.S. Sentencing Commission, there were only 360 tax fraud sentencing nationwide in fiscal year 2024.⁸ In those cases, prosecution typically serves as a warning to other taxpayers.

Given resource constraints and lower proof thresholds, civil fraud enforcement has traditionally been more expansive than its criminal counterpart. By comparison, the IRS assessed approximately 1,400 civil fraud penalties totaling roughly \$115 million during the 2024 tax year.⁹ That said, we may be entering a period of more robust criminal enforcement. The Trump Administration recently announced the creation of a DOJ division dedicated to national fraud enforcement, which will assume operational control over the Criminal Division’s Tax Section.¹⁰ Like the IRS CEO’s push to combat fraud as a means of bridging the tax gap, this development signals that fraud prosecutions, including those involving tax fraud, will likely increase in the coming years. Taxpayers who misrepresent their returns would be naive to dismiss the possibility of criminal prosecution.

Taxpayers under criminal tax fraud investigation face a substantial risk of prison time. The U.S. Sentencing Commission reported that tax fraud cases rose 11% in fiscal year 2024 compared to fiscal year 2020.¹¹ Of those sentenced, 66% received prison terms, with an average sentence of 15 months.¹² The government’s high conviction

rate in the cases it chooses to pursue should serve as a clear warning to anyone contemplating tax fraud.

A Clean Slate: Voluntary Disclosure

If you determine that a client engaged in willful conduct—and the client is willing to admit as much—the IRS Voluntary Disclosure Practice (“VDP”) may be an attractive option.¹³ The VDP requires the taxpayer to come clean to the IRS, but a successful submission offers two significant benefits: clarity on penalty exposure and the IRS’ “consideration” of the disclosure when deciding whether to refer the case to criminal prosecution.¹⁴ In practice, while the VDP contains no explicit promise not to prosecute, the IRS is highly unlikely to pursue criminal sanctions against a taxpayer who complies with all of its requirements.¹⁵ This makes sense: the VDP exists to encourage voluntary compliance, and it would offer little incentive if the IRS routinely used submissions to build criminal cases. Accordingly, while the VDP is no guarantee against criminal exposure, it is about as close to a “get out of jail free” card as exists in this area.

A voluntary disclosure is only available if it is timely, truthful, and complete (and if the income at issue does not derive from an illegal source).¹⁶ To be timely, the disclosure must be submitted before the IRS opens a civil or criminal examination, and before the IRS learns of the noncompliance from any other source. If a third party contacts the IRS before your client comes forward, or the IRS discovers the noncompliance through a separate enforcement action, the window has closed.

The process itself is multi-step. Taxpayers must first seek preclearance by submitting basic identifying information (not the full details of the noncompliance), which IRS CI uses to determine whether the taxpayer is eligible to proceed.¹⁷ If preclearance is granted, the taxpayer must then submit a detailed narrative, which IRS CI reviews to determine whether the taxpayer may formally participate in the VDP.¹⁸

The IRS recently invited public comments on proposed updates to the VDP.¹⁹ According to the IRS, the proposed revisions are intended to incentivize noncompliant taxpayers to come into compliance, and would touch on disclosure and compliance requirements, the penalty framework, and the application and processing procedures.²⁰ This period of flux raises practical questions for taxpayers considering the VDP—most notably, whether any changes will apply retroactively to participants who are mid-process when revisions take effect, for better or worse.²¹ Despite this uncertainty, the VDP remains an attractive option in many cases, as successfully completing

the process provides the taxpayer with a meaningful degree of finality.

Another Route: Amending Tax Returns Without Voluntary Disclosure

Amending problematic tax returns outside of the VDP can sometimes be a sensible approach. When a taxpayer is not yet under investigation and chooses to amend returns to correct prior fraudulent filings, the IRS and DOJ have historically not pursued criminal charges with great vigor. The DOJ recognizes that it is far harder to prosecute a taxpayer who voluntarily made amends before being caught than one who never corrected past noncompliance, or who only took corrective steps after coming under scrutiny.

That said, amending a fraudulent return is not a silver bullet. While the return can be corrected and the proper tax assessed, submitting a fraudulent original return is a bell that cannot be unrung. The IRS retains the right to investigate and, unlike with a voluntary disclosure, may assert any penalties it deems appropriate, including the 75% civil fraud penalty for each year in which fraud is present. For this reason, where the VDP is available, it is often the safer choice, particularly when the fraud is clear-cut and spans multiple years, as penalty exposure is capped under that program.

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Fraud, however, is often not clear-cut. Misstatements and misrepresentations on tax returns can come in varying shades of gray. Where a taxpayer's situation falls in that gray zone, attempting to file a Qualified Amended Return ("QAR") may be worth considering. To qualify, a taxpayer must generally file the amended return before certain triggering events occur—such as being contacted by the IRS.²² A QAR is only effective if it is timely and the IRS concludes that the original return was not fraudulent.²³ For this reason, practitioners should carefully analyze the badges of fraud discussed in our earlier articles before advising a taxpayer on whether the IRS is likely to accept an amended return as a QAR. The primary benefit of a QAR is that, if accepted, the taxpayer avoids liability for accuracy-related penalties under Code Sec. 6662 on the

additional tax reported, a result that can significantly reduce overall financial exposure.²⁴

Even where a QAR is not available, amending a return may still offer some benefit. It can provide a degree of finality, and where an error on a prior return risks carrying forward into future years, an amendment creates an opportunity to correct the issue and establish a clean baseline going forward. As noted, however, amending a return does not cure the underlying fraud—the period of limitations on assessment remains open indefinitely, even after a corrected return is filed. This unsatisfactory result may nonetheless be the only viable path for a taxpayer who wants to come clean before being caught but cannot access the VDP (for instance, because the original fraud involved illegal source income).

Do Something by Doing Nothing

Finally, in some circumstances, the best advice may be to do nothing. There is no legal requirement that a taxpayer file an amended return, nor is the IRS required to accept one if filed.²⁵ While an amendment may be the right course when neither the VDP nor a QAR is available, there are scenarios where it is inadvisable. If a taxpayer is already subject to an eggshell audit or a grand jury investigation, filing an amended return could do more harm than good by drawing attention to an issue that is already under close scrutiny. However, practitioners should understand that "do nothing" means refraining from further action with respect to fraud that has already occurred. It does not mean perpetuating the fraud.

It bears emphasizing that no circumstance justifies advising a taxpayer to file further false or fraudulent returns. While there is no legal obligation to amend or correct past noncompliance, a tax practitioner cannot and must not participate in any prospective noncompliance. If a position erroneously taken on a prior return would ordinarily carry forward into a subsequent year, such as a fraudulently claimed capital loss that has not been fully utilized, the practitioner cannot prepare a return that claims any benefit flowing from that tainted position.

The ABA Model Rules of Professional Conduct ("Model Rules"), Circular 230, and the American Institute of Certified Public Accountants' ("AICPA's") Statement on Standards for Tax Services ("SSTS") address many thorny ethical issues that may arise when practitioners find themselves advising a client who has committed tax fraud. As a general rule, it is wise for practitioners to familiarize themselves with these rules periodically to be prepared when ethical issues inevitably arise. For example, the SSTS provides in relevant part:

If a member believes that a taxpayer may face possible exposure to allegations of fraud or other criminal misconduct, the member should promptly advise the taxpayer to consult with an attorney before the taxpayer takes any action. The member should also consider consulting with the member's legal counsel before deciding whether to provide advice to the taxpayer and whether to continue a professional or employment relationship with the taxpayer.²⁶

There has been recent debate over the interplay between the Model Rules, Circular 230, and the SSTS. This debate

was spurred in part by proposed amendments to Circular 230 that would require tax practitioners to advise clients to take corrective action with respect to errors or omissions on a return.²⁷ This proposed requirement conflicts with the current version of Circular 230, which obligates practitioners only to advise the client promptly of the noncompliance, error, or omission and to explain the consequences.²⁸ For attorneys, it also arguably conflicts with the Model Rules.²⁹ Whether the proposed amendments will be finalized remains to be seen. What is clear, however, is that when a practitioner suspects fraud is at issue, the client should be advised to consult with an attorney promptly.

ENDNOTES

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- ² See Marie Sapirie, *The Mission for the IRS's Cool Cats: More With Less?*, TAX NOTES (Jan. 26, 2026), www.taxnotes.com/featured-analysis/mission-irss-cool-cats-more-less/2026/01/23/7twrk; Nathan J. Richman, *'Tax Enforcement Is Not Dead,' Departing IRS Fraud Counsel Says*, TAX NOTES (Oct. 6, 2025), www.taxnotes.com/taxpractice/fraud-civil-and-criminal/tax-enforcement-not-dead-departingfraudcounselsays/2025/10/06/7t211?highlight=%22tax%20fraud%22%20%2B%20%22voluntary%20disclosure%22; James Lee & Damon Rowe, *Get a closer look at how IRS Criminal Investigation and the newly established Office of Fraud Enforcement work to combat tax fraud* (Nov. 19, 2021), www.irs.gov/about-irs/irs-priorities-detecting-fraud-and-protecting-taxpayers.
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- ¹¹ U.S. Sentencing Commission, *supra* note 8.
- ¹² *Id.*
- ¹³ IRM 9.5.11.9 (Nov. 19, 2025).
- ¹⁴ *Id.*
- ¹⁵ Bryan C. Skarlatos & Stephen A. Josey, *To Amend or Not to Amend: Correcting Non-Compliance on Past Returns*, J. TAX PRACT. PROC., Feb.-Mar. 2019, at 15, 21.
- ¹⁶ IRS, *IRS Criminal Investigation Voluntary Disclosure Practice*, www.irs.gov/compliance/criminal-investigation/irs-criminal-investigation-voluntary-disclosure-practice (last updated Feb. 12, 2026); Daniel N. Price, *A Plain Language Handbook on the IRS Voluntary Disclosure Practice*, www.pricetaxlaw.com/_files/ugd/6311c3_1212b79209084a499ffde0e513bd9c57.pdf?index=true (last visited Feb. 22, 2026).
- ¹⁷ IRM 9.5.11.9.1 (Nov. 19, 2025).
- ¹⁸ *Id.*
- ¹⁹ IRS News Release, IR-2025-124, Dec. 22, 2025 (allowing public comments through Mar. 22, 2026).
- ²⁰ *Id.*
- ²¹ Price, *supra* note 16.
- ²² Reg. §1.6664-2(c)(3).
- ²³ *Id.* subpara. (2) ("The amount shown as the tax by the taxpayer on his return includes an amount shown as additional tax on a qualified amended return ... except that such amount is not included if it relates to a fraudulent position on the original return.")
- ²⁴ *Id.*
- ²⁵ E. Badaracco, Sr., SCT, 84-1 USTC ¶19150, 464 US 386, 393, 104 SCT 756 ("[T]he Internal Revenue Code does not explicitly provide either for a taxpayer's filing, or for the Commissioner's acceptance, of an amended return; instead, an amended return is a creature of administrative origin and grace.")
- ²⁶ SSTS No. 1, §1.2.9 (effective Jan. 1, 2024).
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