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"Understanding The IRS' Heavy-Handed Interpretation Of Tax Fraud," Forbes

Tom Cullinan in Forbes article

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The IRS typically has three years from the time that a taxpayer files a tax return to assess additional tax. One of the exceptions is if the taxpayer files a fraudulent return, which indefinitely extends the assessment period.

Last week, the IRS convinced the United States Tax Court that the fraud exception can apply even when the taxpayer does not act fraudulently. In *Murrin vs Commissioner*, the Tax Court found (based on the parties' agreement) that "[u]nbeknownst to the Murrins, [their return preparer] placed false or fraudulent entries on [their] returns with the intent to evade tax. The Murrins themselves did not put any false or fraudulent information on their returns, nor did they intend to evade tax." "Although the Murrins did not intend to evade tax, their tax return preparer did, and, to that end, he put false or fraudulent information on the Murrins' returns." The Tax Court then gave the IRS an indefinite amount of time to assess additional tax against the Murrins.

In this article, I raise the question whether this is good tax administration and offer some practical advice to protect yourself from this type of bad situation.

Is This Proper Tax Administration?

This is not the first time the Tax Court has agreed with the IRS that a return preparer's fraud gives the IRS unlimited time to assess additional tax against the affected taxpayer. In fact, the Tax Court has accepted the IRS argument in several cases going back to 2007 when it decided *Allen vs Commissioner*, where it held that the IRS did not have to prove that the taxpayer acted fraudulently for their returns to be fraudulent.

Other courts, though, have disagreed with the Tax Court. Both the United States Court of Federal Claims and the United States Court of Appeals for the Federal Circuit rejected Tax Court holdings and the IRS' position in a case called *BASR Partnership vs. United States*, which was finally decided in 2015. (Full disclosure: I litigated and won the *BASR Partnership* case, and technically, the Department of Justice was defending the government.)

Let's start with a question about tax administration. If the Tax Court has interpreted the law correctly, then the IRS is within its rights to take as long as it needs to assess tax against a taxpayer when the person who prepared the tax return does so with the intent to evade tax. My question is, should the IRS be taking that position to begin

"Understanding The IRS' Heavy-Handed Interpretation Of Tax Fraud," Forbes,

Continued

with? I think the answer is "no" and that the IRS is being heavy-handed in doing so.

For example, in *City Wide Transit Inc. v. Commissioner*, the taxpayer (which transported disabled children in New York City) hired a fraudster who falsely held himself out as a certified public accountant. The taxpayer gave the fraudster a blank Power of Attorney, payroll tax returns to give to the IRS and checks to cover the tax. The fraudster embezzled the checks and prepared a second set of returns to file with the IRS, claiming credits that vastly decreased the tax due. He also wrote new checks for the significantly decreased tax, pocketing several hundred thousand dollars for himself.

Those facts scream for sympathy to the taxpayer. Of course the IRS cannot simply forgive taxes when a taxpayer makes a poor and costly choice in who they hire to represent them. But that is not the question. The question is whether that taxpayer should benefit from the statute of limitations that applies in most tax cases – a three-year period after which the IRS can no longer assess additional tax. Unfortunately for the taxpayer, both the IRS and the court answered "no" to that question. In *City Wide Transit*, the IRS successfully argued that the normal three-year statute of limitations did not apply and that it had unlimited time to assess the taxpayer for the additional taxes due (which the taxpayer thought it had already paid). According to the IRS and the court, the tax returns the fraudster filed with the IRS "were false or fraudulent with the intent to evade tax" even though the taxpayer did not intend to evade tax.

There is a legal issue here about whose intent matters. The Tax Court has held in *Allen* and *City Wide* and several other cases including most recently in *Murrin* that it can be the taxpayer's or the return preparer's intent. The government has argued even more broadly that it can also be the intent of someone who gave advice that was material to what was reported on the return even if that person did not physically prepare the return, although that position has not yet gained much traction in the courts. Alternatively, the Court of Federal Claims and the Federal Circuit held in *BASR Partnership* that the government must prove that the *taxpayer*, not any third parties, intended to evade tax.

I am not writing this to debate the legal issue. My point is to question whether we, as taxpayers, want the IRS, our tax administrator, to be making this type of "stretch the law" argument, even if some courts will accept it. The IRS should not try to win at all costs.

The IRS' mission is to "provide America's taxpayers top quality service by helping them understand and meet their tax responsibilities and enforce the law with integrity and fairness to all." Is it fair, though, for the IRS to argue that it has an indefinite amount of time to assess tax against a taxpayer whose return preparer, unbeknownst to them, engaged in fraud, when it has only three years to assess tax against the taxpayer whose return preparer, also unbeknownst to them, makes an innocent mistake in the taxpayer's favor? In both of these circumstances, the taxpayer is not culpable. Why should one taxpayer have to worry about the IRS forever, but not the other? How is that fair?

I should disclose here that I spent part of my career working at the IRS and am proud of my prior service. The IRS serves a critical function, and its employees work hard to serve the American taxpayers. IRS employees are dedicated public servants who perform often thankless work and are often unfairly criticized. Yet, the call for change is warranted. To be frank, I hope the IRS reconsiders and decides to abandon its position on unbeknownst fraud, regardless of its legal merit.

Practical Advice

"Understanding The IRS' Heavy-Handed Interpretation Of Tax Fraud," Forbes,

Continued

This brings me to some practical advice. First, whenever the IRS tries to assess additional tax after the normal three-year period of limitations because a return preparer or tax advisor acted fraudulently, those affected taxpayers should seriously consider avoiding the Tax Court, given the adverse precedent. The taxpayers might instead consider paying the tax and suing for a refund in the Court of Federal Claims, where they are very likely to prevail, given the binding precedent established by the *BASR Partnership* case.

Unfortunately, that in itself can be unfair, as filing suit in the Court of Federal Claims requires the taxpayer to be able to prepay the tax -- something not all taxpayers can do. This also illustrates the sometimes strange nature of the American justice system, in that the outcome of a case can depend entirely on the specific court. In these situations, hiring an experienced tax attorney at the front end can pay significant dividends.

Second, the tax law is complicated. Most taxpayers would be unable to second-guess their return preparers. It seems that the IRS' position only reinforces the notion that taxpayers would be best served working with a reputable return preparer they know and trust.

I will keep hoping, though, that the IRS abandons its position to take a more taxpayer-friendly approach.

Please note that the article is informational only. It does not create an attorney-client relationship, and you should not rely on it for legal advice.

