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Internal Revenue Manual 25.1.2.3

Indicators of Fraud

1. Listed below are categories of fraud indicators. Each category list is not intended to be all-inclusive, instead citing examples of actions taxpayers may take to deceive or defraud.

2. The following table shows indicators of fraud based on the taxpayer's income:

Indicators of Fraud—Income
Omitting specific items where similar items are included.
Omitting entire sources of income.
Failing to report or explain substantial amounts of income identified as received.
Inability to explain substantial increases in net worth, especially over a period of years.
Substantial personal expenditures exceeding reported resources.
Inability to explain sources of bank deposits substantially exceeding reported income.
Concealing domestic or foreign bank accounts, brokerage accounts, digital assets such as virtual currency or other property.
Inadequately explaining dealings in large sums of currency, or the unexplained expenditure of currency.
Consistent concealment of unexplained currency, especially in a business not routinely requiring large cash transactions.
Failing to deposit receipts in a business account, contrary to established practices.
Failing to file a tax return, especially for a period of several years, despite evidence of receipt of substantial amounts of taxable income.

Indicators of Fraud—Income
Cashing checks, representing income, at check cashing services and at banks where the taxpayer does not maintain an account.
Concealing sources of receipts by false description of the source(s) of disclosed income, and/or nontaxable receipts.

3. The following table shows indicators of fraud based on the taxpayers expenses and deductions:

Indicators of Fraud—Expenses or Deductions
Claiming fictitious or substantially overstated deductions.
Claiming substantial business expense deductions for personal expenditures.
Claiming dependency exemptions for nonexistent, deceased, or self-supporting persons. Providing false or altered documents, such as birth certificates, lease documents, school/medical records, for the purpose of claiming the education credit, additional child tax credit, earned income tax credit (EITC), or other refundable credits.
Disguising trust fund loans as expenses or deductions.

4. The following table shows indicators of fraud based on the taxpayer’s books and record keeping:

Indicators of Fraud—Books and Records
Multiple sets of books or no records.
Failure to keep adequate records, concealment of records, or refusal to make records available.
False entries, or alterations made on the books and records; back-dated or post-dated documents; false invoices, false applications, false statements, or other false documents or applications.
Invoices are irregularly numbered, unnumbered or altered.
Checks made payable to third parties that are endorsed back to the taxpayer. Checks made payable to vendors and other business payees that are cashed by the taxpayer.

Indicators of Fraud—Books and Records
Variances between treatment of questionable items as reflected on the tax return, and representations within the books.
Intentional under- or over-footing of columns in journal or ledger.
Amounts on tax return not in agreement with amounts in books.
Amounts posted to ledger accounts not in agreement with source books or records.
Journalizing questionable items out of correct account.
Recording income items in suspense or asset accounts.
False receipts to donors by exempt organizations.

5. The following table shows indicators of fraud based on how the taxpayer allocates income:

Indicators of Fraud—Allocations of Income
Distribution of profits to fictitious partners.
Inclusion of income or deductions in the tax return of a related taxpayer, when tax rate differences are a factor.

6. The following table shows indicators of fraud based on the conduct and actions of the taxpayer:

Indicators of Fraud—Conduct of Taxpayer
False statement about a material fact pertaining to the examination.
Attempt to hinder or obstruct the examination. For example, failure to answer questions; repeated cancelled or rescheduled appointments; refusal to provide records; threatening potential witnesses, including the examiner; or assaulting the examiner.
Failure to follow the advice of accountant, attorney or return preparer.

Indicators of Fraud—Conduct of Taxpayer
Failure to make full disclosure of relevant facts to the accountant, attorney or return preparer.
The taxpayer’s knowledge of taxes and business practices where numerous questionable items appear on the tax returns.
Testimony of employees concerning irregular business practices by the taxpayer.
Destruction of books and records, especially if just after examination was started.
Transfer of assets for purposes of concealment, or diversion of funds and/or assets by officials or trustees.
Pattern of consistent failure over several years to report income fully.
Proof that the tax return was incorrect to such an extent and in respect to items of such magnitude and character as to compel the conclusion that the falsity was known and deliberate.
Payment of improper expenses by or for officials or trustees.
Willful and intentional failure to execute pension plan amendments.
Backdated applications and related documents.
False statements on Tax Exempt/Government Entity (TE/GE) determination letter applications.
Use of false social security numbers.
Submission of false Form W-4.
Submission of a false affidavit.
Attempt to bribe the examiner.
Submission of tax returns with false claims of withholding (Form 1099-OID, Form W-2) or refundable credits (Form 4136, Form 2439) resulting in a substantial refund.
Intentional submission of a bad check resulting in erroneous refunds and releases of liens.

Indicators of Fraud—Conduct of Taxpayer
Submission of false Form W-7 information to secure Individual Taxpayer Identification Number (ITIN) for self and dependents.

7. The following table shows indicators of fraud based on how a taxpayer may hold title in, or use assets:

Indicators of Fraud—Methods of Concealment
Inadequacy of consideration.
Insolvency of transferor.
Asset ownership placed in other names.
Transfer of all or nearly all of debtor's property.
Close relationship between parties to the transfer.
Transfer made in anticipation of a tax assessment or while the investigation of a deficiency is pending.
A concealed interest in the property transferred.
Transaction not in the usual course of business.
Retention of possession or continued use of asset.
Transactions surrounded by secrecy.
False entries in books of transferor or transferee.
Unusual disposition of the consideration received for the property.
Use of secret bank accounts for income.
Deposits into bank accounts under nominee names.
Conduct of business transactions in false names.