Surprise–The Fraud of Your Tax Preparer May Extend the Statute of Limitations on Tax Assessments

By Steve Toscher and Della Bauserman

Steve Toscher and Della Bauserman discuss the consequences the *Allen* Tax Court decision has on the application of the statute of limitations.

Introduction

Tsunamis are caused by submarine earthquakes. In the ocean, tsunamis have a small wave height and often go unnoticed. However, once they reach shore, tsunamis may have a devastating effect. The Tax Court's 2007 decision in *V. Allen*[1] can be described as a submarine earthquake from which an unnoticed tsunami has been picking up speed and may engulf many unsuspecting taxpayers.

The issue in *Allen* was whether the *taxpayer* must have an intent to evade tax in order to keep the statute of limitations on assessment open indefinitely under Code Sec. 6501(c)(1).[2] The Tax Court concluded the statute of limitations would remain open if the *tax preparer* had the intent to evade tax.[3] To state this conclusion another way, the Tax Court allowed the statute of limitations on assessment to remain open forever[4] when the tax preparer has fraudulently filed a tax return even if the innocent taxpayer was also defrauded by the tax preparer. This was a startling proposition—at least at first blush—for most of us in the tax litigation field.

While *Allen* was viewed by many as an outlier, it seems to have had staying power, and the IRS recently advised its agents that the issue should be developed where appropriate. The IRS has added *Allen* to its Internal Revenue Manual.[5] The Treasury Inspector General for Tax Administration also added, "Period of limitations also held open by fraudulent intent of third party (e.g., preparer). *Allen …*" to a fraud checklist that was an appendix to a memorandum sent to the Commissioner, Small Business/Self-Employed Division on March 13, 2013.[6] The subject of the memorandum was "Final Audit Report—Actions Can Be Taken to Reinforce the Importance of Recognizing and Investigating Fraud."[7]

Allen has potentially serious consequences—not only on the application of the statute of limitation under Code Sec. 6501, but also on the application of the statute of limitations under Code Sec. 6229(c) (for partners in partnerships). The IRS has even recently considered whether *Allen* affects the statute of limitations for shareholders of S corporations. Some might even argue that the logic of *Allen* suggests that the fraud of the preparer could implicate a fraud penalty on an innocent taxpayer—but this would seem a bit paranoid. However, as one old-time lawyer told one of the authors, we are paid to be paranoid.

Some History

Allen seemed to come out of the blue, however, there were warnings of the pending submarine earthquake. Prior to 2001, the perception was that the IRS would not extend the statute of limitations of an otherwise innocent taxpayer if there was fraud by the tax preparer. In 2001, the IRS changed its position and came up with the theory that a tax preparer's intent to evade taxes could hold the statute of limitations open forever. In 2001, the IRS released two Field IRS Advice Memoranda ("the FSAs"), written six months apart, on substantially the same set of facts, by the same author, coming to the opposite conclusion on

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whether the tax preparer's intent to evade taxes could allow the statute of limitations on assessment on the taxpayers return to remain open forever under Code Sec. 6501(c)(1).[8]

In these FSAs, the taxpayer was a truck driver that had heard that a tax preparer was able to obtain large refunds for truck drivers based on their diesel fuel purchases.[9] The taxpayer sought out the services of this preparer.[10] The preparer knew that the taxpayer was not entitled to the diesel fuel excise credit upon which the refunds were based.[11] The preparer was prosecuted for preparing false returns with respect to the taxpayer and several other drivers.[12] The IRS proposed to issue a notice of deficiency outside of the three-year statute of limitations disallowing the diesel fuel credit.[13] Although the IRS did not impose the fraud penalty under Code Sec. 6663, the IRS proposed relying on the fraud of the preparer to extend the statute of limitations under Code Sec. 6501(c)(1).[14]

In the first FSA issued in 2000, the IRS came to the conclusion that the fraudulent intent of the tax preparer *was insufficient* to extend the statute of limitations for the taxpayer.[15] The IRS based this conclusion on the fact that, since Code Sec. 6501(c)(1) and Code Sec. 6663 were part of a single section of the Revenue Act of 1918, Congress intended for the term "fraud" to have the same meaning for both purposes.[16] The FSA concludes the fraudulent intent of the tax preparer would be insufficient to extend the statute based on cases under Code Sec. 6663.[17]

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FSA 200126019

In the second FSA, FSA 200126019, the IRS came to the opposite conclusion—that the fraudulent intent of the tax preparer could extend the statute of limitations for assessment for the taxpayer under Code Sec. 6501(c)(1).[18] The second FSA relies on the following points:

- The statute phrases the exception in terms of a fraudulent return with intent to evade tax.[19]
- The focus of inquiry regarding intent is not the same under Code Sec. 6501(c)(1) and Code Sec. 6663.[20]
- Under agency law, the taxpayer bears the consequences of errors made by the tax preparer.[21]
- The application of the badges of fraud is not appropriate in this case.[22]
- The IRS is disadvantaged by the fraud the same whether the fraud is the fraud of the taxpayer or the fraud of the tax preparer.[23]

Same Statutory Language but Different Intent?

The first two points of the FSA revolve around the interpretation of the language in Code Sec. 6501(c)(1) and whether that language should be interpreted in a manner consistent with the identical language of Code Sec. 6663. The IRS interprets the passive voice of Code Sec. 6501(c)(1) as indicating that the intent of *any* person to evade tax is sufficient to allow the statute of limitations on assessment to remain open forever. The Tax Court interpreted the same passive voice in Code Sec. 6663 as requiring the intent to be the intent of the taxpayer in a series of cases decided in the 1950s with facts similar to those in the FSAs.[24] In those decisions, the Tax Court determined that, although the *tax preparer* filed a false and fraudulent return, the predecessor to Code Sec. 6663 did not apply because there was no proof that the *taxpayer intended* to defraud the Government.[25]

The language in Code Sec. 6501(c)(1) should be interpreted the same as the language in Code Sec. 6663 because, not only were they passed as part of the same section of the Revenue Act of 1918, they are also on the same page, merely one sentence apart.[26] An analysis of the statute strongly suggests that the language of both sections was intended to have the same meaning.

Beginning with the second to the last sentence of subsection (b) of section 250, the Revenue Act of 1918 states:

> (b) … If the understatement is due to *negligence on the part of the taxpayer, but without intent to defraud,* there shall be added as part of the tax 5 per centum of the total amount of the deficiency, plus interest at the rate of 1 per centum per month on the amount of the deficiency of each installment from the time the installment was due.
>
> If the understatement is *false or fraudulent with the intent to evade the tax,* then, in lieu of the penalty provided by section 3176 of the Revised Statutes, as amended, for false or fraudulent returns willfully made, but in addition to other penalties provided by law for false or fraudulent returns, there shall be added as part of the tax 50 per centum of the amount of the deficiency.
>
> (c) If the return is made pursuant to section 3176 of the Revised Statutes as amended, the amount of

> tax determined to be due under such return shall be paid upon notice and demand by the collector.
>
> (d) Except in the case of *false or fraudulent returns with intent to evade tax,* the amount of tax due under any return shall be determined and assessed by the Commissioner within five years after the return was due or was made, and no suit or proceeding for the collection of any tax shall be begun after the expiration of five years after the date when the return was due or was made. *In the case of such false or fraudulent returns,* 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.[27]

The last sentence of subsection (b) became Code Sec. 6663. The last sentence of subsection (d) became Code Sec. 6501(c)(1). The first sentence quoted above does not apply if the taxpayer has the intent to defraud. The following sentence lays out what rules do apply if the understatement is false or fraudulent because the taxpayer has the intent to evade. Subsection (d) is organized similarly to (b). The first sentence does not apply if the taxpayer has the intent to evade tax. Since Congress used the same wording in this sentence as it used in subsection (b) (two sentences previously and on the same page), the person required to have the intent to evade in (d) is the same as the person required to have the intent to evade in (b)—the taxpayer. The second sentence of subsection (d) lays out the rules if the return is false or fraudulent because the taxpayer has the intent to evade tax. The original context of Code Secs. 6663 and 6501 indicates that the person required to have the intent to evade in both statutes is the taxpayer.

Courts have consistently interpreted the words in Code Secs. 6501 and 6663 the same way.[28] In fact, the Supreme Court in *Badaracco* relied upon case law in *G.M. Still*[29] under a predecessor to Code Sec. 6663 to interpret Code Sec. 6501(c)(1). In *Still*, the issue was whether a taxpayer could avoid the fraud penalty under a predecessor to Code Sec. 6663 after filing fraudulent returns by filing nonfraudulent amended returns and paying the tax owed.[30] In *Badaracco*, the issue was whether the extended statute of limitations in Code Sec. 6501(c)(1) applied if the taxpayer filed a fraudulent return and then subsequently filed a nonfraudulent amended return.[31] In determining that a taxpayer who submits a fraudulent return does not purge the fraud by voluntary disclosure, the Supreme Court in *Badaracco* quoted *Still*.[32] At the time, the IRS agreed that cases under Code Sec. 6663 should be used to interpret Code Sec. 6501(c)(1), since it cited *Still* in its brief to the Supreme Court for *Badaracco* to be used to interpret Code Sec. 6501(c)(1).[33]

In response to this argument in FSA 200126019, the IRS stated that while the elements of fraud may be the same under Code Sec. 6501(c) and Code Sec. 6663, the focus on the inquiry of intent may be different. The IRS stated that, "The focus in section 6501(c) is on whether fraud was committed in connection with the return, while the focus in section 6663 is on whether the taxpayer committed the fraud."[34] The IRS also noted that "for many years the fraud exception to the period of limitations and the fraud penalty have no longer been contained within the same statutory provision."[35]

Suggesting that these similar statutory provisions—which were born from the same section of the same tax act—have different intent elements because they are no longer in the same section seems like a stretch. In *Badaracco*, the Supreme Court stated, "The word 'return,' however, appears no less than 64 times in §6501. Surely, Congress cannot rationally be thought to have given that word one meaning in §6501(a), and a totally different meaning in §§6501(b) through (q)."[36] The same statutory interpretation should apply in construing who has "the intent to evade" when the language is found in the same section of an act of Congress only a sentence apart.

Granting the IRS an Unlimited Statute of Limitations Is Punitive

In FSA 200126019, the IRS justifies the application of an indefinite statute of limitations to an innocent taxpayer's return by arguing that a fraudulent return places the IRS at a disadvantage whether or not the fraud is perpetrated by the taxpayer. This statement can only justify applying an unlimited statute of limitations to an innocent taxpayer if the punitive nature of extending the statute of limitations forever is ignored. The Supreme Court recognized the punitive nature of Code Sec. 6501(c)(1) in *Badaracco*.[37] The Supreme Court stated:

> The substantive operation of the fraud provisions of the Code itself confirms the conclusion that §6501(c)(1) permits assessment at any time in fraud cases regardless of a taxpayer's later repentance. It is established that a taxpayer who submits a fraudulent return does not purge the fraud by subsequent voluntary disclosure; *the fraud was committed,* and *the offense completed,* when the original return was prepared and filed.[38]

The Supreme Court later addressed the fairness of keeping the statute of limitations open forever:

> Petitioners claim that it is unfair "to forever suspend a Sword of Damocles over a taxpayer who at one time may have filed a fraudulent return, but who has subsequently recanted and filed an amended return providing the Government with all the information necessary to properly assess the tax." But it seems to us that a taxpayer who has filed a fraudulent return with intent to evade tax hardly is in a position to complain of the fairness of a rule that facilitates the Commissioner's collection of the tax due.[39]

Allen (the Earthquake)

In 2007, the concept that Code Sec. 6501(c)(1) only requires an intent to evade tax, not necessarily the taxpayer's intent to evade tax, was presented to the Tax Court in *Allen*.[40] The facts *of Allen* are similar to the facts in FSA 200104006 and FSA 200126019. In *Allen*, the taxpayer was a UPS driver who had Mr. Goosby prepare his income tax returns.[41] Mr. Goosby claimed false and fraudulent itemized deductions on the tax returns for both years at issue.[42] Mr. Goosby was convicted of 30 violations of Code Sec. 7206(2) for willfully aiding and assisting in the preparation of false and fraudulent returns, but was not convicted on the basis of the taxpayer's returns.[43] The parties agreed on the following:

- The taxpayer *did not* have the intent to evade tax.[44]
- The false deductions on the taxpayer's returns made the returns false and fraudulent.[45]
- Mr. Goosby claimed the false deductions on the taxpayer's returns with the intent to evade tax.[46]

The Tax Court determined that the statute of limitations was open on the taxpayer's returns based on Mr. Goosby's fraudulent intent.[47] The Tax Court relied on the following points in its decision:

- "Nothing in the plain meaning of the statute suggests the limitations period is extended only in the case of the taxpayer's fraud."[48]
- The Tax Court was asked to decide this issue for the first time in this case.[49]
- The IRS has a special disadvantage investigating fraudulent returns.[50]
- Other cases have extended limitations periods in the Code due to third-party malfeasance.[51]
- "To find otherwise would allow a taxpayer to receive the benefit of a fraudulent return by hiding behind the preparer."[52]

Plain Meaning of the Statute

The Tax Court determined that the plain meaning of Code Sec. 6501(c)(1) does not indicate that the statute of limitations is only extended by the taxpayer's fraud.[53] The Tax Court appeared to base this conclusion on the fact that in 1934, the House Ways and Means committee passed a version of Code Sec. 6501(c)(1) that would have clarified that the intent was the intent of the taxpayer and the Senate Finance Committee disregarded this language.[54]

The Tax Court does not appear to dispute that the language in Code Sec. 6501(c)(1) should be interpreted the same as the language in Code Sec. 6663.[55] The Tax Court states, "Nor do we read these cases to require that the person who causes a return to be fraudulent under section 6501 must be the person who owes the tax or against whom the fraud penalty is asserted under section 6663."[56] This statement implies that not only could the statute of limitations be extended due to the fraud of the tax preparer, but that the fraud penalty could also be asserted against the taxpayer as well.[57]

The Tax Court also noted that statutes of limitations are to be strictly construed in favor of the government.[58] However, there is also another line of cases that state, "taxing acts, including provisions of limitation embodied therein, [are] to be construed liberally in favor of the taxpayer."[59] Given the importance of the statute of limitations for tax enforcement, the Tax Court's choice of one rule of construction over another can be fairly questioned.

This Issue Has Been Before the Tax Court Previously

While the Tax Court in *Allen* states that this is the first time it has considered the issue of whether the limitations period for assessing income tax under Code Sec. 6501(c)(1) is extended due to the fraudulent intent of the tax preparer,[60] it appears the Tax Court has touched upon the issue before. In 1971, in a Memorandum Opinion, the Tax Court decided that since an individual did not have the required intent to evade tax, the statute of limitations was not extended. [61] The taxpayer was in a partnership with Mr. Bear.[62] During the years at issue, Mr. Bear prepared both the partnership's tax returns and the taxpayer's tax returns.[63] The taxpayer and Mr. Bear were both indicted by a federal grand jury for alleged fraudulent evasion of federal income taxes based on the understatement of income from the partnership.[64] Mr. Bear pled guilty to all counts in the indictment, but the indictment was dismissed against

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the taxpayer.[65] In finding that the taxpayer did not have the intent to commit fraud under the predecessor to Code Sec. 6663, the Tax Court stated:

> In retrospect, petitioner was negligent in not exercising greater care in the supervision of his own personal affairs and was guilty of poor judgment in not verifying the correctness of his income tax returns. However, [n]egligence, careless indifference, or disregard of rules and regulations do not suffice to establish fraud. Furthermore, poor judgment and ignorance are not tantamount to fraud. There is lacking one essential element, the very heart of the fraud issue, namely, the intent to defraud the Government by calculated tax evasion.[66]

In finding that the statute of limitation was not extended by Code Sec. 6501(c)(1), the Tax Court stated, "For the reasons set forth above [referring to the reasons that the taxpayer did not have intent to evade taxes for the fraud penalty], we hold that petitioners did not file false or fraudulent returns with the intent to evade tax for 1958 and 1959; and consequently, the assessment for those years is barred by the statute of limitations."[67]

The IRS's Disadvantage in Investigating Fraudulent Returns

Like the IRS in FSA 200126019, the Tax Court in *Allen* focused on the disadvantages to the IRS in investigating fraudulent returns.[68] As mentioned above, this justification for allowing the statute of limitations to remain open forever when the taxpayer is innocent loses much of its force and support in the law if Code Sec. 6501(c)(1) is a punitive provision. As discussed by Supreme Court in *Badaracco*, Code Sec. 6501(c)(1) is a punitive provision. Therefore, the provision should not be applied to an innocent taxpayer.

Other Cases Extending Limitations Periods in the Code Due to Third-Party Malfeasance Are Not Analogous to Extending the Statute of Limitations Under Code Sec. 6501(c)(1) for Fraud

In referencing other cases that have extended limitations periods in the Code due to third-party malfeasance, the Tax Court cited two cases under Code Sec. 6532(b), one case where there was a joint return, and one case under Code Sec. 6229.[69]

Code Sec. 6532(b) states in part, "such suit may be brought at any time within 5 years from the making of the refund if it appears that any part of the refund was induced by fraud *or misrepresentation of a material fact.*" (Emphasis added.) Because Code Sec. 6532(b) includes the phrase "or misrepresentation of a material fact," it lacks the intent element that is required for Code Sec. 6501(c)(1).

Joint returns are not comparable to third parties under Code Sec. 6501(c)(1) because the spouses filing the joint return are jointly and severally liable for the return. Third parties are not jointly and severally liable for the return.

The Tax Court in *Allen* cited a case "extending limitations period for assessing taxes of partners attributable to partnership items under sec. 6229(c) where [a] partner intended to evade taxes of other partners."[70] Code Sec. 6229(c)(1) extends the statute of limitations on assessment "If *any partner* has, *with the intent to evade tax,* signed or participated directly or indirectly in the preparation of a partnership return which includes a false or fraudulent item." (Emphasis added.) In the case that the Tax Court cited, the Court of Appeals for the Federal Circuit found that a partner who had signed the returns in 1983 and 1984 had the intent to evade taxes in both years.[71] This finding is in accordance with Code Sec. 6229(c)(1) which on the face of the statute requires that *the partner* have the *intent to evade tax.* The Federal Circuit did not extend the statute of limitations due the malfeasance of a third party beyond what is clearly stated on the face of the statute.

None of these cases are analogous to extending the statute of limitations on an innocent taxpayer's return because of the fraudulent intent of a third party with the exception of the case under Code Sec. 6229(c)(1). In the case of Code Sec. 6229(c)(1), the extension due to the fraudulent intent of the third party is clearly stated in the statute. In addition, if the partner was innocent of the fraudulent intent, then the statute of limitations under Code Sec. 6229(c)(1) is only extended to six years instead of being extended forever as under Code Sec. 6501(c)(1).

Taxpayers Can Not Hide Behind Tax Preparers

To the extent that the Tax Court is concerned with taxpayers receiving the benefit of a fraudulent return by hiding behind tax preparers, there are ways to deal with that issue. More than 50 years before *Allen* was decided, the Tax Court was concerned with another taxpayer benefiting from a tax preparer's fraudulent conduct.[72] In *F. Ambuhl*, the taxpayer's former husband and cur-

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rent partner in a business prepared the taxpayer's tax returns.[73] The tax preparer was convicted of tax evasion with respect to his partnership income for the years at issue.[74] The taxpayer admitted that all of her returns at issue were false and fraudulent, but denied that she had a fraudulent intent.[75] The Tax Court compared this case with *D.R. Fulton*, where the preparation of false and fraudulent returns was found to be outside the scope of the taxpayer's agent's authority.[76] The Tax Court concluded that the tax preparer in *Ambuhl* was generally known to be disreputable.[77] The taxpayer was aware of the tax preparer's true character and reputation.[78] The taxpayer accepted and benefitted from the tax preparer's fraudulent conduct.[79] Therefore, the preparation and filing of such false and fraudulent returns were within the scope of the tax preparer's authority as an agent of the taxpayer.[80] The Tax Court found that "some part of the deficiency of the petitioner's income tax for each of the years was due to fraud with intent to evade tax."[81] The Tax Court was thus able to prevent a taxpayer from hiding behind the tax preparer while consistently defining the intent in Code Sec. 6663 as the intent of the taxpayer. With the doctrine of "willful blindness" now included in civil fraudulent intent cases, neither the IRS nor the Tax Court will permit a culpable taxpayer to hide behind a fraudulent preparer.[82]

The Tsunami

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Since *Allen*, there have been a number of cases and a CCA that shed additional light on how the decision in *Allen* may be used by the IRS and interpreted by the courts in the future. In *River City Ranches #1 Ltd.,*[83] *P.W. Browning* and *S.M. Eriksen*, the Tax Court indicated that it will follow *Allen*.

CCA 201238026[84]

In this CCA, the issue was whether the statute of limitations could be extended for the personal return of a shareholder in an S corporation when the Form 1120S for the S corporation was fraudulent.[85] The IRS determined that the statute of limitation under Code Sec. 6501(c)(1) would not be extended on this set of facts.[86] However, part of the reasoning as to why the statute of limitations would not be extended was based on the Tax Court decision in *City Wide Transit*.[87] The Tax Court opinion in *City Wide* was recently overturned by the Second Circuit.[88]

City Wide

In *City Wide*, Ms. Fouche retained Mr. Beg, an accountant, on behalf of the corporation for the sole purpose of negotiating with the IRS a reduction in the corporation's outstanding employment tax liabilities for periods that are not at issue in this case.[89] Ms. Fouche never requested for Mr. Beg to prepare any of the corporation's Forms 941.[90] Mr. Beg convinced Ms. Fouche that he had reached an agreement with the IRS.[91] Mr. Beg claimed that he needed to deliver the corporation's Forms 941 along with a certified check for the amount due as the forms became due as part of the agreement that he had reached with the IRS.[92] Ms. Fouche delivered the correctly prepared forms to Mr. Beg and certified checks for the amount due payable to the IRS.[93] Mr. Beg altered the checks and deposited them in a foreign bank account.[94] Mr. Beg also altered the Forms 941 that he filed by fraudulently claiming that the corporation had made advance EIC payments to employees. Mr. Beg filed these altered forms with the IRS along with checks drawn on the foreign bank account for the lesser amounts due shown on the forms.[95] Unbeknownst to Ms. Fouche, Mr. Beg also filed amended Forms 941, fraudulently claiming that the corporations had made advance EIC payments to employees in prior periods.[96] Mr. Beg pled guilty to charges of knowingly and willfully signing false returns and knowingly and willfully preparing and presenting false tax returns.[97]

One of the issues was whether Mr. Beg willfully attempted to defeat or evade tax within the meaning of Code Sec. 6501(c)(2) in addition to whether Mr. Beg intended to evade tax within the meaning of Code Sec. 6501(c)(1).[98] Under Code Sec. 6501(c)(2), there is no statute of limitations on assessment if there was a willful attempt to defeat or evade tax. Code Sec. 6501(c)(2) was not an issue in *Allen* because Code Sec. 6501(c)(2) does not apply to income tax. The Tax Court applied *Allen* to Code Sec. 6501(c)(2) and stated that Mr. Beg's intent to evade taxes could keep the statute of limitations open under Code Sec. 6501(c)(2).[99]

The Tax Court found that the IRS had not proved that Mr. Beg intended to evade tax under Code Sec. 6501(c)(1) or that Mr. Beg willfully attempted to defeat or evade tax under Code Sec. 6501(c)(2).[100] The Tax Court determined that Mr. Beg's filing of the Forms 941 and amended Forms 941 was an incidental consequence or secondary effect of his embezzlement scheme.[101] The IRS appealed to the Second Circuit.[102]

The Second Circuit reversed the Tax Court.[103] A critical part of the Second Circuit's opinion is footnote 3 where the court noted:

> In front of the tax court, City Wide argued that it was not liable for the returns Beg prepared where (1) City

Wide did not know of the preparer's defalcations; and (2) City Wide did not sign or knowingly allow to be filed a false return. The Commissioner anticipated these claims on appeal and rebutted them in its opening brief. City Wide, however, conceded these issues in its response brief. Moreover, each member of this panel asked City Wide whether it had intended this concession, and City Wide responded affirmatively to each of us in turn. *Accordingly, we accept this concession without deciding whether certain factual situations might arise that sever the taxpayer's liability from the tax-preparer's wrongdoing.*[104]

On its face, it appeared that the Second Circuit in *City Wide* endorsed the Tax Court's decision in *Allen*, but that is not the case. The Second Circuit has not ruled on whose intent is necessary under Code Sec. 6501(c)(1) or Code Sec. 6501(c)(2).

The Tax Court's decision in *City Wide* distinguishes *Allen* in finding that Mr. Beg's filing of the Forms 941 and amended Forms 941 was an only an incidental consequence or secondary effect of his embezzlement scheme, which may well reflect the Tax Court's reluctance to keep the statute of limitations open forever on the taxpayer's returns when the taxpayer is innocent. The Second Circuit did not accept this distinguishing logic. However, in its footnote 3, the Second Circuit indicated that it may not be prepared to sign on to the logic of *Allen*.

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Conclusion

In 2001, the IRS changed its interpretation of Code Sec. 6501(c)(1) to include the intent of third parties. In 2007, the Tax Court agreed with the IRS in *Allen*, that the intent of a third party could keep the statute of limitations open forever under Code Sec. 6501(c)(1), even when the taxpayer was innocent.

The Tax Court has shown some uneasiness with leaving open the statute of limitations for innocent taxpayers and rightfully so, but has continued to follow its decision in *Allen*. None of the Courts of Appeals have yet ruled on whether the Tax Court was correct in *Allen*.

Taxpayers and their representatives need to prepare for the IRS to test the limits of its new found power. *City Wide* raises the specter of identity fraud. The facts of that case are close to an identity fraud case. If a fraudulent return is filed for the purposes of identity fraud without the taxpayer's knowledge and the taxpayer later files a correct return, is the statute of limitations for that tax return open forever under a combination of *Allen* and *Badaracco*? That would be an absurd result.

On a more positive note, in *Eriksen*, the Tax Court gave us a clue as to how to deal with the IRS's new found power. The IRS still has a high bar to prove the fraudulent intent of the third party.[105] Therefore, practitioners should not stipulate to the fraud of the third party.

Allen can mean no statute of limitations for innocent taxpayers, who may not know who they are until the IRS comes knocking on their door years after their tax preparer has been investigated and convicted of tax fraud. The Supreme Court has previously addressed the issue of having no statute of limitations in the income tax system and stated:

> It probably would be all but intolerable, at least Congress has regarded it as ill-advised, to have an income tax system under which there never would come a day of final settlement and which required both the taxpayer and the Government to stand ready forever and a day to produce vouchers, prove events, establish values and recall details of all that goes into an income tax contest. Hence, a statute of limitation is an almost indispensable element of fairness as well as of practical administration of an income tax policy.[106]

The passive language of Code Secs. 6501(c)(1) and 6663 does not specifically state whose intent the statute is referring to—perhaps because tax statutes governing taxpayers are referring to taxpayers and not third parties—unless, of course, the statute expressly refers to the action or state of mind of a third party. Given the historical and understood interpretation that fraud statutes refer to the fraud of the taxpayer and the importance of the statute of limitations to tax enforcement and administration, an unlimited statute of limitation should require a clear expression of Congressional intent instead of a mere inference from the passive language of the statute.

Endnotes

1 *V. Allen*, 128 TC 37, Dec. 56,851 (2007).
2 *Id.*, at 39.
3 *Id.*, at 40.
4 "[U]nder §6901(c) the Commissioner is entitled to asses deficiencies against a taxpayer's beneficiaries after his or her death for one year after the limitations period runs. Since the limitations period will never run, the Commissioner may presumably hound

Endnotes

a taxpayer's beneficiaries and their descendants in perpetuity." *E. Badaracco, Sr.,* SCt, 84-1 USTC ¶9150, 464 US 386, 406, note 7 (1984) (Stevens, J., dissenting).

5 IRM §25.6.23-3(4) states, "ASED alpha code OO can be used when the IRS is relying on the fraudulent acts and intent to evade tax on the part of the return preparer to keep the assessment statute open on the returns of the preparer's clients, see *Allen*."
6 2013 TNT 75-34.
7 *Id.*
8 FSA 200104006 (Sept. 15, 2000); FSA 200126019 (Mar. 30, 2001).
9 *Id.*
10 *Id.*
11 *Id.*
12 *Id.*
13 *Id.*
14 *Id.*
15 FSA 200104006.
16 *Id.*
17 *Id.*
18 FSA 200126019.
19 *Id.*
20 *Id.*
21 *Id.* The Third Circuit has rejected this agency argument in *Asphalt Industries, Inc.,* CA-3, 67-2 USTC ¶9620, 384 F2d 229, 235 (1967) (stating that there was no apparent authority to commit fraud and that the government was not an innocent third party that was misled.)
22 FSA 200126019. The Tax Court has applied the badges of fraud in post-*Allen* cases. *See P.W. Browning,* 102 TCM 460, Dec. 58,803(M), TC Memo. 2011-261, *45–*55; *S.M. Eriksen,* 104 TCM 146, Dec. 59,117(M), TC Memo. 2012-194, *26–*36.
23 FSA 200126019.
24 *See, e.g., D.R. Fulton,* 14 TC 1453, Dec. 17,732 (1950); *G.H. Sperry,* 9 TCM 554, Dec. 17,751(M) (1950).
25 *Id.*
26 Revenue Act of 1918 (P.L. 65-254), 40 Stat. 1057, 1083 (1919).
27 *Supra* note 24 (emphasis added).
28 *E.g., Asphalt Industries, supra* note 21, 384 F2d, at 232; *U.R. Neely,* 116 TC 79, 85, Dec. 54,241 (2001); *Rhone-Poulenc Surfactants & Specialties,* 114 TC 533, 548, Dec. 53,929 (2000); *L.K. Murphy,* 69 TCM 1916, Dec. 50,485(M), TC Memo. 1995-76, *30 (with respect to the predecessor to Code Sec. 6663); *Gong Y.T. Chin,* 67 TCM 2140, Dec. 49,663(M), TC Memo. 1994-54, *38 (same); *J. Williamson,* 65 TCM 2854, Dec. 49,078(M), TC Memo. 1993-246, *53–*54 (same); *H. Richman,* 65 TCM 1808, Dec. 48,836(M), TC Memo. 1993-32, *9 (same); *W.H. Callahan,* 63 TCM 2285, Dec. 48,050(M), TC Memo. 1992-132, *26 (same).
29 *G.M. Still,* 19 TC 1072, 1076–77, Dec. 19,511 (1953).
30 *Id.*
31 *Badaracco, supra* note 4, 464 US, at 388.
32 *Id.,* at 394 (*quoting Still, supra* note 29, 19 TC 1072, at 1077).
33 Brief for Respondent at 23, note 10, *Badaracco, supra* note 4, No. 82-1453 and 82-1509, 1983 U.S. S. Ct. Briefs LEXIS 268.
34 *Id.*
35 *Id.*
36 *Badaracco, supra* note 4, 464 US, at 397.
37 *See Badaracco, supra* note 4, 464 US, at 394, 400.
38 *Id.,* at 394 (emphasis added).
39 *Id.,* at 400 (citations omitted).
40 *Allen, supra* note 1, 128 TC, at 39–40.
41 *Id.,* at 37–38.
42 *Id.,* at 38.
43 *Id.*
44 *Id.*
45 *Id.*
46 *Id.*
47 *Id.,* at 42.
48 *Id.,* at 40.
49 *Id.,* at 37.
50 *Id.,* at 40.
51 *Id.*
52 *Id.,* at 42.
53 *Id.,* at 40.
54 *Id.,* at 39.
55 *See id.,* at 40–41.
56 *Id.,* at 41.
57 Note that, if the Tax Court does agree that the language in Code Sec. 6501(c) should be interpreted the same as the language in Code Sec. 6663, then the fraudulent intent required should be the intent of the taxpayer as in *Fulton et al.*
58 *Allen, supra* note 1, 128 TC, at 40 (*citing Badaracco, supra* note 4, 464 US, at 391; *J.P. Lucia,* CA-5, 73-1 USTC ¶16,075, 474 F2d 565, 570 (1973)).
59 *N.B. Updike,* SCt, 2 USTC ¶533, 281 US 489, 496 (1930); *see also K.J. Reuter,* 51 TCM 99, Dec. 42,536(M), TC Memo. 1985-607, *11.
60 *Allen, supra* note 1, 128 TC, at 37.
61 *E. Klemach,* 30 TCM 723, Dec. 30,882(M), TC Memo. 1971-169, *10–*11.
62 *Id.,* at *4.
63 *Id.,* at *7.
64 *Id.,* at *10.
65 *Id.*
66 *Id.,* at *17–*18 (citations omitted).
67 *Id.,* at *18.
68 *Allen, supra* note 1, 128 TC, at 40.
69 *Allen, supra* note 1, 128 TC, at 40, note 5.
70 *Id.*
71 *Id.*; *Transpac Drilling Venture,* CA-FC, 96-1 USTC ¶50,271, 83 F3d 1410, 1415 (1996).
72 *See Allen, supra* note 1, 128 TC, at 42, *F. Ambuhl,* 12 TCM 284, Dec. 19,524(M), *14–*15.
73 *Ambuhl, supra* note 73, 12 TCM 284, *3–*8.
74 *Id.,* at *8.
75 *Id.,* at *12.
76 *Id.,* at *14.
77 *Id.,* at *15.
78 *Id.*
79 *Id.*
80 *Id.*
81 *Id.,* at *16.
82 *O.G. Fiore,* 105 TCM 1141, Dec. 59,422(M), TC Memo. 2013-21, *P21–*P31.
83 *River City Ranches #1 Ltd.,* 94 TCM 1, Dec. 56,988(M), TC Memo. 2007-171.
84 CCA 201238026 (June 4, 2012).
85 *Id.*
86 *Id.*
87 *Id.*
88 *City Wide Transit, Inc.,* CA-2, 2013-1 USTC ¶50,211, 709 F3d 102, 109.
89 *City Wide Transit, Inc.,* 102 TCM 542, Dec. 58,821(M), TC Memo. 2011-279, at *2–*3.
90 *Id.,* at *3.
91 *Id.,* at *4.
92 *Id.*
93 *Id.,* at *4–*5.
94 *Id.,* at*5.
95 *Id.,* at *6.
96 *Id.,* at *8.
97 *Id.,* at *11.
98 *Id.,* at *16.
99 *See id.,* at *16–*19.
100 *Id.,* at *22–*23.
101 *Id.,* at *21–*22.
102 *City Wide, supra* note 88, 709 F3d 102, *1.
103 *Id.,* at *16–*17.
104 *Id.,* at *12–*13, note 3.
105 *See Eriksen, supra* note 22, TC Memo. 2012-194 at *28–*34.
106 *Badaracco, supra* note 4, 464 US, at 405–06 (Stevens, J., dissenting) (*quoting Rothensies v. Elec. Storage Battery Co.,* SCt, 47-1 USTC ¶9106, 329 US 296, 301 (1946)).

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