THE WALL STREET JOURNAL.

TAX REPORT

The $26 Million Question: What Happens if You Don’t File Your Taxes for a Decade?

Expect an unhappy return if you don’t pay or submit your IRS bill, as penalties and interest will quickly mushroom, our tax columnist writes.

By Laura Saunders

Even if you don’t go to jail, blowing off the Internal Revenue Service is a really bad idea.

Take Larry Cecil Cabelka of Megargel, Texas. Mr. Cabelka didn’t submit tax returns for 12 years during the 1990s and 2000s, according to a March 26 ruling in a civil case by a U.S. appeals court. As a result, said the court, he owes the U.S. more than $26 million.Mr. Cabelka, who has worked as a farmer, harvester and farm-equipment dealer, says he doesn’t believe he should owe the $26 million because income and bank accounts attributed to him weren’t his, and that he thought his then-wife was filing some of his returns. He also calls a government attorney in his case “crooked and deceitful.”

“I don’t have the assets to pay millions of dollars of taxes,” he says.

‘IRS debts grow faster than other debts because of daily compounding of interest on the tax and penalties.’

Bryan Skarlatos, a criminal tax lawyer in New YorkMr. Cabelka’s biggest mistake, in addition to not paying his taxes, is that he allowed interest and penalties to pile up because he didn’t file his returns. About two-thirds of Mr. Cabelka’s bill consists of these items, according to his appeals-court attorney, Christian Weiler of New Orleans.His tax debt includes IRS penalties for Failure to File a return and Failure to Pay taxes due. Each one mounts over time to 25% of the unpaid tax and causes an IRS bill to mushroom. Mr. Cabelka didn't file returns for 1997-2003 and 2005-2009, according to the federal court decisions."The outcome of this case is a shame, because so much of his tax debt was absolutely avoidable," says Josh Ungerman, a former trial attorney for the IRS and Department of Justice who is now a tax lawyer in Dallas. He adds that it's the largest tax bill for failing to file returns he has ever seen.Taxpayers can often avoid these stiff penalties by taking simple steps. For example, a filer who submits a Form 4868 extension by April 15 gains six months to complete a return, although taxes must be paid by the April due date.Mr. Ungerman adds that if a taxpayer needs even more time, he or she may stop the Failure to File penalty by submitting an incomplete return based on the best available information. Then the filer should submit a complete amended return as soon as possible.If missing personal deductions are an issue, another strategy is to file a return using the standard deduction and revise it when write-offs are known.

More Tax ReportsA SALT-y Tax Problem You Didn't Know You Had

Meghan Markle Is About to Have a Little Bundle of Tax Headaches

How the Wealthy Like Jack Benny Avoided a 70% Tax Rate

The Failure to Pay penalty kicks in as of the April due date. Interest on taxes due accrues from that date, and eventually there's interest on the penalty as well. The current annual interest rate is 6%, compounded daily, and the rate can reset quarterly.For filers who don't have the money to pay their bill, the IRS has an online payment plan for those owing less than $50,000 who can pay within six years. Approval is almost automatic if the filer has a good tax record, according to an IRS spokesman, and using it lowers the penalty a bit. The agency also has other payment options.

But Bryan Skarlatos, a criminal tax lawyer in New York, advises people who can't pay their tax bills to borrow from another source if possible.

"IRS debts often grow faster than other debts because of daily compounding of interest on the tax and penalties," he says. He adds that the IRS has super-creditor status, so it can seize money from a filer's bank account or wages.Mr. Cabelka didn't take such steps to minimize penalties. Then, because he didn't file returns, the IRS exercised its right to fill out substitute returns for him.These returns are usually a disaster, say tax specialists, because the IRS includes a taxpayer's income it knows about but not deductions it's unaware of. The agency determined that Mr. Cabelka had $3.3 million of income in 2000, according to one court decision. Mr. Weiler says his client's taxable income was far lower because of legitimate business expenses and issues the IRS didn't consider.With interest and penalties, that $3.3 million grew to $4.9 million by June 30, 2017—and that's just one year of 12.

Mr. Cabelka also made a misstep in not making good use of professional tax help early on. Mr. Skarlatos says a professional would, among other things, have worked to whittle the tax owed, which also eliminates the interest and penalties on it.

Instead, Mr. Cabelka represented himself when the IRS asked the federal court for Northern District of Texas for more time to collect his tax debt. In court, he argued against the IRS and lost. He then appealed his case to the Fifth Circuit in New Orleans—represented by Mr. Weiler—but lost that as well.As a result, Mr. Cabelka owes the IRS more than $26.4 million, with interest still growing. Unless he successfully appeals to the Supreme Court or gains a rehearing in a lower court, U.S. officials have many more years to collect from him. They could also accept an "offer in compromise," settling the bill for much less.

But at least he won't go to jail, as the U.S. doesn't have debtors' prisons for IRS bills.Write to Laura Saunders at laura.saunders@wsj.com