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By Kelly A. McGinnity

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by Kelly A. McGinnity


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Kelly A. McGinnity is a partner at Schlack & McGinnity PC. This report was adapted from a research paper prepared for the tax LLM seminar at Loyola University Chicago School of Law.

In this report, McGinnity analyzes the legislative history, IRS guidance, and case law on the indefinite assessment period under section 6501(c)(1) for false or fraudulent returns when the fraud is on the part of the preparer rather than the taxpayer.

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I. Introduction

As most taxpayers know, the IRS generally does not have unlimited time to assess income tax against them. In most cases, section 6501(a) establishes a three-year limitations period for assessment. However, there are several exceptions to this general rule. Section 6501(c)(1), for example, provides an exception for ''false or fraudulent return[s] with the intent to evade tax.'' For those returns, the assessment period remains open indefinitely and the IRS can assess tax at any time.

Court decisions have created a divide on whether the requisite intent to evade tax under section 6501(c)(1) is that of the taxpayer, the preparer, or, oddly enough, the return itself.[1] Although the statute is silent about whose intent controls, the IRS has recently taken the position that the intent can be either that of the taxpayer or the preparer.[2] Not surprisingly, taxpayers with no knowledge that their preparers made fraudulent returns with the intent to evade tax have argued that they should not be subject to open-ended assessments for wrongful acts committed by the preparers.[3]

This report details the history of the unlimited assessment period for false or fraudulent returns and examines the code's definition of fraud since 1918. It analyzes recent and not-so-recent IRS chief counsel advice and court decisions on the issue of whose fraud is relevant for the application of section 6501(c)(1). It also looks at the fairness and due process concerns that arise when taxpayers are penalized for acts committed by their return preparers.[4] Finally, it concludes that taxpayers should not bear responsibility for fraudulent acts of their preparers absent evidence of actual involvement or knowledge on the part of the taxpayer.[5]

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[1] *See, e.g.*, *BASR Partnership v. United States*, 795 F.3d 1338 (Fed. Cir. 2015), *aff'g* 113 Fed. Cl. 181 (2013); *City Wide Transit v. United States*, 709 F.3d 102 (2d Cir. 2013), *rev'g* T.C. Memo. 2011-279; and *Allen v. Commissioner*, 128 T.C. 37 (2007).

[2] *See* FSA 200126019.

[3] *See* Ronald Stein, ''Whose Fraudulent Intent Can Extend the Time for Assessing Tax?'' 124 *J. Tax'n* 205 (2016) (''the government's expansive reading of section 6501(c)(1) serves its interest of tax collection, but leads to statutory disharmony, and other considerations weigh against it, as well. The cause of sound tax administration would be well served by laying the present interpretational dispute to rest as expeditiously as possible.'').

[4] For an excellent analysis of the unfairness of section 6501(c)(1)'s unlimited assessment period in general, see Ausher M.B. Kofsy, ''Because Forever Is Too Long,'' 37 *W. New Eng. L. Rev.* 265 (2015) (''the incongruent unlimited tax writ is no longer, if it ever was, appropriate'').

[5] Preparer fraud manifests itself in various ways. Sometimes taxpayers are complicit. Often the fraud is coincidental to an enrichment or embezzlement scheme. Other frauds have involved illegal tax shelters. According to the IRS website, return preparers have been convicted of, or have pleaded guilty to,

(Footnote continued on next page.)

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II. Section 6501(c)(1)

A. Legislative History of Section 6501(c)(1)

The open-ended limitations period for assessment of tax in cases of false or fraudulent returns dates back to the Revenue Act of 1918. The language of section 250(d) of the 1918 act, the predecessor of section 6501(c)(1), was remarkably similar to the current statute's unlimited assessment period for "false or fraudulent returns with the intent to evade tax." Section 250(d) stated in part:

> In the case of such false or fraudulent returns [with the intent to evade the tax], the amount of tax due may be determined at any time after the return is filed, and the tax may be collected at any time after it becomes due.

By the time the 1939 code was enacted, language identical to what is now section 6501(c)(1) existed in its predecessor provision, section 276:

> In the case of a false or fraudulent return with intent to evade tax or of a failure to file a return the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time.

Current section 6663 imposes civil fraud penalties when "any part of any underpayment of tax required to be shown on a return is due to fraud." Because section 6663 was enacted simultaneously with section 6501(c)(1), it is referenced by litigants and the courts when attempting to interpret the statutory language of section 6501(c)(1). Like the predecessor to section 6501, the predecessor to section 6663 was also found in section 250 of the Revenue Act of 1918. Section 250(b) of the 1918 act became section 6663, while section 250(d) became section 6501(c)(1). Because both sections originated in section 250 of the 1918 law, taxpayers have argued that the definition of fraud in both sections should have the same meaning.[6]

B. Fraud Undefined in the Code

Fraud is not defined in the code or the regulations, but a 1999 Tax Court decision provided the following definition: "intentional wrongdoing on the part of a taxpayer with the specific purpose to evade a tax believed to be owed."[7] In light of the absence of a definition of fraud for purposes of section 6501(c)(1), other sections of the code must be examined for guidance.[8]

Section 6663 imposes a civil fraud penalty on a taxpayer when an underpayment of tax required to be shown on a return is the result of fraud. A long-standing definition of fraud was articulated by the Fifth Circuit in the context of that penalty:

> Negligence, whether slight or great, is not equivalent to the fraud with intent to evade tax named in the statute. The fraud meant is actual, intentional wrongdoing, and the intent required is the specific purpose to evade a tax believed to be owing.[9]

Applying the same definition of fraud for statute of limitations and civil penalty purposes is logical in view of the common history of these provisions, particularly their common origins. By including both provisions in section 250 of the Revenue Act of 1918, Congress presumably intended that the term "fraud" have the same meaning for both purposes.[10]

In FSA 200104006, the IRS endorsed the position that the definition of fraud under the section 6663 fraud penalty should also apply for purposes of section 6501(c)(1). The Fifth Circuit in *Payne* provided the following additional guidance:

> Fraud implies bad faith, intentional wrongdoing and a sinister motive. It is never imputed or presumed and the court should not sustain findings of fraud upon circumstances which at most create only suspicion. . . . [The government's determination of a deficiency is presumptively correct, but when the government relies on an exception to the three-year statute of limitations] it bears the burden of proving its entitlement to rely on that exception. . . . There must be additional evidence, independent of the general presumption of correctness [of the deficiency determination], from which fraudulent intent on the part of the taxpayer can be properly inferred.[11]

Further, the Ninth Circuit articulated what it deems to be "badges of fraud," which have been followed by other courts when determining whether fraud exists:

1. understatement of income;
2. inadequate records;
3. failure to file tax returns;

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felony charges, and courts have issued more than 255 permanent injunctions against abusive tax scheme promoters and abusive return preparers since 2003.

[6]*See* Steve Tosher and Della Rauserman, "Surprise — the Fraud of Your Tax Preparer May Extend the Statute of Limitations on Tax Assessments," 15 *J. Tax Prac. & Proc.* 31 (Apr.-May 2013).

[7]*Sadler v. Commissioner*, 113 T.C. 99, 102 (1999).

[8]*See* FSA 200104006.

[9]*Mitchell v. Commissioner*, 118 F.2d 308 (5th Cir. 1941).

[10]*Commissioner v. Estate of Ridgway*, 291 F.2d 257, 259 (3d Cir. 1961).

[11]*Payne v. Commissioner*, 224 F.3d 415, 420-421 (5th Cir. 2000).

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4. implausible or inconsistent explanations of behavior;

5. concealing assets; and

6. failure to cooperate with tax authorities.[12]

Courts applying the badges of fraud have done so with the taxpayer's activities and intent in mind.[13] As noted above, *Payne* refers to the necessity of proving fraudulent intent on the part of the taxpayer,[14] and the Tax Court has indicated that "fraud by its very nature is a question of a taxpayer's intent."[15]

Internal Revenue Manual section 25.1.2.3 describes the following "indicators of fraud":

> Indicators of Fraud are actions that may have been done for the purpose of deceit, concealment or to make things seem other than what they are. Examples include substantial unexplained increases in net worth, substantial excess of personal expenditures over available resources, and bank deposits from unexplained sources substantially exceeding reported income. See IRM 25.1.1.3(1)(a), *Indicators of Fraud vs. Affirmative Acts of Fraud*, in and of themselves do not establish that a particular process was done. Fraud is an actual, intentional wrongdoing. While bad faith or evil intent need not be shown, it must be shown that the taxpayer had the specific purpose to evade a tax believed to be owed in mind when performing an act (or making an omission).
>
> Affirmative Acts (Firm Indications) of Fraud are those actions that establish that a particular process was deliberately done for the purpose of deceit, subterfuge, camouflage, concealment, some attempt to color or obscure events, or make things seem other than what they are. Examples include omissions of specific items where similar items are included, concealment of bank accounts, failure to deposit receipts to business accounts, and covering up sources of receipts.

C. The IRS's Evolving Position

1. FSA 2001040006. Under section 6663, it is clear that the taxpayer's conduct leading to the fraud penalty must be intentional, knowing, and wrongful.[16] Thus, civil fraud penalties would not be assessed against taxpayers for wrongful conduct of their return preparers. One might expect that the same standard would apply for the assessment statute, but current IRS guidance on section 6501(c)(1) makes clear that the fraud of *either* the taxpayer or the preparer is sufficient to trigger the unlimited statute of limitations.[17] This was not always the IRS's position.

In early 2001 the IRS released field service advice providing guidance on whether a preparer's fraudulent intent in making an income tax return is sufficient to render section 6501(c)(1) applicable to the taxpayer.[18] The hypothetical taxpayer was a truck driver who heard that a preparer-accountant could obtain huge tax refunds for truck drivers based on their diesel fuel purchases. The taxpayer retained the services of the preparer, who filed fraudulent returns on behalf of the taxpayer for several years, which resulted in tax refunds. The preparer was experienced and knew that the taxpayer was not entitled to the diesel fuel excise tax credit on which each of the refunds was based. The preparer was then prosecuted for preparing false returns for the taxpayer and several other truck drivers.

The IRS concluded that the preparer's fraudulent intent alone is insufficient to extend the limitations period for assessment indefinitely. In its analysis, the IRS rebutted several arguments that support using the preparer's fraud as the basis for holding the statute of limitations open. First, it found that preparer fraud on a taxpayer's return is dissimilar to the fraud of one spouse, which is sufficient to render section 6501(c)(1) applicable to both spouses.[19] The IRS rejected that analogy because spouses who file a joint tax return are jointly and severally liable for the taxes on that return, whereas a preparer is neither a party to the return nor jointly liable with the taxpayer.

The IRS also rejected the comparison of preparer fraud with fraudulent intent on the part of corporate officers and employees, which may be imputed to the corporation in some situations.[20] According to the IRS's analysis in FSA 200104006, preparer fraud is different because a corporation is an artificial person that acts through its employees, officers, and directors.[21] Thus, to prove that a corporate

[12] *Bradford v. Commissioner*, 796 F.2d 303, 307 (9th Cir. 1986).

[13] *See, e.g.*, *Bacon v. Commissioner*, T.C. Memo. 2000-257; and *Kaissy v. Commissioner*, T.C. Memo. 1995-474.

[14] *Payne*, 224 F.3d at 420 and 421.

[15] *Kaissy*, T.C. Memo. 1995-474 at *18.

[16] *See* IRM section 25.1.2.3.

[17] FSA 200126019.

[18] FSA 200104006.

[19] *See Vannaman v. Commissioner*, 54 T.C. 1011 (1970); *Estate of Upshaw v. Commissioner*, 416 F.2d 737 (7th Cir. 1969); and *Howell v. Commissioner*, 175 F.2d 240 (6th Cir. 1949).

[20] *See Ruidoso Racing Association Inc. v. Commissioner*, 476 F.2d 502 (10th Cir. 1973), *aff'g* T.C. Memo. 1971-194.

[21] *See Grant v. Commissioner*, T.C. Memo. 1994-161.

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return was fraudulent, the intent of the corporation's officers and employees must necessarily be considered. By contrast, an individual taxpayer may act independently of the preparer and his intent may differ from that of the preparer. The focus in proving fraud must therefore be on the individual's intent rather than the preparer's intent. The IRS concluded that section 6501(c)(1) does not by its express language require that the intent to evade tax be the personal intent of the taxpayer, but, as noted, the IRS ultimately decided in the memorandum that the preparer's fraudulent intent alone is insufficient to trigger the statute.

2. FSA 200126019. A mere six months after it released FSA 200104006, the IRS reversed itself. In FSA 200126019, which was based on the same hypothetical fact pattern and written by the same author as the earlier field service advice, the IRS took the position that section 6501(c)(1) applies for any fraudulent return with intent to evade tax — including returns made by a preparer. Nothing in the law had changed in the intervening six months, but the IRS rationalized its flip-flop by focusing on the agency relationship between the taxpayer and the return preparer, as well as the investigative difficulties presented when fraudulent returns are filed by taxpayers or preparers. The IRS asserted that under agency principles, the preparer was the taxpayer's agent, who committed a fraud on the government that directly benefited the taxpayer at the expense of the government. Based thereon, the IRS said the taxpayer must bear responsibility for the actions of the preparer.

On the difficulty of discovering fraudulent tax returns, the IRS noted that fraudulent returns generally appear correct on their face and that the true facts concerning the tax liability are deliberately withheld from the agency. It then quoted passages from the Supreme Court's decision in *Badaracco*[22]:

> "Fraud cases ordinarily are more difficult to investigate than cases marked for routine tax audits. Where fraud has been practiced, there is a distinct possibility that the taxpayer's underlying records will have been falsified or even destroyed." Moreover, "three years may not be enough time for the Commissioner to prove fraudulent intent."

The IRS stated its belief that section 6501(c)(1) provides an unlimited assessment period as a way to compensate for the burden imposed on the agency of having to prove fraudulent intent and determine the correct tax liability. Observing that this was the only way the government's interest could be protected, the IRS concluded that for purposes of section 6501(c)(1), it doesn't matter whether the fraud is that of the taxpayer or of the taxpayer's agent.

The IRS said that it was unnecessary to reach the same conclusion regarding the fraud penalty under section 6663:

> We do not dispute that the same definition of fraud applies for purposes of section 6501(c)(1) and section 6663. However, the focus of the fraud inquiry differs for these two sections because only section 6663 is penal in nature. Congress intends section 6663 "to punish and deter wrongful conduct." . . . In contrast, the purpose of section 6501(c)(1) is to preserve the ability of the government to assess the correct tax liability in a situation where the return was prepared in a manner calculated to conceal that liability. Congress logically could, and we believe Congress did, intend the focus of a fraud inquiry to be different in these two sections. Thus, we conclude that fraud exists for purposes of section 6501(c)(1) when a taxpayer's agent commits fraud, even though the fraud penalty may not be imposed based solely on the fraud of the taxpayer's agent."

The IRS cited *Caulkins*, a Tax Court decision holding that "fundamental agency law provides that the actions of the tax preparer (agent) are imputed to the taxpayer (principal)."[23] In *Caulkins*, the taxpayer should have attached a particular form to his income tax return to make a depreciation election, but the preparer failed to complete the necessary form. The Tax Court held that when a taxpayer signs and thereby adopts a tax return made by a preparer, the taxpayer bears the consequences of errors made by the preparer. This is a well-settled principle of tax law.[24]

Finally, the IRS rejected the badges of fraud analysis that had been established by courts in determining the existence of taxpayer fraud.[25] That analysis was inappropriate, according to FSA 200126019, because the specific factual issues presented for chief counsel advice were not present in any of the cases applying the badges of fraud.

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[22]*Badaracco v. Commissioner*, 464 U.S. 398 (1984).

[23]*Caulkins v. Commissioner*, T.C. Memo. 1984-504.

[24]*Magill v. Commissioner*, 70 T.C. 465, 479-480 (1978), *aff'd*, 651 F.2d 1233 (6th Cir. 1981); *Teschner v. Commissioner*, T.C. Memo. 1997-498; *Kooyers v. Commissioner*, T.C. Memo. 2004-281; *Estate of Clause v. Commissioner*, 122 T.C. 115, 123-124 (2004); *Am. Props. Inc. v. Commissioner*, 28 T.C. 1100, 1116-1117 (1957), *aff'd*, 262 F.2d 150 (9th Cir. 1958).

[25]*See, e.g., Bacon*, T.C. Memo. 2000-257; *Kaissy*, T.C. Memo. 1995-474.

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III. Court Decisions

A. *Allen*

In the years since the IRS issued its conflicting field service advice, section 6501(c)(1) has been the subject of litigation, with differing results. In *Allen*,[26] the Tax Court held that the limitations period for assessment is extended under section 6501(c)(1) if the return is fraudulent, even though it was the preparer rather than the taxpayer who had the intent to evade tax. The taxpayer in *Allen* was a truck driver for UPS whose accountant prepared and filed his tax returns for two years. The accountant claimed false and fraudulent deductions for charitable contributions, meals and entertainment, pager and computer expenses, as well as various other expenses. The court referenced the statutory language of section 6501(c)(1) and said that the "plain meaning of the statute indicates that it is the fraudulent nature of *the return* that extends the limitations period."[27] Therefore, the court held that the limitations period for assessing tax against the taxpayer was extended indefinitely.

In reaching its decision, the Tax Court cited cases holding that taxpayers are charged with the "knowledge, awareness, and responsibility" for their tax returns.[28] The court also said that the taxpayer, not the preparer, has the ultimate responsibility to file the return and pay the tax due.[29] Taxpayers cannot generally avoid penalties by relying on an agent.[30]

B. *City Wide*

Six years after *Allen*, the Second Circuit considered the government's appeal in *City Wide*.[31] In *City Wide*, the Tax Court had determined that section 6501(c)(1) did not apply to a taxpayer whose return preparer committed a series of fraudulent and illegal acts without the taxpayer's participation or knowledge. The Second Circuit reversed, finding that section 6501(c)(1) applied and that the IRS could assess unpaid payroll taxes beyond the general three-year limitations period.

The facts of *City Wide* paint a disturbing picture of a preparer who swindled the taxpayer in an elaborate embezzlement scheme. The taxpayer had multiple unpaid payroll tax delinquencies, and it engaged a preparer who falsely claimed to be a CPA. At the preparer's request, the taxpayer signed a blank power of attorney form. Then the preparer falsely informed the taxpayer that he had negotiated a settlement with the IRS that required him to hand-deliver to the IRS the tax forms and certified checks for tax due. The preparer then completed and filed fraudulent Forms 941 in place of the taxpayer's properly prepared and signed Forms 941, altered and deposited the taxpayer's payment checks into his account, drew replacement checks for the lower tax amount that appeared on the fraudulent returns, and pocketed the difference in the tax due on the proper returns and the fraudulent returns. In total, the unscrupulous preparer embezzled $280,000 from the taxpayer.

The IRS pursued a civil collection case against the taxpayer to recover the lost funds, and it assessed additional tax beyond the three-year limitations period. Based on *Allen*, the IRS argued that the statute remained open because of the fraudulent returns filed on behalf of the taxpayer. The Tax Court disagreed. Instead, it found that although the preparer had filed false tax forms, it was not with the primary purpose of evading tax. Rather, the Tax Court held, the sole purpose of the false tax returns was to cover up an elaborate embezzlement scheme that the preparer was operating to the detriment of the taxpayer. Theft from the taxpayer was the preparer's goal, and the fraud on the IRS was only incidental to that goal, according to the Tax Court.

The government appealed, and the Second Circuit sided with the IRS, finding that the Tax Court had erred in determining that the preparer's sole purpose was to evade taxpayer's taxes, even though doing so would benefit the preparer rather than the taxpayer. The Second Circuit found fault with the Tax Court's determination that evading the tax was a secondary or incidental effect of the scam. Rather, the court of appeals determined that tax evasion was a crucial part of the accountant's scheme because it was necessary in order for the accountant to steal funds that the taxpayer believed had been sent to the IRS to pay payroll taxes.

The Second Circuit took time to outline the differences between the types of fraud present in *City Wide* compared with a different sort of fraud that would not lead to the same result:

> This would be another case if, for example, [the accountant] falsely recorded certain personal expenses as corporate expenses on City Wide's ledger that in turn caused City Wide to file a tax return that fraudulently understated its income. If that had been the case, [the accountant's] fraud on the company would have caused the company to file a false return, and we would not assume that the company intended to evade a tax by filing that false

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[26] *Allen*, 128 T.C. 37.

[27] *Id.* at 42 (emphasis added).

[28] *Id*. at 41, citing *Magill v. Commissioner*, 70 T.C. 465, 479-480 (1978), *aff'd*, 651 F.2d 1233 (6th Cir. 1981); *Teschner*, T.C. Memo. 1997-498.

[29] *Id.*, citing *Kooyers v. Commissioner*, T.C. Memo. 2004-281.

[30] *Id.*, citing *Estate of Clause*, 122 T.C. 115, 123-124; *Am. Props. Inc.*, 28 T.C. 1100, 1116-1117, *aff'd*, 262 F.2d 150.

[31] *City Wide*, 709 F.3d 102.

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> return. Here, however, [the accountant's] actions were not as secondary or remote to the fraudulent returns as the Tax Court suggested; [he] was not a third party unrelated to the preparation and filing of the returns.[32]

The result in *City Wide* is a harsh reminder of the IRS's long-standing position that taxpayers bear the ultimate responsibility for their tax filings, including the acts of individuals or organizations that taxpayers hire to prepare their returns.

However, a footnote to the Second Circuit's opinion provides a significant ray of hope for taxpayers who are concerned about the harshness of this result. In footnote 3, we learn that although the taxpayer had argued in the Tax Court that it was not responsible for the fraud of the return preparer, it conceded that point on appeal.[33] Essentially, the taxpayer admitted that it would bear responsibility for the returns filed by the preparer if the court determined that the preparer acted fraudulently. Because of that concession, the court did not address whether scenarios might arise in which a taxpayer would not be liable for the preparer's fraud and the assessment period would not be unlimited under section 6501(c)(1). In other words, the court in dicta left open the possibility of a situation in which a taxpayer could escape liability for fraud committed by an unscrupulous return preparer. This leads us to *BASR Partnership*.[34]

C. *BASR Partnership*

Fraud on the part of someone other than the taxpayer does not automatically expose the taxpayer to liability, according to the Federal Circuit's opinion in *BASR Partnership*.[35] The court of appeals rejected the *City Wide* and *Allen* analyses and instead required the IRS to abide by the three-year limitations period for assessment when the preparer — in this case, an attorney — committed fraud.

BASR Partnership involved a partnership whose attorney structured a son-of-BOSS abusive tax shelter for the entity in 1999. The IRS did not become aware of the fraud until 2010, when it made an adjustment of more than $6 million in taxable income to the partnership's return. On appeal, the taxpayer argued that the statute of limitations for assessment had expired. It was conceded that the attorney had fraudulent intent and that the individual partners did not. Thus, the issue in the case was limited to whether the fraudulent returns prepared and filed by the attorney with intent to evade tax were sufficient for the IRS to invoke the unlimited assessment period under section 6501(c)(1) against the partnership.

As it had in *Allen*, the IRS asserted that the return itself was fraudulent and that section 6501(c)(1) should therefore apply. The Court of Federal Claims rejected the analysis of *Allen* and *City Wide* and instead found that the statute clearly contemplates fraudulent intent *on the part of the taxpayer* in order for the assessment period to be extended indefinitely.

The taxpayer argued that the IRS should be bound by the narrower limitations period of section 6229(c)(1), which applies to partnerships. The court, however, held that section 6229 does not override section 6501's general statute of limitations. But it noted that the words "intent to evade tax" in both section 6229(c)(10) and section 6501(c)(1) have the same meaning.

The claims court agreed with the government that the existence of fraud, regardless of who perpetuated it, makes it much more difficult for the agency to uncover understatements of income. However, it held that the legislative branch was the proper place to address that concern:

> That is not to say that the Government did not advance a number of persuasive policy arguments why [section] 6501(c)(1) needs to be amended, particularly in light of the practical impediments to the discovery of tax fraud. . . . The integrity of our constitutional system, however, rests on each branch of the federal government performing the function specified therein. The function of the court is to interpret, not re-write, the law.[36]

Not unexpectedly, the government appealed *BASR Partnership*. The Federal Circuit, in a surprising 2-1 opinion, affirmed the claims court. Each member of the appellate panel wrote his or her own opinion. Two of the three judges reached the same result on different grounds, and the third judge wrote a dissenting opinion in which she asserted that the Tax Court's decision in *Allen* was correct.

Judge Raymond T. Chen wrote the well-reasoned opinion of the court, which held that taxpayer fraud must exist for section 6501(c)(1) to apply. Chen supported the decision with a detailed analysis of the statutory scheme and the absence of persuasive case law. He also pointed out the questionable change in the IRS's position on this issue:

> It is also worth noting that the Government's interpretation is of relatively recent vintage.

[32]*Id.* at 108.
[33]*Id.* at 107 n.3.
[34]*BASR Partnership*, 795 F.3d 1338.
[35]*Id. See also City Wide*, T.C. Memo. 2011-279.

[36]113 Fed. Cl. at 194.

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> The IRS previously held the exact opposite position on the scope of [section] 6501(c)(1) than the one it asserts in the present case. Namely, in a 2001 Field Service Advisory, the IRS concluded that, although "section 6501(c)(1) does not by its express language require that the 'intent to evade tax' be the personal intent of Taxpayer . . . we nonetheless conclude that the fraudulent intent of the return preparer is *insufficient* to make section 6501(c)(1) applicable." . . . The IRS obviously changed its position on the interpretation of section 6501(c)(1) at some point between 2001 and 2005, when the IRS issued the deficiency notices that led to the *Allen* litigation. It is unclear what prompted this change in the IRS's position, given that Congress had not altered the text of section 6501(c)(1) in any meaningful way over the past century.[37]

Judge Kathleen M. O'Malley's concurring opinion held for the taxpayer but on different grounds. She found that section 6229, not section 6501, was the controlling statute because the taxpayer was a partnership. Because section 6229 requires intent to evade tax by at least one partner, which did not exist in this case, O'Malley would have held in the taxpayer's favor based on that provision. Her concurring opinion didn't address whether section 6501 applies to cases in which there is no fraudulent intent on the part of the taxpayer.

The dissent by Judge Sharon Prost adopted the same reasoning as the Tax Court in *Allen* — that fraudulent returns themselves are envisioned by the statute:

> The majority construes [section] 6501(c)(1) to encompass only the intent of the taxpayer and not the intent of the taxpayer's hired tax professional. In my view, the statute means what it says: the three-year limitation does not apply if the intent to evade tax manifests in a *fraudulent return*.[38]

The IRS filed a petition for a rehearing *en banc*, which was denied in November 2015.

D. *Finnegan*

In an interesting twist, in June 2016 the Tax Court issued a memorandum decision in *Finnegan*,[39] in which it declined to follow the holding of *BASR Partnership*. It instead followed *Allen.* In rejecting reliance on *BASR Partnership*, the court pointed to Proust's "persuasive dissent" in that case, as well as O'Malley's concurring opinion based on the application of section 6229.[40] The Tax Court also noted that neither party before it had cited *BASR Partnership* as authority for its positions. Lastly, the Tax Court explained that the Federal Circuit had no jurisdiction over Tax Court decisions under section 7482(a)(1). Thus, the Tax Court's memorandum decision in *Finnegan* was based on applying *Allen* to the facts.

The facts of *Finnegan* were similar those in *Allen* — a preparer who completed and filed fraudulent returns for the individual taxpayers over several years. After determining that *Allen* was controlling authority, the Tax Court conducted a factual analysis and concluded that the preparer acted fraudulently and with the intent to evade tax. The taxpayers ultimately conceded their responsibility for the deficiencies asserted by the IRS.

IV. What the Court Decisions Mean for Taxpayers

A. Technically, There's a Split in the Circuits

Where does that leave us? To say that there is a split in the circuits on the application of section 6501(c)(1) misses the mark. The decisions in *Allen*, *City Wide*, *BASR Partnership*, and *Finnegan* are not factually similar enough to justify such a broad statement. *Allen* and *Finnegan* involved individual taxpayers whose accountants prepared and filed false and fraudulent returns with the intent to evade tax. In *City Wide*, a corporate taxpayer whose preparer was given carte blanche by the taxpayer proceeded to file a series of fraudulent payroll tax returns as part of an elaborate embezzlement scheme. The taxpayer conceded its responsibility for the tax returns filed by the preparer, so the decision is far less compelling than it appears on its face. *BASR Partnership* was a 2-1 decision involving a partnership that obtained tax advice from a criminally indicted attorney. Only one of the three judges on the Federal Circuit panel held that section 6501(c)(1) did not apply. Because each of these cases has not only a unique fact pattern but also holdings based on different types of taxpayers and different preparers with various forms of fraudulent intent, it stretches logical and legal bounds to lump them all together and simply declare there is a circuit split. Also, critical legal issues were conceded by the taxpayers in both *City Wide* and *Finnegan*; thus, their precedential value is somewhat limited. In my view, it would be imprudent for the IRS or taxpayers to rely on the holdings of any one of these cases absent a nearly identical set of facts.

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[37] *Id.* at 1348.
[38] *Id.* at 1358 (emphasis added).
[39] *Finnegan v. Commissioner*, T.C. Memo. 2016-118.
[40] *Id.* at *18 n.6.

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B. Fairness and Due Process Concerns

That's not to say that taxpayers shouldn't attempt to capitalize on the portions of each decision that are favorable to them. *City Wide*'s dicta, along with *BASR Partnership*'s main opinion, are compelling and provide solid authority that taxpayers can cite to support their argument that preparer fraud alone does not warrant the application of section 6501(c)(1). And Chen's detailed analysis of the legislative origins of section 6501(c)(1) in *BASR Partnership* provides legal rationale that can be applied to all cases in which section 6501(c)(1) is at issue.

Moreover, fundamental fairness and due process concerns can be raised by taxpayers. The effect of an unlimited assessment statute when a return preparer has swindled or misadvised his clients creates patently unfair results for taxpayers who have already been victimized. Additional tax plus interest and penalties accruing over years can quickly multiply a relatively minor understatement into an assessment that destroys taxpayers' businesses and lives. This makes sense when the taxpayer is an active participant in the fraud that created the situation, but it is a harsh result for taxpayers who are not even remotely aware of the preparer's fraud.

V. Conclusion

BASR Partnership coupled with the compelling dicta in *City Wide* gives taxpayers something to hang their hats on when fighting the IRS on assessments made after expiration of the three-year period under section 6501(a). Taxpayers certainly hope that the holding in *BASR Partnership* is part of a trend despite its contradiction with the IRS's current position. I believe *BASR Partnership* has correctly tilted the scales in taxpayers' favor. By holding that fraudulent intent on the part of taxpayers is essential for section 6501(c)(1) to apply, the Federal Circuit has come down on the side of fairness. However, it simultaneously has dealt the IRS a significant financial setback.

An unlimited assessment statute for fraud by a preparer awards the IRS the right to assess taxes well after alleged fraud occurs. One could argue that it also allows the agency to act without diligence or good faith in uncovering fraudulent returns. This is a serious concern for taxpayers who already view the IRS as a slow and unfair bureaucracy.

It remains to be seen what the tax policies of the Trump administration will be, but most of them will probably be pro-business. Thus, it seems unlikely that Congress will heed the Second Circuit's not-so-hidden suggestion to amend the code in a manner consistent with the IRS's position that preparer fraud is enough for section 6501(c)(1) to apply.

In light of the *Allen* and *Finnegan* decisions by the Tax Court, taxpayers affected by IRS assessments made under the color of section 6501(c)(1) would be best served to pay the disputed amount and file refund cases in the Court of Federal Claims rather than going through the Tax Court. That is, until another case is decided. ■

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