Taxpayers Take Note: A Fraudulent Return Preparer Means the Statute of Limitations on Assessment Never Ends

by Robert S. Horwitz

Each year the majority of taxpayers who retain the services of return preparers to navigate the complexities of the tax laws to ensure the filing of accurate returns are in good hands. However, countless numbers of taxpayers who look to others to assist in this often daunting task discover years later, when the IRS knocks, that their returns were actually prepared by return preparers who are incompetent, poorly trained, or who knowingly prepare false returns claiming deductions and, credits to which the taxpayer is not entitled. The continuing problem with such return preparers has been repeatedly highlighted by the National Taxpayer Advocate in her Annual Report to Congress. These types of return preparers are the targets of IRS civil and criminal investigations.

Unethical return preparers who knowingly prepare false and fraudulent returns not only cost the fisc, but their actions can also extend the statute of limitations on assessment of taxes against their client-taxpayers indefinitely as the Tax Court recently reaffirmed in *Murrin v. Commissioner*, T.C. Memo 2024-10.

For the 1993 through 1999 tax years the Murrins' returns, and those of several partnerships in which Ms. Murrin was a general partner, were prepared by a return preparer who placed false and fraudulent entries on the returns with an intent to evade tax. The Murrins did not make any false or fraudulent entries and had no intent to evade tax. Their returns were timely filed. Under the normal three-year statute of limitations, the time for the IRS to assess a deficiency against the Murrins had expired more than twenty years ago. Nonetheless, in 2019, after the IRS discovered the return preparer's fraud, it issued notices of deficiency that asserted additional tax and accuracy-related penalties to the Murrins for 1993 through 1999. The Murrins petitioned the Tax Court for a redetermination of tax.

The case was tried on stipulated facts with the sole issue being whether the fraud exception in Internal Revenue Code (IRC) sec. 6501(c)(1) only applies when the taxpayer herself has filed a false or fraudulent return with the intent to evade tax.

The relevant statutory provisions, IRC secs. 6501(a) and 6501(c)(1), provide as follows:

> (a) General rule -- Except as otherwise provided in this section, the amount of any tax imposed by this title shall be assessed within 3 years after the return was filed (whether or not such return was filed on or after the date prescribed) or, if the tax is payable by stamp, at any time after such tax became due and before the expiration of 3 years after the date on which any part of such tax was paid, and no proceeding in court without assessment for the collection of such tax shall be begun after the expiration of such period. For purposes of this chapter, the term "return" means the return required to be filed by the taxpayer (and does not include a return of any

person from whom the taxpayer has received an item of income, gain, loss, deduction, or credit).

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(c) Exceptions

(1) False return -- In the case of a false or fraudulent return with the intent to evade tax, the tax may be assessed, or a proceeding in court for collection of such tax may be begun without assessment, at any time.

Previously, the Tax Court in *Allen v. Commissioner*, 128 T.C. 37 (2007), held that the fraud exception contained in sec. 6501(c)(1) applies "where a tax return preparer prepares a false or fraudulent return with the intent to evade tax." The taxpayers in *Murrin* argued that *Allen* was wrongly decided; they asked the Court to reconsider the *Allen* opinion and hold that only a taxpayer's fraud triggers the fraud exception to the three-year statute of limitations. They relied on the Federal Circuit's opinion in *BASR Partnership, Ltd. v. United States*,795 F.3d 1338, 1342 (2015), to support their argument.

The Court stated that "stare decisis" requires it to "follow the holdings of a previously decided case absent special justification." It then pointed out that, in *Finnegan v. Commissioner*, T.C. Memo 2016-118, it had rejected the taxpayers' argument on the ground that each of the three judges on the *BASR* panel wrote an opinion, and while the majority opinion concluded that only the taxpayer's fraud suspends the three-year statute of limitations, the concurring opinion implied that fraud by the taxpayer's "authorized agent" would possibly extent the statute while the dissenting opinion agreed with *Allen*. Thus, stare decisis weighed against reconsidering *Allen.*

Nonetheless, the Court held that even if stare decisis was inapplicable it would reach the same result as in *Allen.*

The Court began its analysis with the statutory text. Section 6501(c)(1) is not by its terms limited to cases where the taxpayer personally intended to evade tax. It was the false or fraudulent nature of the return, rather than a taxpayer's intent, that was the key to the extension of the limitations period. Since the text did not on its face limit the intent to evade to the taxpayer, the text did not support the taxpayers' argument.

The Court rejected the taxpayers' argument that the fraud penalty of sec. 6663 supports their reading of the statute. Unlike sec. 6663, sec. 6501(c)(1) does not contain an exception where the taxpayer had reasonable cause and acted in good faith, which would make the taxpayer's intent to evade key.

The Court then discussed the different purposes for the fraud exception of sec. 6501(c)(1) and the fraud penalty. The former is to give the IRS unlimited time to assess in the case of fraud because of the difficulty in uncovering and investigating fraud cases as compared to other audits. The latter is meant to reimburse the Government for the expenses resulting from the taxpayer's fraud.

The Court also rejected the taxpayers' argument that sec. 7454(a), which places on the IRS the burden of proving the taxpayer is guilty of fraud, indicated that Congress considered only the taxpayer's fraudulent intent.

The lesson the Court drew from comparing the fraud exception with other statutory provisions was that where Congress intended to limit fraud to that of the taxpayer it did so explicitly, which it did not do in sec. 6501(c)(1). The Court further noted that it had limited the fraud exception to cases where the pool of actors whose intent might matter to those who had a hand in the preparation or filing of a tax return."

Based on its analysis, the Court concluded that there was no reason for reversing *Allen*. The notices of deficiency issued to the Murrins were therefore timely.

While the holding in *Allen* applies to more well-heeled taxpayers, particularly those who get involved in potentially abusive tax shelters, especially those where accountants, attorneys and appraisers have been convicted of tax-related crimes, more often, the taxpayers who are victimized by fraudulent return preparers are moderate or low-income taxpayers, especially those residing in minority and immigrant communities. The taxpayer in *Allen* was a UPS driver whose returns were prepared by a return preparer who targeted truck drivers.

Independent of one's economic standing, it is clear from the different conclusions reached by different judges, this is a difficult issue. Less difficult is the conclusion that allowing the IRS to go back for what amounts to unlimited periods is very bad tax policy and, in particular, hurts the most vulnerable taxpayers. The harm to these taxpayers and tax administration far outweighs any potential cost to the Treasury. Congress should act and change the law as it has done in sec. 7454(a), to make clear that only the taxpayer's intent to evade tax triggers the fraud exception of sec. 6501(c)(1).

Until then, when choosing a return preparer, the old maxim, *caveat emptor* applies.

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