ON THE USE AND ABUSE OF LEGISLATIVE HISTORY IN THE "PREPARER FRAUD" DOCTRINE

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ABSTRACT

For more than a century, U.S. tax evaders have been liable for unpaid tax at any time so that statutes of limitation do not stymie collection of fruits of fraud. Today, however, federal courts of appeal are split over a novel doctrine that holds unwitting victims of abusive tax professionals strictly and perpetually liable for their mistake. For eight years the U.S. Tax Court followed by the Second Circuit Court of Appeals have promulgated a new rule of tax assessment masquerading under an historical veneer that for the first time eliminates repose from honest taxpayers who filed their returns in good faith. The Federal Circuit's recent decision to fight the doctrine of preparer fraud on first principles requires an accurate historical record on which to decide the contest and which this article finally provides.

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INTRODUCTION

Under Section 6501 of the Internal Revenue Code of 1986 ("Code"),[2] the Internal Revenue Service ("IRS") must ordinarily assess taxpayers for a deficiency of federal income tax "within 3 years after the return was filed."[3] This statutory period is extended indefinitely, however, "[i]n the case of a false or fraudulent return with the intent to evade the tax" under a 96-year-old tax law that has only recently been applied to innocent taxpayers on the basis of someone else's tax fraud.[4]

As federal tax returns have grown more complex, individuals and businesses have become increasingly dependent on professional tax advice to complete their federal income tax returns.[5] The IRS estimates that 61% of U.S. taxpayers who file 87 million individual income tax returns annually now rely on tax professionals to prepare their returns.[6] But no consensus has emerged as to how long innocent taxpayers may be held liable for relying on fraudulent tax advice.[7]

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[2] Throughout this article, capital "Section" numbers refer to current and historical provisions of federal tax law, including, but not limited to, the Internal Revenue Code of 1986, codified, as amended, in Chapter 26 of the United States Code.

[3] I.R.C. § 6501(a).

[4] *See* I.R.C. § 6501(c)(1); Adam S. Wallwork, *What You Don't Know Can Hurt You: Paying for Preparer Fraud*, 145 Tax Notes 1509, 1509–1510 (2015) (collecting cases).

[5] I.R.S. Publication 4832, Rev. 12-2009, at *7 (Dec. 2009) [hereinafter *Return Preparer Review*].

[6] *Id.*

[7] *Compare Allen v. Comm'r*, 128 T.C. 37, 38 (2007); *City Wide Transit Inc. v. Comm'r*, 709 F.3d 102, 107–108 (2d Cir. 2013), *rev'g*, T.C. Memo. 2011-279, 102 T.C.M. (CCH) 542 (2011) (upholding otherwise-untimely assessment against an innocent taxpayer whose tax-return preparer committed fraud), *with BASR P'ship v. United States*, 795 F.3d 1338, 1339–1357 (2015), *aff'g*, 113 Fed.Cl. 181 (2013) (rejecting *Allen*'s doctrine of preparer fraud).

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Congress never specified *who's* fraudulent "intent to evade tax" counts for purposes of Code § 6501(c)(1) when a third party files a fraudulent return on the taxpayer's behalf and the only federal courts of appeal to have addressed the issue are split.[8] Currently, the U.S. Tax Court and Second Circuit Court of Appeals authorize unlimited assessment of fraudulent returns regardless of the taxpayer's fault, while the U.S. Court of Federal Claims ("Claims Court") and Federal Circuit Court of Appeals require fraud on the part of the taxpayer under Section 6501(c)(1).

In *Allen v. Commissioner*,[9] the U.S. Tax Court introduced the theory of "preparer fraud" with the following remark on the statute's legislative history:

> Rules regarding the limitations period in the case of false and fraudulent returns have been in the Code since the Revenue Act of 1918.[10] That provision addressed the statute of limitations that applied "in the case of false or fraudulent returns" and did not by its terms require that the fraud be that of the taxpayer. The version of the Revenue Act of 1934 that passed the House Ways and Means Committee would have amended this section to read: "If the taxpayer . . . files a false or fraudulent return with intent to evade tax . . . the tax may be assessed . . . at any time."[11] The Senate Committee on Finance discarded this language, however, with no discussion.[12] The enacted version continued to focus on the return with no express requirement that the fraud be the taxpayer's and remains the language in sec. 6501(c)(1) today.[13]

Judge Diane L. Kroupa's legislative history of Section 6501(c)(1) has never been conclusively refuted because neither of the courts that have rejected *Allen* have focused on the statute's history. In July 2015, a panel of the U.S. Court of Appeals for the Federal Circuit joined the U.S. Court of Federal Claims ("Claims Court") in rejecting the Tax Court's doctrine of preparer fraud.[14] Although the Claims Court and Federal Circuit panel agreed that "failed legislative proposals are a particularly dangerous ground on which to rest an interpretation of a prior statute," they failed to provide a convincing alternative.[15] For this reason, Chief Judge Sharon Prost of the Federal Circuit Court of Appeals dissented from her colleagues on a three-judge panel who rejected *Allen* on the basis of

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[8] *See supra* note 7.

[9] 128 T.C. 37 (2007).

[10] Revenue Act of 1918 § 250(d), Pub. L. No. 65-254, 40 Stat. 1057 (Feb. 24, 1919).

[11] H.R. 7835, 73d Cong., 2d Sess. sec. 276(a) (1934) (as passed by House, Feb. 21, 1934).

[12] S. Rept. 558, 73d Cong., 2d Sess. 43–44 (1934), 1939–1 C.B. (Part 2) 586, 619.

[13] *Allen*, 128 T.C., at 39 n. 3 (internal citations omitted).

[14] *BASR P'ship v. United States*, 795 F.3d 1338, 1339–1357 (2015), *aff'g*, 113 Fed.Cl. 181 (2013).

[15] *Id*. at 1349 n. 12.

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an analysis of other Code provisions which had not historically been read together with the fraudulent-return extension.[16]

This Article cuts through the current judicial debate over who's fraud counts under Section 6501(c)(1) with the first comprehensive study of the fraudulent-return provision's history from 1789 to present. This longer view makes clear that federal lawmakers have never authorized unlimited tax assessments on the basis of someone else's fraud.[17]

The Article proceeds in three parts. Part I tracks the historical development of the fraudulent-return extension of the statute of limitations in tax cases. Part II evaluates the Tax Court's novel doctrine of preparer fraud. And Part III considers the doctrine's future.

I. A BRIEF HISTORY OF THE FRAUDULENT-RETURN EXTENSION

The U.S. income tax system and the procedural rules that effectuate it are designed to balance (1) fairness to taxpayers, with (2) effective tax collection. As Justice Jackson has explained:

> 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. . . .
>
> Statutes of limitation . . . in their conclusive effects are designed to promote justice by preventing surprises through the revival of claims that have been allowed to slumber until evidence has been lost, memories have faded, and witnesses have disappeared.[18]

But although Justice Jackson's famous passage captures the taxpayer's side of the equation, it misses the government's interest in preventing tax evasion, which is also a perennial focus of tax policy. For as long as Congress has imposed a statute of limitation

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[16] *See BASR P'ship*, 795 F.3d, at 1357 (J. O'Malley concurring) ("I do not agree that § 6501 is controlling in these circumstance."); *BASR P'ship*, 795 F.3d, at 1358 (J. Prost dissenting) ("[A]ll this survey reveals is that Congress can write a provision that explicitly applies only to taxpayer fraud."); *Woods v. Lewellyn*, 252 F. 106, 107 (3d Cir. 1918) (refusing to interpret Congress fraudulent-return extension in light of the fraud penalty).

[17] *See, e.g., Summerill Tubing Co. v. Comm'r*, 36 B.T.A. 347 (1937) (holding that corporation's fraudulent intent could be imputed for its president's tax-evasion and embezzlement scheme).

[18] *Rothensies v. Elec. Storage Battery Co.*, 329 U.S. 296, 301 (1946) (internal quotation omitted).

in tax matters, there have been exceptions in cases where taxpayers or their agents intentionally defraud the IRS.[19] And, for nearly a century, no assessment period has applied at all "[i]n the case of false or fraudulent returns with intent to evade [federal] tax."[20]

From the earliest days of the federal income tax, Congress has excluded intentional wrongdoers from the statute of repose that protect honest taxpayers.[21] Code § 6501(c)(1) continues that tradition by authorizing the Commissioner of Internal Revenue ("Commissioner") to assess "fraudulent return[s] with the intent to evade tax . . . at any time."[22]

A. Antebellum Taxes

The U.S. Constitution was conceived, in part, to give the federal government the means to fund itself by collecting taxes.[23] Although the first national income tax would have to wait until the Civil War, the first substantive acts of the First Congress imposed duties on foreign goods and stationed tax collectors at the nation's borders to collect them.[24]

Like today's taxpayers, each ship's commander was required to report their foreign cargo to the customs collector "before such ship or vessel shall be permitted to clear out."[25] But Congress also empowered federal collectors to seize taxes through forfeiture of fraudulently-invoiced goods at any time after the fraud had been committed.[26]

In *Clifton v. United States* (1846), the Supreme Court considered the case of an importer whose foreign goods had been fraudulently invoiced in England and taxed on that basis in New York before being seized in Philadelphia.[27] The importer claimed that the Philadelphia collector's forfeiture was untimely because it was not made "before such

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[19] Act of August 5, 1861 § 16, 12 Stat. 298 [hereinafter *Revenue Act of 1861*] ("And be it further enacted, that if any such person [subject to tax] shall deliver or disclose to any assessor or assistant assessor appointed in pursuance of this act, and requiring a list or lists, as aforesaid, any false or fraudulent list, with intent to defeat or evade the [tax].").

[20] Revenue Act of 1918 § 250(d), 40 Stat. 1057.

[21] *See Lilienthal's Tobacco v. United States*, 97 U.S. 237 (1877) (authorizing U.S. Treasury seizures of tobacco on grounds that agents of the company had deceived the government about tax characteristics).

[22] *See* I.R.C. § 6501(c)(1).

[23] *Compare* Articles of Confederation, Art. 8 (Mar. 1, 1781), *with* U.S. Const., Art. 8, Cl. 1.

[24] *See* Act of July 4, 1789, 1 Stat. 24 (imposing duties on imported goods); Act of July 20, 1789, 1 Stat. 27 (imposing duties on tonnage); Act of July 31, 1789, 1 Stat. 29 (establishing officers "for the due collection of the duties imposed by law on the tonnage of ships" and "on goods, wares and merchandise imported into the United States").

[25] Act of July 31, 1789 § 20, 1 Stat. 42.

[26] Act of July 31, 1789 § 22, 1 Stat. 42.

[27] *Clifton v. United States*, 45 U.S. 242, 250 (1846).

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ship or vessel [was] permitted to clear out" of New York Harbor.[28] But the Supreme Court authorized forfeiture under Section 66 of the Revenue Act of 1799, which provided:

> That if any goods . . . of which entry shall have been made in the office of a collector shall not be invoiced according to the actual cost thereof, at the place of exportation, *with design to evade the duties thereupon* . . . all such goods, . . . to be recovered *of the person making entry*, shall be forfeited.[29]

Writing for a unanimous Court, Justice Samuel Nelson first noted the strong evidence that the ship's captain intentionally misrepresented the value of his English goods to the New York collector.[30] Justice Nelson then explained that Congress had "le[ft] the time and place of detection unrestricted" in "the case of fraud in making up the invoice prices below the actual cost of the goods"[31] The Court held that under these circumstances, "whether the discovery of the fraud in making up the invoice prices be made by the custom-house officers while the goods are passing inspection, or afterwards, is immaterial. In either case condemnation follows."[32]

The early judicial policy of allowing unlimited tax enforcement against "the person making [fraudulent] entry" is noteworthy because the forfeiture statute expressly required taxes to be collected "*before* such ship or vessel shall be permitted to clear out."[33] It appears that the Supreme Court carved out an exception for fraudulent returns for the 1789 law much like the one codified in Section 6501(c)(1) today.

B. The Civil War Income Taxes

The Civil War provided the occasion for the nation's first federal income tax. Three months after Fort Sumter, on July 4, 1861, President Abraham Lincoln asked Congress for $400 million to provision 400,000 Union soldiers capable of "making this contest a short, and decisive one."[34] Less than three weeks later, the Chairman of the Ways and Means Committee, Thaddeus Stevens, introduced a bill to raise $48 million in revenues from a national land tax, excise tax, and tariffs with "an army of officers whose

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[28] *Id.*

[29] Act of March 2, 1799 § 66, 1 Stat. 627, 677 (emphasis added).

[30] *Clifton*, 45 U.S., at 243.

[31] *Id.* at 250.

[32] *Id.*

[33] Act of July 31, 1789 § 20, 1 Stat. 42 (emphasis added).

[34] Abraham Lincoln, *July 4th Message to Congress* (July 4, 1861), available at http://millercenter.org/president/speeches/speech-3508.

business it is to collect these taxes."[35] This, Representative Stevens said, was the only way of ensuring "that we have laid taxes which we can enforce."[36]

The Ways and Means Committee originally reported a bill that only taxed real estate and "enumerated" items of personal property.[37] It contained no provision for taxing income or wealth directly. During the House debate, however, Representative Owen Lovejoy of Illinois (brother of Elijah Lovejoy[38]) raised serious concerns about the ability of well-informed taxpayers to escape or evade the tax proposed:

> Mr. STEVENS. We propose to levy a direct tax upon real estate, and internal taxes upon personal property of a certain character, the same as they do in the states.
>
> Mr. LOVEJOY. Suppose a man has bought land, and given his note for the same: is the holder of the note taxed upon the note?
>
> Mr. STEVENS. No, sir.
>
> Mr. LOVEJOY. But the man who nominally holds the land is taxed?
>
> Mr. STEVENS. The land is taxed.
>
> Mr. LOVEJOY. I think that is unjust. . . . I shall, at the proper time, move to recommit the bill, in order that the committee may take into consideration whether the tax should not be so levied that every citizen of a State shall pay according to what he is worth.[39]

Many congressmen echoed Representative Lovejoy's fear that a tax on specified properties would be a roadmap for evasion and Chairman Stevens was forced to

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[35] Representative Stevens acknowledged that most members of the House had not been given an opportunity to review the revenue bill prior to debate because "it was not printed and open to examination until morning [of July 24, 1861]." Cong. Globe, 37th Cong., 1st Sess. 247 (1861).

[36] *Id.*

[37] *Id.*

[38] Elijah Lovejoy published an Abolitionist newspaper in Illinois and was murdered by a lynch mob in 1837. He became a martyr in the Abolitionist community. *See* Jennifer Phillips, *Elijah Lovejoy's Fight for Freedom* 39–41 (Nose 2010).

[39] Cong. Globe, 37th Cong., 1st Sess. 248 (1861) (Remarks of Representative Lovejoy).

acknowledge that "[a]n income tax may be the most equitable that can be raised."[40] [41] Thus, the nation's first income tax was born out of a desire to ensure that "the wealthy could not escape or evade."[42]

President Abraham Lincoln signed the Revenue Act of 1861 into law on August 5, 1861.[43] The Act established a new bureaucratic infrastructure under a Commissioner of Tax in the U.S. Treasury Department.[44] U.S. tax assessors and collectors were charged with enforcing the 3% tax on less than 1% of Americans with annual income of more than $800.[45] Tax assessors were required to make a return for "persons [who] shall neglect or refuse to pay after due notice [of] said tax assessed against them" and to collect the tax from anyone whose payment remained delinquent for more than 30 days.[46]

Thus, contrary to Justice Jackson's suggestion, Congress's first income tax had no statute of limitations on collection. And, as *Clifton* made clear, the courts would not imply such limitations for tax evaders where none appeared in print.[47]

Assessments under the national land tax of 1861, however, were time-limited except in cases of intentional tax fraud.[48] In general, tax collectors could only collect unpaid taxes on real estate within "two years after the time [the tax] shall annually become due and payable."[49] But federal assessors had an unlimited time to assess the tax "if any such person [liable for the tax] shall deliver or disclose to any assessor or assistant assessor . . . any false or fraudulent list, with intent to defeat or evade the valuation" of land subject to tax.[50] Under the same provision, the person filing the false list with a tax collector was also made liable for civil and criminal penalties.[51]

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[40] *Id.* at 248–249 (Remarks of Representatives Lovejoy, McClernand, Colfax, Ashley, and Stevens).

[41] *Id.* at 248 (Remarks of Representative Stevens).

[42] Professor Sheldon D. Pollack explains: "In the debate over the Civil War income tax we hear the first expressions of contemporary American concern over the 'equity' of taxation. Invariably, such ethical concerns relate to the distribution of the tax–namely, who will bear the burden of the impost. This question is the fundamental political issue raised by *all* tax policies. In the 1860s, an 'equitable' tax was commonly perceived as one in which the wealthy could not escape or evade." Pollack, *The First National Income Tax, 1861-1872*, 67 Tax Law. 331, 332 (2014).

[43] Revenue Act of 1861 §§ 49–58, 12 Stat. 309–313.

[44] *Id.*

[45] U.S. citizens residing abroad were actually subject to a higher 5% tax rate but the $800 exclusion was the same for everyone. Revenue Act of 1861 § 49, 12 Stat. 309. *See also* Samuel H. Williamson, *Seven Ways to Compute the Relative Value of a U.S. Dollar Amount, 1774 to Present*, www.measuringworth.com/uscompare (2015) (calculating measures of relative wealth in 1861 America compared to today).

[46] In addition, taxpayers were given a 30-day grace period after the 1861 tax return's due date, until July 30, 1862, before collectors could levy their property for unpaid taxes. Revenue Act of 1861 § 51, 12 Stat. 310.

[47] *See Clifton,* 45 U.S., at 250. (1846).

[48] Revenue Act of 1861 § 51, 12 Stat. 310.

[49] *Id.* at 303.

[50] *Id.* at 298.

[51] *Id.* at 298 (emphasis added).

This "fraudulent list" provision, while not within the income tax sections of the 1861 Act, focused on the acts or omissions of the taxpayer.[52] Sections 14 and 15 of the Act provided that owners, possessors, and managers of land were responsible for providing a list of their taxable property to federal assessors.[53] Congress then provided that when "*such persons* shall deliver or disclose" a fraudulent list to the tax assessor "with intent to defeat or evade the valuation . . . *such person*" shall be assessable at any time.[54] Thus, Congress's first "false or fraudulent return" provision required fraud on the part of the taxpayer to apply.

In 1862, Congress broadened the income tax base as well as the government's means of enforcing it.[55] Although the 1862 income tax still covered only 1.3% of Americans, the Act created a new Office of the Commissioner of Internal Revenue along with 370 district assessors and collectors to supervise its collection.[56] During the six months from July to December 1862, the Bureau of Internal Revenue's field staff grew from three agents to 3,882.[57]

Section 92 of the Revenue Act of 1862 unified procedures for collecting income taxes and other duties by providing:

> That it shall be the duty of *all persons of lawful age . . . to make return in the list or schedule*, as provided in this act, to the proper officer of internal revenue, *of the amount of his or her income . . . and in the case of neglect or refusal to make such return*, the assessor or assistant assessor shall assess the amount of his or her income *as is provided for in other cases of neglect and refusal to furnish lists or schedules in the general provisions of this act*.[58]

As a general rule, the 1862 Act required the government to make assessments within 30 days of the return's due date unless the taxpayer failed to file a return or filed

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[52] *See Dandelet v. Smith*, 85 U.S. 642, 647 (1873) (discussing the assessor's authority to collect excise taxes governed by the same limitation established for federal income taxes).

[53] Revenue Act of 1861 § 14–15, 12 Stat. 297–298.

[54] *Id*. at 298 (emphasis added).

[55] Congress's Act of July 1, 1862 § 89, 12 Stat. 432, 473 [hereinafter *Revenue Act of 1862*] lowered the annual exclusion amount from $800 to $600. According to Professor Pollack, the 1862–1866 exemption of $600, the 1867–1870 exemption of $1,000, and the 1871–1872 exemption of $2,000, excluded 98.7%, 99.3%, and 99.8% of the U.S. population, respectively. Pollack, *The First National Income Tax, 1861-1872*, 67 Tax Law., at 337 n. 98.

[56] In 1862, Congress reduced the exclusion amount from $800 per year to $600. *See also* Revenue Act of 1862 §§ 89–93, 12 Stat. 473–475 Act of June 30, 1864 § 66, 13 Stat. 223 [hereinafter *Revenue Act of 1864*]; Act of July 13, 1866 § 9, 14 Stat. 101–102, 104 [hereinafter *Revenue Act of 1866*]; Act of March 2, 1867 § 13, 14 Stat. 477–480; Act of July 14, 1870 §§ 6–8, 16 Stat. 256, 257–258.

[57] Joe Thorndike, *An Army of Officials: The Civil War Bureau of Internal Revenue*, 93 Tax Notes 1739 (Dec. 24, 2001).

[58] Revenue Act of 1862 § 93, 12 Stat. 432, 475 (emphasis added).

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one that was fraudulent.[59] The Revenue Act of 1862 authorized unlimited assessment in cases of intentional tax fraud:

> "[I]f *any person . . . liable to pay any duty, tax or license*, . . . shall deliver or disclose to any assessor assistant assessor appointed in pursuance of this act, . . . *any false or fraudulent list or statement, with intent to defeat or evade the [tax]* . . . the said assessors and assistant assessors are hereby authorized and required to make according to the best information they can obtain [a correct list or return]; and from the valuation and enumeration so made there shall be no appeal.[60]

Under the Revenue Act of 1862 the only person who's fraudulent intent counted for purposes of tolling the statute was the person "liable to pay" the tax.[61] Clearly, someone else's fraudulent intent would not do.

This same understanding is reflected in the federal income tax laws enacted from 1864 to 1870 and in 1894, as well as the court decisions applying them. Under both the Revenue Acts of 1864 and 1894, Congress distinguished between the rights of delinquent taxpayers on the basis of their culpability. While any "person [who] shall have taxable property" was liable for "*rendering* a false or fraudulent list or return," a taxpayer whose false return was "*occasioned* by sickness or absence" had an extra 30 days to amend it.[62] The principle of agency embodied in this distinction between "rendering" a fraudulent return and making a false one "occasioned" by outside forces should decide cases of preparer fraud today, although it rarely does.[63]

The Supreme Court too supported the view that fraud on the part of the taxpayer or his agents was both necessary and sufficient to suspend the tax code's first statute of limitations in the Revenue Act of 1866.[64] The 1866 Act went into effect on July 13, 1866,

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[59] Generally, assistant assessors were required to submit their "lists" of taxpayers' liabilities to the chief assessor of the district within 30 days of tax day. After that, the assessor was required to advertise any adjusted tax liabilities in four public places for a period for 15 days ("15-day advertisement period"). If the taxpayer applied to the assessor during the 15-day advertisement period for a redetermination, the assessor was authorized to hear and redetermine the taxpayer's liability as justice required. Revenue Act of 1862 §§ 14–15, 12 Stat. at 436–437.

[60] *Id* (emphasis added).

[61] *Id*.

[62] The structure of the last sentence of Section 14 of the Revenue Act of 1864 makes clear (1) that the subject of the sentence is the "person [who] shall have taxable property" in the district; (2) that only "such person so refusing or neglecting, or rendering a false or fraudulent list or return" was properly assessable under the paragraph; and (3) that only such person's "neglect occasioned by sickness or absence" would afford a second chance. Revenue Act of 1864 § 14, 13 Stat. 227 (emphasis added).

[63] *See City Wide Transit, Inc.*, 709 F.3d, at 107 (holding victim-taxpayer liable for rogue accountant's fraud).

[64] *See Lilienthal's Tobacco*, 97 U.S., at 242–243 (holding under the Revenue Act of 1866 § 9, 14 Stat. 104, that taxes returned prior to July 13, 1866, could nonetheless be collected more than 18 months later when the returns of tax were filed with "an intent on [the taxpayer's] part throughout to defraud the government").

and required federal tax authorities to assess "false or fraudulent statements contained in any return or returns *made by any person or persons liable to tax* . . . within fifteen months from the time of the passage of this act or from the time of the delivery of the [return] to the collector."[65]

In *Lilienthal's Tobacco v. United States* (1877),[66] the Supreme Court nonetheless authorized assessment of tobacconist Christian Lilienthal's March 1865 excise tax return more than 15 months after the 1866 Act's passage on grounds that "Lilienthal or his agents" had backdated sales to March 1865 in order to avoid an excise tax increase in April 1865.[67] The Court held that no limitation applied to the assessment of Lilienthal's fraudulent tax return because "[o]therwise a party would be able to take advantage of his own wrong."[68]

Thus, the Supreme Court had already developed a robust fraud exception to statutes of limitation in tax cases by the time the Court ruled the national income tax unconstitutional in *Pollock v. Farmers' Loan & Trust Company* (1895).[69] *Pollock* was from the outset a deeply-divided and highly-controversial decision that generated three more dissents than *Plessy v. Ferguson* (1896), decided two years later.[70] But it would take the Progressive Era's radical shift in national politics nearly three decades later to finally secure the passage of the Sixteenth Amendment and the first modern income tax in 1913.[71]

C. Modern Income Tax History

On October 3, 1913, President Woodrow Wilson signed into law the first national tax act under the Sixteenth Amendment. The administrative provisions of the Revenue Act of 1913 followed those of the nineteenth century and the 1909 corporate income tax law by extending the period of tax collection "in cases of false or fraudulent returns."[72] It provided that:

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[65] Revenue Act of 1866 § 9, 14 Stat. 104 (emphasis added).

[66] 97 U.S. 237 (1877).

[67] *Id.* at 255.

[68] *Lilienthal's Tobacco*, 97 U.S., at 240, 249.

[69] *See generally Pollock v. Farmers' Loan & Trust Company* 157 U.S. 429 (1895); *Lilienthal's Tobacco*, 97 U.S. 237 (1877).

[70] *See generally Plessy v. Ferguson*, 163 U.S. 537 (1896).

[71] Congress proposed the Sixteenth Amendment to the states on July 12, 1909. 44 Cong. Rec., 61st Cong., 1st Sess. 4390. The Amendment was expressly intended to reverse the decision in *Pollock v. Farmers' Loan & Trust Company* 157 U.S. 429 (1895), and establish that: "The Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration." Ratification by two-thirds of the states was completed on February 25, 1913. 37 Stat. 1785.

[72] *See* Act of October 3, 1913 § II(D)–(E), 38 Stat. 169 [hereinafter *Revenue Act of 1913*].

> *[A]ll persons* shall be *notified of the amount for which they are respectively liable* on or before [June 1st] of each successive year, and *said assessments shall be paid* on or before [June 30th], *except in cases of false or fraudulent returns* in which cases the Commissioner of Internal Revenue shall, upon the discovery thereof, at any time within three years after said return is due, make a return upon information obtained as provided for in this [Act].[73]

This exception for "false or fraudulent returns" mirrored the one enacted in 1866 in making the taxpayer its subject.[74] Since courts during the Reconstruction Era had not required a statutory provision in order to suspend the statute of limitations on grounds of fraud, Congress might have expected the same rules to apply under the 1913 Act.[75]

But the federal judiciary soon made clear that the 1913 Act's limitation provision would be strictly construed. In *Eliot National Bank v. Gill*,[76] the U.S. Court of Appeals for the First Circuit construed an identical assessment provision in the 1909 corporate tax law to require assessments within three years for "false *or* fraudulent returns."[77] And, in early 1918, the Third Circuit ruled for the first time that the 1913 Act's three-year assessment period applied uniformly to fraudulent and merely-incorrect returns.[78] Congress took swift action at the end of 1918 to reestablish the nineteenth century's unlimited assessment period for tax evaders.[79]

1. The Revenue Act of 1918

Section 250(d) of the Revenue Act of 1918 established for the first time, by statute, that intentional tax evaders could be assessed without limitation at any time.[80] Since February 24, 1919, the Commissioner has faced no time limit on the assessment of "fraudulent returns with intent to evade the tax."[81]

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[73] Revenue Act of 1913 § II(D)–(E), 38 Stat. 169 (emphasis added).

[74] *Compare* Revenue Act of 1913 § II(D)–(E), 38 Stat. 169 (authorizing assessment of "false or fraudulent returns" within three years) [hereinafter *Revenue Act of 1913*], *with* Revenue Act of 1866 § 9, 14 Stat. 104 (authorizing assessment of "false or fraudulent . . . returns" made by taxpayers within 15 months).

[75] *See Lilienthal's Tobacco*, 97 U.S., at 261 (holding).

[76] 218 F. 600 (1st Cir. 1914).

[77] *Id.* at 602–603 (holding that Corporation Tax Law's provision applied alike to fraudulent and merely false returns) (emphasis added).

[78] *See National Bank of Commerce v. Allen*, 223 F. 472, 478 (8th Cir. 1915) (following the First Circuit's ruling in *Eliot National Bank*); *Woods v. Lewellyn*, 252 F. 106, 109 (3d Cir. 1918) (holding that the same time extension applied to innocently or intentionally fraudulent returns under the 1913–1916 income tax laws).

[79] *Lilienthal's Tobacco*, 97 U.S., at 249.

[80] Revenue Act of 1918 § 250(d), 40 Stat. 1083 (emphasis added).

[81] *Id.*

a) Section 250 of House Bill No. 12863. The Ways and Means Committee drafted House Bill No. 12863 ("H.R. 12863"), which President Wilson signed into law as the Revenue Act of 1918.82 The Committee reported the original version of Section 250 out of committee without subdivisions.[83]

The section's eight paragraphs were evidently conceived as a whole: the first and second establishing filing and payment deadlines; the third providing rules for overpayments; and the fourth through eighth describing the consequences of underpayment.[84] And Section 250 described the consequences of fraud in the following paragraphs:[85]

> **SEC. 250.** [No penalties apply] if the return is made in good faith and the understatement of the amount in the return is *not due to any fault of the taxpayer* [but] [i]f the understatement is *due to negligence on the part of the taxpayer*, *without intent to defraud*, [or] . . . is *false or fraudulent with intent to evade the tax*, then, [penalties apply]. . . .
>
> In the case of *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.[86]

From their inception, the "fault of the taxpayer" was essential to application of both the fraud penalty and the fraud exception to the statute of limitations in tax cases.[87] Only the taxpayer's "good faith," "negligence," or "intent to evade the tax" determined the terms of assessment under original Section 250.

Even *Allen*'s harshest critics appear to concede that the fraudulent-return and penalty provisions in Section 250 of the 1918 Act were originally conceived apart. But Section 250's fraud provisions were in fact drafted together with a single requirement of "intent to defraud . . . on the part of the taxpayer" before clerical amendments in the Senate subdivided them.[88] And the IRS's concession that in the fraud penalty, "Congress made it perfectly clear that they were talking about taxpayer's intent," applies with equal force to the fraudulent-return extension for assessment and collection.[89]

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[82] *See* H.R. 12863 (House Report No. 767), 65th Cong., 2d Sess., Doc. No. 1267, at 20–21 (Sept. 3, 1918); Revenue Act of 1918, 40 Stat. 1083.

[83] *Id.*

[84] *Id.*

[85] H.R. 12863, 65th Cong., 3rd Sess., Document No. 310, at 70–72 (Dec. 6, 1918) (reproducing the original House version of H.R. 12863 reported to the Senate on September 21, 1918, with changes made by the Senate on December 6, 1918).

[86] H.R. 12863 (House Report No. 767), 65th Cong., 2d Sess., Doc. No. 1267, at 21 (emphasis added).

[87] H.R. 12863 (House Report No. 767), 65th Cong., 2d Sess., Doc. No. 1267, at 20–21 (emphasis added).

[88] H.R. 12863 (House Report No. 767), 65th Cong., 2d Sess., Doc. No. 1267, at 21.

[89] *See BASR Partnership v. United States*, 795 F.3d 1338, 1349 (Fed. Cir. 2015).

b) Subsection 250(d) of the Revenue Act of 1918. The Senate Finance Committee made no substantive changes to Section 250 of H.R. 12863, except to divide fraudulent-return and penalty provisions into subsections (d) and (b), respectively. To preserve their unity, Senate Finance added the fraud penalty's requirement of "intent to evade the tax" into the fraudulent-return extension in order to prevent innocent taxpayers from being brought within its ambit.[90]

The Senate Finance Committee summarized amended Section 250(d) of the 1918 Revenue Act as a provision whereby:

> Authority is given to the Commissioner to take summary proceedings for collection of the tax in cases where there is evidence that *the taxpayer designed to evade the tax*.[91]

Members of the 65th U.S. Congress who voted to enact Section 250(d) into law did so on the belief that only culpable taxpayers would be held liable into perpetuity for unpaid taxes.[92] It is highly doubtful that such lawmakers would have burdened the already-controversial federal income tax with a provision that "punishes the larger number of innocent people for the sake of preventing tax evasion by others."[93]

Section 250(d)'s language and structure have been preserved in Code § 6501(c)(1). But the Tax Court's recent decisions have eviscerated its purpose by holding innocent taxpayers strictly and forever liable for the frauds of others.

2. Early Case Law

Federal courts quickly developed a jurisprudence that required the taxpayer's "intent to evade the tax" in order to toll the collection statute.[94] Early decisions by the U.S. Board of Tax Appeals ("Board")[95] and Court of Appeals for the Fifth Circuit bear

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[90] *Id.* at 71–72.

[91] H.R. 12863, 65th Cong., 2d Sess., Document No. 1267, at 21 (Sept. 3, 1918) (emphasis added).

[92] *Id.*

[93] Cong. Rec., 65th Cong., 1st Sess. (Apr. 30, 1924) (Letter of Governor Ritchie of Maryland to the U.S. Senate Finance Committee) (discussing another proposed safeguard against tax evasion that was eventually defeated).

[94] *See*, *e.g.*, *United States v. Updike*, 1 F.2d 550, 555 (D. Neb. 1924) (finding that the "false or fraudulent return" provision is intended to preclude the taxpayer from "tak[ing] advantage of his own wrongful act, especially if the return he does make is 'incorrect, misleading, and false.").

[95] The U.S. Board of Tax Appeals was established by the Revenue Act of 1924 § 900, 43 Stat. 253, 336 (June 2, 1924), and became the U.S. Tax Court by virtue of the Revenue Act of 1942 § 504(a), Pub. L. No. 77-753, 56 Stat. 798, 957 (Oct. 21, 1942).

special mention because of their relevance to the issue of who's fraud counts in cases of preparer fraud.[96]

a) ***Weinstein* and *Karger*.** Both *Weinstein* and *Karger* concerned innocent wives whose husbands had committed tax fraud. Neither Sarah Weinstein ("Weinstein") nor Stella Karger ("Karger") were personally guilty of any wrongdoing, although their husbands were.[97] In all respects, Weinstein's case was identical to Karger's, except that only Weinstein had filed "a joint return [in 1923] to which she was a party, so as to impose upon her [ ] joint [and] several liability."[98] As a result, the Board of Tax Appeals ruled that the Commissioner was time-barred from assessing Karger but could assess Weinstein's joint return "at any time."[99]

In *Weinstein*, the Board reasoned that statutory tolling and penalties for "fraudulent returns with intent to evade tax" are "impersonal provision[s]" when applied to a joint filer.[100] While *Weinstein*'s language is similar to *Allen*'s, its analysis is different. The Board's decision in *Weinstein* is premised on a finding that the wife was jointly-and-severally liable for her husband's tax fraud.[101] As between such joint filers, the Board held, one taxpayer's fraud is sufficient to toll the statute and impose liability for fraud on another joint filer. But *Weinstein* did not imply that another's fraud could be imputed to the taxpayer if no such agency existed.[102]

Karger drove the point home two years later. In *Karger*, the wife had not filed a joint return, although she lived in a community-property state, and the question was whether that fact alone made her perpetually liable for her husband's tax fraud. The Board summarized the Commissioner's position regarding Karger as follows:

> No evidence of individual fraudulent intent on the part of Mrs. Karger, or evidence that she participated in or had knowledge of her husband's financial transactions, is available. The charge of fraud against her therefore is not pressed.
>
> Notwithstanding these facts, in as much as the returns filed by her were false and fraudulent with intent to evade tax, as reporting materially less than half her husband's income for each year, the statute of limitations has not run against

[96] *See Mitchell v. Comm'r*, 118 F.2d 308, 309 (5th Cir. 1941), *rev'g*, 40 B.T.A. 424 (1939); *Washington v. Comm'r*, 36 B.T.A. 74, 79 (1937); *Weinstein v. Comm'r*, 33 B.T.A. 105, 107–108 (1935); *Karger v. Comm'r*, 38 B.T.A. 20, 219–220 (1938).

[97] *See Weinstein v. Commissioner*, 33 B.T.A. 105 (1935) (holding the jointly-filing spouse was responsible for her husband's fraud); *Karger v. Commissioner*, 38 B.T.A. 209, 219–220 (1938) (holding that a separately-filing spouse was not liable for her husband's tax fraud).

[98] *Weinstein*, 33 B.T.A., at 106.

[99] *See Weinstein*, 33 B.T.A., at 107; *Karger*, 38 B.T.A., at 219–220.

[100] *Weinstein*, 33 B.T.A., at 107.

[101] *Id.*

[102] *Id.* at 106.

assessment and collection of the resulting deficiency for 1929, under the provision of Section 276(a), Revenue Act of 1928 (45 Stat. 791, 857).[103]

The Board of Tax Appeals disagreed. It held that since there was "[n]o evidence of individual fraudulent intent on the part of Ms. Karger," the Internal Revenue Bureau could not prove "that the return of the petitioner, Stella Karger, for 1929, was false or fraudulent with intent to evade tax, or that any part of any of the contested deficiencies, against her was due to fraud."[104]

Two other cases, *Washington v. Commissioner* (B.T.A. 1937) and *Mitchell v. Commissioner* (5th Cir. 1941), further elaborate the principle that holds taxpayers liable for their own fraud and fraud on the part of authorized agents.[105]

b) ***Washington v. Commissioner*.** *Washington* was decided by Judge John Murdock, who was to serve the second-longest tenure in the history of the U.S. Board of Tax Appeals and Tax Court.[106] Judge Murdock's analysis of the fraudulent-return exception in *Washington* reveals precisely what Board members required as proof of fraud under tax collection statutes of the 1920s and 1930s.

The taxpayer, George C. Washington ("George"), was the inventor of instant coffee and the principal shareholder of the world's first instant coffee maker ("Coffee Co.").[107] At the beginning, George was Coffee Co.'s only shareholder and executive officer. He lived frugally and the company reinvested everything it earned. As the instant coffee business grew, George divested some of his stock to his wife (Lina) and daughter (Louise), which was costless because the company never issued a dividend during its first 18 years.[108] He also hired a vice president, Clarence Mark ("Mark"), who became a "valued friend and advisor of the petitioner and his wife."[109] By 1929, Coffee Co. was ready to pay its first dividend.[110]

George "relied upon Mark and others to handle many of his business and personal financial transactions," including several "tax conscious" transfers to a trust just before the 1929 dividend, which the Internal Revenue Bureau considered fraudulent.[111] It was popular among tax lawyers of the day to try to skirt the progressive tax rate by use of

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[103] *Karger*, 38 B.T.A., at 219–220.

[104] *Id.* at 218.

[105] *Mitchell v. Comm'r*, 118 F.2d 308, 309 (5th Cir. 1941); *Washington v. Comm'r*, 36 B.T.A. 74, 79 (1937).

[106] Harold Dubroff and Brant J. Hellwig, *United States Tax Court: A Historical Analysis*, 2d Ed., 5 (GPO 2014).

[107] *Washington*, 36 B.T.A., at 74*;* Obituary of George C. Washington, N.Y. Times, at A15 (Mar. 30, 1946).

[108] *Washington*, 36 B.T.A., at 75–76.

[109] *Id.* at 78.

[110] *Id.* at 78.

[111] *Id.* at 80.

grantor trusts.[112] Although Section 219(g)–(h) of the Revenue Act of 1928 prohibited the grantor from assigning income to a nominal beneficiary, Professor Roswell Magill claimed in the Harvard Law Review that "if [the grantor] can find any such person whom he can trust to join him in exercising the power as he may desire, he can completely circumvent the statutory provisions."[113] And that's precisely what George's financial advisors did.

They created a trust for George giving him the "power to alter, modify, or revoke the trust during his lifetime."[114] George's wife and daughter were each given a remainder interest in the trust and were listed as beneficiaries. Then, George deposited dividend-paying life insurance policies into the trust with the premiums to be paid by his wife from dividends on stock George had given to her. This way George could spread the tax burden of his dividends to his wife and daughter while enjoying equivalent economic benefits from the dividends paid on life insurance purchased with his wife's dividends.[115] The structure probably was not legal under existing law but George thought it was.[116]

It took the Internal Revenue Bureau some time to catch onto George's scheme and, by the time it did, the statutory period for assessment had passed "unless the petitioner's return . . . was false or fraudulent with intent to evade tax."[117] As in *Karger* and *Weinstein*, the Bureau's claim for a fraudulent-return exception to the statute of limitations was accompanied by a fraud-penalty assessment against George.[118] In fact, the author has not found a single case from the twentieth century in which the IRS asserted a "naked" claim for statutory tolling on the basis of a fraudulent return without asserting the fraud penalty as well.[119]

The Board required the government to prove the taxpayer's fraud in order to be eligible for statutory tolling.[120] While Judge Murdock found George's "faith in and reliance upon others" both "unusual and extremely interesting," and that George "was extremely tax conscious," the judge found no evidence that George had personally disregarded a known legal obligation by failing to report his wife's dividends on his own

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[112] C.W. Leaphart, *The Use of the Trust to Escape the Imposition of Federal Income and Estate Taxes*, 15 Cornell L. Rev. 587, 589 (1930) [hereinafter *The Use of Trust to Escape Taxation*].

[113] Roswell Magill, *The Taxation of Unrealized Income*, 39 Harv. L. Rev. 82, 98 (1925).

[114] *Washington*, 36 B.T.A., at 80.

[115] *Id.* at 79.

[116] *See* Leaphart, *The Use of Trust to Escape Taxation*, *supra* note 112, at 589–595 (explaining that some tax reduction may be possible through grantor trusts but only "if the grantor is willing to reserve no beneficial interest in himself and *no power to alter, amend, or revoke the trust except in conjunction with a beneficiary*.").

[117] Revenue Act of 1928 § 276(a), 45 Stat. 791, 857 (May 29, 1928), provides: "In the case of a false or fraudulent return with intent to evade tax . . . the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time." *Washington*, 36 B.T.A., at 76.

[118] *Washington*, 36 B.T.A., at 74.

[119] *Washington*, 36 B.T.A., at 74.

[120] *Id.* at 78.

tax return.[121] Since the taxpayer had intended to make gifts of property to his wife and daughter and his family trust, and had relied on others to assess the legality of such transfers, the Board concluded that the Bureau had failed to prove the taxpayer's intent to commit tax fraud, which was necessary to toll the statute of limitations on assessment.[122]

c) *Mitchell v. Commissioner*. The Fifth Circuit Court of Appeals directly confronted the issue of preparer fraud in *Mitchell*. The taxpayer, William E. Mitchell ("Mitchell"), had granted his accountant, P.H. Nabors ("Nabors"), "full power of attorney" to prepare and file tax returns for the years 1928 through 1930.[123] The Bureau of Internal Revenue concluded that Nabors had prepared Mitchell's return fraudulently and sought to collect taxes from Mitchell outside the normal limitations period on the basis of the accountant's fraud.[124]

Mitchell acknowledged that he had underreported capital gains on his 1930 tax return but explained "that he relied upon the correctness of the computations made by Nabors and that it did not occur to him to question their accuracy."[125] Nabors, for his part, "testified positively that he alone prepared [Mitchell's] return, and what mistakes were made were his own."[126] While the Board of Tax Appeals held Mitchell liable on this basis, the Fifth Circuit reversed on grounds that the accountant's fraud could not be imputed to the taxpayer unless "Mitchell knew the return [prepared by Nabors] was false and nevertheless filed it as true."[127]

Other cases decided by the Third and Seventh Circuits under the Revenue Acts of 1918 and 1926, respectively, assumed that only the taxpayer's fraud would authorize assessment or collection of taxes returned "at any time."[128]

3. The Revenue Act of 1934

The legislative history of the Revenue Act of 1934 ("1934 Act")[129] bears special mention here only because the Tax Court's "preparer fraud" doctrine is based on a misreading of that history. According to the Tax Court, Congress "discarded" an early version of Section 276(a) of the 1934 Act that would have required the taxpayer's fraud

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[121] *Id.* at 81.

[122] *Washington*, 36 B.T.A., at 79–80 (evaluating the fraudulent-return exception in terms of what George, personally, "intended," "desired," "thought," and "wanted" out of his "tax conscious" transfers).

[123] *Mitchell*, 118 F.2d, at 310.

[124] *Mitchell*, 118 F.2d, at 309.

[125] *Id.*

[126] *Mitchell*, 118 F.2d, at 310.

[127] *Id.*

[128] *Woods v. Lewellyn*, 252 F. 106, 107 (3d Cir. 1918) (stating that fraud determination depends on whether the taxpayer made any concealment of material fact); *Tinkoff v. United States*, 86 F.2d 868, 876 (7th Cir. 1936) (imposing liability on "any person who attempts willfully and unlawfully to evade the tax of himself or of any other person").

[129] Revenue Act of 1934, Pub. L. No. 73-216, 48 Stat. 680 (May 10, 1934).

for statutory tolling to apply in favor of an "enacted version" that "continued to focus on the return with no express requirement that the fraud be the taxpayer's."[130] But *Allen*'s claim about the 1934 Act is demonstrably false.

Congress remained focused on preventing fraud by U.S. taxpayers throughout the drafting of the 1934 Act. During President Franklin D. Roosevelt's first hundred days, the House of Representatives appointed a Subcommittee on Tax Revision ("Subcommittee") "to investigate methods of preventing the evasion and avoidance of the internal revenue law."[131] After six months of investigation, the Subcommittee submitted recommendations for improving tax collection at the end of 1933 "that eventually became the basis for the Revenue Act of 1934."[132]

The report's only discussion of Section 276(a) occurs in the context of a doomed proposal to allow unlimited assessment of taxpayers guilty of gross negligence but not fraud:

> Section 276 provides for the assessment of the tax without regard to the statute of limitations in case of a failure to file a return or in the case of a false or fraudulent return with intent to evade tax.
>
> Your subcommittee is of the opinion that the limitation period on assessments should also not apply to certain cases where the taxpayer has understated his gross income on his return by a large amount, even though fraud with intent to evade tax cannot be established. It is, therefore, recommended that the statute of limitations shall not apply where the taxpayer has failed to disclose in his return an amount of gross income in excess of 25 percent of the amount of the gross income stated in the return. The Government should not be penalized when a taxpayer is so negligent as to leave out items of such magnitude from his return.[133]

Although many of the Subcommittee's proposals were adopted by Congress, the Senate Finance Committee rejected this proposal for the following reason:

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[130] *Allen*, 128 T.C. at 40 n. 4.

[131] Letter from Chairman Samuel Hill of the Subcommittee on Tax Revision to Chairman Robert Doughton of the Committee on Ways and Means (Dec. 4, 1933); George Grayson Tyler and John P. Ohl, *The Revenue Act of 1934*, 83 Penn. L. Rev. 607, 607–608 (1935) (stating that the subcommittee was authorized pursuant to House Resolution 183 the 1934 Act's history).

[132] H. SUBCOMM. ON TAX REVISION OF THE COMM. ON WAYS AND MEANS, 73D CONG., PREVENTION OF TAX AVOIDANCE 21 (Comm. Print. 1934) [hereinafter *Subcomm. Report on Preventing Tax Evasion*]; Tax Analysts, Tax History Project: 1934 Ways and Means Committee Report on Tax Avoidance (June 20, 2008), http://www.taxhistory.org/thp/readings.nsf/ArtWeb/3931ECC6107ECDC8852574B80001915F?OpenDocument.

[133] *Subcomm. Report on Preventing Tax Evasion*, *supra* note 132, at 21.

> [I]t is believed that in the case of a taxpayer who makes an honest mistake, it would be unfair to keep the statute open indefinitely. For instance, a case might arise where a taxpayer failed to report dividends because he was erroneously advised by the officers of the corporation that it was paid out of capital or he might report as income for one year an item of income which properly belonged in another.[134]

Both the House and Senate reports on the Revenue Act of 1934 presume that Section 276(a) does not "keep the statute open indefinitely" for any "taxpayer who makes an honest mistake," however negligently, of filing a false return.[135] If Section 276(a) already applied "where a taxpayer failed to report dividends [or other income] because he was erroneously advised," neither the House's proposal nor the Senate's objection would make sense.[136] Thus, the Tax Court's claim that Senate Finance rewrote the 1934 Act to focus on fraudulent returns rather than the taxpayer's fraudulent intent is untrue.[137]

Chairman of the Senate Finance Committee Pat Harrison's discussion of his Committee's amendments to Section 276(a) on the Senate floor further contradicts Judge Kroupa's claim that such amendments were meant to be substantive.[138] During congressional debates over the wording of Section 276(a), Senator Harrison assured Senator Clyde Reed that the Finance Committee's amendments worked no such change:

> THE PRESIDING OFFICER. The amendments will be passed over.
>
> The next amendment was, on page 175, after line 3, to strike out [the House Ways and Means Committee's version]:
>
>> (a) *No return or false return*: If *the taxpayer* fails to file a return, or *files a false or fraudulent return with intent to evade tax*, or omits from gross income an amount properly includible in excess of 25 percent of the amount of gross income stated in the 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*.

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[134] S. Rep. No. 73-558, 73d Cong., 2d Sess., 43–44 (1934).

[135] Revenue Act of 1928 § 276(a), 45 Stat. 745 ("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.").

[136] *See* S. Rep. No. 73-558, 73d Cong., 2d Sess., 43–44 (1934); *Subcomm. Report on Preventing Tax Evasion*, *supra* note 132, at *21.

[137] It should be noted that in 1934 the Senate rejected unlimited assessment even "when a taxpayer is so negligent as to leave out items of [great] magnitude from his return," while the Tax Court's rule in *Allen* would impose indefinite liability on much less culpable taxpayers. *See Subcomm. Report on Preventing Tax Evasion*, *supra* note 132, at *21; S. Rep. No. 73-558, 73d Cong., 2d Sess., 43–44 (1934).

[138] *Allen*, 128 T.C., at 40 n. 4.

> And in lieu thereof to insert [the Senate Finance Committee's version]:
>
> > (a) *No return or false return*: *In the case of a false or fraudulent return with intent to evade tax* or 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*.
>
> MR. REED. Mr. President, I think this amendment ought to be passed over along with the other.
>
> MR. HARRISON. *It is merely a clerical change*.
>
> MR. REED. *I do not see the effect of the change* from a quick reading.
>
> MR. HARRISON. It is existing law. *The clerks tell me it is merely a clerical change*.[139]

Since the Tax Court acknowledges that Section 276(a)'s language "remains the language in sec. 6501(c)(1) today,"[140] *Allen*'s only source of legislative support for its unparalleled expansion of the fraudulent-return extension rests on the gossamer of "a clerical change" to an unenacted bill more than 80 years ago.[141]

II. THE DOCTRINE OF PREPARER FRAUD

The federal courts are now badly split over the question of whether an innocent taxpayer whose returns are fraudulently prepared by someone else must "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."[142] In 2007, the U.S. Tax Court decided for the first time "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 petitioner [taxpayer] who had the intent to evade tax."[143] Two years ago, the Second Circuit Court

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[139] 78 Cong. Rec. 5867 (April 2, 1934) (emphasis added).

[140] *Allen*, 128 T.C., at 40 n. 4.

[141] *Allen*, 128 T.C., at 37 (emphasis added).

[142] *Rothensies v. Elec. Storage Battery Co.*, 329 U.S. 296, 301 (1946).

[143] *Allen*, 128 T.C., at 42.

of Appeals extended the *Allen* doctrine of preparer fraud to cases where tax fraud is merely an "incidental" side-effect of embezzlement against a victim-taxpayer.[144]

Just seven months after the Second Circuit's decision, however, the Claims Court rejected *Allen* on grounds that Code § 6501(c) requires "fraud by the taxpayer."[145] In July 2015, a Federal Circuit panel upheld the Claims Court's decision with all three judges writing separately.[146] Taxpayers who can "pay first and litigate later" can generally choose whether to litigate their case in the Claims Court or the Tax Court.[147] But the Tax Court is the only forum where litigants can bring suit against the IRS before paying their deficiency. For this reason, taxpayers who want the Claims Court's better law in cases of preparer fraud are going to have to pay to play.[148]

A. Deficiency Litigation: *Allen* and its Progeny

1. *Allen v. Commissioner*, 128 T.C. 37 (2007).

In 2007, the Tax Court "decide[d] for the first time [that] the limitations period for assessing income tax under I.R.C. § 6501(c)(1) is extended if the tax on a return is understated due to the fraudulent intent of the income tax return preparer."[149] Both parties in *Allen v. Commissioner*[150] stipulated that Vincent Allen's preparer, Gregory Goosby ("Goosby"), had "claimed false deductions for the years at issue on [Allen]'s returns with the intent to evade tax," but that Mr. Allen had no such intent.[151] The parties further stipulated that Mr. Allen's assessment was untimely unless Goosby's fraud extended the statute of limitations on assessment.[152] *Allen*'s only question was thus whether fraudulent

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[144] *City Wide Transit, Inc. v. Comm'r*, 709 F.3d 102, 107 (2d Cir. 2013).

[145] *BASR P'ship v. United States*, 113 Fed.Cl. 181, 181–194 (2013), *aff'd*, 795 F.3d 1338 (Fed. Cir. 2015).

[146] *BASR P'ship*, 795 F.3d, at 1339–1350; *BASR P'ship*, 795 F.3d, at 1350–1357 (J. O'Malley concurring); *BASR P'ship*, 795 F.3d, at 1357–1361 (C.J. Prost dissenting).

[147] *Flora v. United States*, 357 U.S. 63, 75 (1958), *aff'd on reh'g*, 362 U.S. 145 (1960); I.R.C. § 7422(a), (e).

[148] This assumes, of course, that taxpayers are rational actors with full information. No other assumptions are necessary in preparer-fraud cases because the substantive rule of law in the Claims Court will bar taxes that can be collected in Tax Court. *Compare City Wide Transit, Inc. v. Comm'r*, 709 F.3d 102, 107 (2d Cir. 2013) (holding, in a deficiency case, that the IRS could assess the taxpayer because of a rogue accountant's fraud), *with BASR P'ship*, 795 F.3d, at 1339–1350 (rejecting the doctrine of preparer fraud in refund cases). The Supreme Court has also firmly established that there is no way for taxpayers to get into Claims Court without paying the assessed taxes first and contesting them later. *Flora,* 357 U.S., at 75. *See also* David B. Porter, *Where Can You Litigate Your Federal Tax Case*, 98 Tax Notes 558, 558–559 (2003) (comparing the rules for litigating matters in the U.S. Tax Court and U.S. Court of Federal Claims).

[149] *Allen*, 128 T.C., at 37.

[150] 128 T.C. 37 (2007).

[151] *Id.* at 38.

[152] *Id.*

returns prepared by someone other than the taxpayer trigger open-ended assessment under Code § 6501(c)(1).[153]

Mr. Allen's audit began with an IRS criminal investigation of Goosby who prepared and filed the taxpayer's 1999–2000 tax returns.[154] Goosby's auditors interviewed Mr. Allen in November 2003 and learned that Mr. Allen had allowed Goosby to claim "obviously false" deductions on his 1999 and 2000 tax returns without correcting them.[155] By the time the IRS sent Mr. Allen's notices of deficiency for those years more than three years had passed since the returns had been filed so their timeliness depended on Code § 6501(c)(1).

Although the IRS argued *Allen*, in part, on a theory of agency, the Tax Court embraced the government's broader position that Code § 6501(c)(1) "keys the extension to the fraudulent nature of the return, not to the identity of the perpetrator of the fraud," which makes agency irrelevant.[156] The Tax Court read the taxpayer's culpability out of Section 6501(c)(1) without a backward glance and concluded as a matter of policy that such a result made sense because "to find otherwise would allow a taxpayer to receive the benefit of a fraudulent return by hiding behind the preparer."[157]

2. Deficiency Litigation after *Allen*

Since anyone's fraud could potentially trigger unlimited assessment if the sole criteria of Section 6501(c)(1) were "the fraudulent nature of the return," the Tax Court has constrained *Allen* to cases of preparer fraud so that fraudulent acts of identity thieves and other remote actors do not extend the taxpayer's assessment period indefinitely.[158]

a) *Browning v. Commissioner*, 102 T.C.M. (CCH) 460 (2011), was the Tax Court's second case decided on grounds of preparer fraud, four years after *Allen*.[159] In *Browning*, the Tax Court considered a petition brought by Perry W. Browning ("Browning") from deficiencies arising from an offshore employee leasing ("OEL")

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[153] *See Opening Brief for Respondent*, at 5, *Allen v. Comm'r*, 128 T.C. 37 (2007) (No. 11016-05), 2006 WL 4719797, at *1 [hereinafter *IRS Brief in Allen*] ("This is an issue of first impression.").

[154] Goosby, was ultimately convicted "on thirty counts of willfully aiding or assisting in the preparation and presentation of false or fraudulent income tax returns under 26 U.S.C. § 7206(2)" based on the falsification of deductions on other taxpayers' returns. *United States v. Goosby*, 523 F.3d 632, 635–636 (6th Cir. 2008).

[155] *See Allen*, 128 T.C., at 37; *Brief for Respondent*, at 3, *Allen v. Comm'r*, 128 T.C. 37 (2007) (No. 11016-05), 2006 WL 4692222, at *2.

[156] *IRS Brief in Allen*, *supra* note 153, at *15–29.

[157] *Id*. at *42.

[158] The Claims Court and Federal Circuit simultaneously rejected *Allen* as well as the IRS's claim for an expansion of the preparer-fraud doctrine to cover a tax attorney's fraud. It is unclear how the rule would be applied under the *Allen* doctrine. *BASR P'ship*, 795 F.3d, at 1339–1350, *aff'g*, 113 Fed.Cl. 181 (2013).

[159] *Browning*, 102 T.C.M. (CCH) 460, at *9, *citing*, *Allen*, 128 T.C., at 40–42.

scheme devised by a Florida attorney, Jim Schmidt ("Schmidt"), and faithfully executed by Browning's longtime preparer, Viggo Carstensen ("Carstensen").[160]

Browning was the founder, principal shareholder, and chief executive officer of a Vermont-based electronics manufacturer, S B Electronics ("SBE").[161] He organized SBE as an S corporation in 1985 and managed it until June 2002, when he retired and sold the company.[162] Although Browning was a skilled businessman, he had no special knowledge of federal taxation.[163] Browning and his wife relied on Carstensen to prepare their joint tax returns, as well as Forms 1120S for SBE.[164]

In December 1995, Schmidt convinced Browning and his preparer that leasing Browning's services back to his company would *legally* defer Browning's earnings from SBE by allowing his S Corporation to deduct payments to the owner as "salary" expenses.[165] Under the OEL plan, Browning would contract with an Irish company to sell his services back to SBE through a series of leasing and subleasing arrangements.[166] The plan originally contemplated that the Irish company would use some of its earnings from the sale of Browning's services to set up an offshore account for Browning, although that account wasn't actually created until 1998.[167]

Although Browning's preparer knew some of the transaction's risks, the Tax Court found that both taxpayer and preparer "appeared to believe that the OEL program, as constructed and explained to them by Messrs. Schmidt and Drysdale, would result in the sought-after tax deferral for petitioner."[168]

Carstensen followed the tax lawyer's representations and deducted Browning's salary from SBE's income for each year from 1995 to 2002.[169] And Carstensen truthfully reported that Browning had no foreign financial accounts on Forms 1040 from 1995 through 1997. But when Schmidt issued Browning his foreign charge card in 1998, Carstensen continued to deny its existence on Forms 1040 through 2002 and twice lied about its existence on audit before disclosing the account in July 2002.[170]

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[160] *Browning*, 102 T.C.M. (CCH) 460, at *3–9.

[161] *Id.* at *2.

[162] Congress has authorized small, domestic corporations with no more than 100 shareholders to elect to be treated as a partnership for federal tax purposes. I.R.C. § 1361(b). An "S corporation" is defined by I.R.C. § 1361(a) as a corporation that has made such an election and which passes through items of income, loss and deduction to its shareholders. I.R.C. §§ 1362(a), 1366(a); *Browning*, 102 T.C.M. (CCH) 460, at *3–9.

[163] *Browning*, 102 T.C.M. (CCH) 460, at *3.

[164] *Id.* at *4.

[165] *Browning*, 102 T.C.M. (CCH) 460, at *4–5

[166] *Browning*, 102 T.C.M. (CCH) 460, at *4.

[167] *Id.*

[168] *Id.* at *18.

[169] *Id.* at *7.

[170] *See* I.R.C. § 6501(c)(1); *Browning*, 102 T.C.M. (CCH) 460, at *2.

Browning confronted the factual issue left undecided by *Allen*, which had stipulated that the taxpayer's return was fraudulent. While the Tax Court found Schmidt's OEL plan was fraudulent that did not end the inquiry because only fraud of the taxpayer or of his preparer would extend assessment indefinitely under Code § 6501(c)(1).[171] Consistent with this understanding, Judge James Halpern focuses on evidence of fraud on the part of (1) the taxpayer, Browning, or (2) his preparer, Carstensen, but not on fraud of Browning's lawyer, Schmidt, who designing the illegal tax shelter in the first place.

Judge Halpern explained:

> We strongly suspect that had Messrs. Schmidt and Drysdale been able to comply with petitioner's 1996 request for an offshore credit card at the time of that request, the pattern of tax evasion that petitioner and Mr. Carstensen exhibited during 1998–2000 would have been present during 1996 and 1997; i.e., that the restriction of that behavior to 1998–2000 was merely fortuitous. This Court, however, will not sustain a finding of fraud based upon circumstances which at the most create only suspicion.

Since only fraud by the taxpayer or his preparer was sufficient to toll the statute under Section 6501(c)(1), the Tax Court held in *Browning* that the assessments for 1995 through 1997 were untimely even though the taxpayer's lawyer was undoubtedly engaged in fraud during that period.[172] This blinkered view of fraudulent returns, which requires a fraudulent preparer in order to apply, sets the pattern for analysis in *Ames-Mechelke v. Commissioner* (2013), which is the most recent case in *Allen*'s line[173]

b) *Ames-Mechelke v. Commissioner,* 106 T.C.M. (CCH) 77 (2013), is the most recent preparer fraud case decided by the Tax Court.[174] *Ames-Mechelke* follows *Browning*'s pattern of analysis precisely. The primary issue before the Tax Court was whether the IRS could assess deficiencies against taxpayer Laura Ames-Mechelke ("taxpayer") from a 1993–1995 trust scheme developed by her financial planner, Paul E. Palmer ("Palmer"), and executed by her preparer, Dwight Dennis Larson ("Larson").[175]

Taxpayer was a sole proprietor of a chiropractor business of which Palmer's wife was a customer. The taxpayer met Palmer through his wife and began attending ecstatic prayer sessions led by Palmer.[176] In addition to providing the taxpayer with spiritual counseling, Palmer promoted a trust arrangement that he claimed could legally lower the taxpayer's corporate taxes.[177] To put the taxpayer's mind at ease, Palmer showed her

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[171] *Browning*, 102 T.C.M. (CCH) 460, at *16; I.R.S., Form 1040, Schedule B, Line 7a (1998), *available at* https://www.irs.gov/pub/irs-prior/f1040sab--1998.pdf.

[172] *Browning*, 102 T.C.M. (CCH) 460, at *13–19 (comparing the evidence of fraudulent intent before and after 1998).

[173] *See BASR P'ship*, 113 Fed.Cl. 181, 192–194 (2013), *aff'd*, 795 F.3d 1338 (Fed. Cir. 2015) (rejecting the application of I.R.C. § 6501(c)(1) to a tax attorney who planned the tax shelter at issue).

[174] *Ames-Mechelke*, 106 T.C.M. (CCH) 77, at *6.

[175] *Id.* at *1–2.

[176] *Id.* at *2.

[177] *Id.*

videos and gave her literature about the tax shelter. He also introduced her to Larson, whom the taxpayer believed had an accounting degree, although he did not.[178]

Larson too was apparently taken in by Palmer's pitch.[179] He testified that he believed in 1993 that the trust arrangement was legitimate since Palmer assured him that none of the money in the trusts would be controlled by the taxpayer.[180] But Larson also acknowledged that he later became aware that "Palmer had 'sneaky' ways of returning trust funds to the taxpayer without the funds 'showing up.'"[181]

In 1993, the taxpayer purchased Palmer's tax shelter for $46,000. Palmer set up four trusts and convinced the taxpayer to incorporate her sole proprietorship as a C Corporation ("Chiropractor Co.").[182] Although Palmer never obtained taxpayer identification numbers for the trusts, he set up bank accounts for each, with himself and the taxpayer as co-signatories. Palmer used fake taxpayer IDs for each of the taxpayer's four trust accounts without the knowledge of the taxpayer or her preparer. Larson also did not know that the trust arrangement was illegitimate when he prepared the taxpayer's 1993 tax return and deducted Palmer's $46,000 fee as "Cost of Sales" and "Contract Services."[183]

In 1994, however, the taxpayer transferred $144,000 from her Chiropractor Co. to her trust accounts, which she then used to pay personal expenses, as well as Palmer's second-year fee of $10,000. 1994 was also the first year that Larson prepared the Chiropractor Co.'s Corporate Income Tax Return (Form 1120), which gave him a full picture of the trust arrangement.[184] Larson timely filed the company's Form 1120 for the fiscal year ending November 30, 1994 on which he disguised Chiropractor Co.'s $154,000 payment to the taxpayer's trusts and Palmer as cost of sales, rent, and management fees.[185] Larson also concealed Chiropractor Co.'s trust-arrangement payments of $162,000 in 1995 under similar line-items on the company's Form 1120 for the year.[186] And Larson continued to prepare the taxpayer's returns through 1997.[187]

During this period, Palmer convinced the taxpayer to invest her tax savings with him in return for a promised return of 15–20%.[188] Palmer then fled to New Zealand around August 1997 with about $500,000 of the taxpayer's money, plus money belonging to many other investors.

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[178] *Ames-Mechelke*, 106 T.C.M. (CCH) 77, at *2.

[179] *Id.*

[180] *Id.*

[181] *Id.*

[182] *Ames-Mechelke*, 106 T.C.M. (CCH) 77, at *2.

[183] *Id.*

[184] *Id.* at *3.

[185] *Id.*

[186] *Ames-Mechelke*, 106 T.C.M. (CCH) 77, at *2.

[187] *Id*. at *2–4.

[188] *Id.* at *4.

In 2001, Palmer was extradited from New Zealand and charged along with Larson with tax crimes.[189] Larson pleaded guilty in January 2002 to filing false tax returns, including Chiropractor Co.'s Forms 1120 for fiscal years ending November 30, 1994 and 1995. Between December 2002 and August 2003, the IRS sent the taxpayer notices of deficiency for the years 1993–1997, all of which were untimely in the absence of fraud except for 1996 and 1997.[190]

The Tax Court held that, for 1993, taxpayer's return preparer, Larson, "believed, albeit mistakenly, that the trust arrangement was legitimate. Larson also incorrectly viewed the trust arrangement as a financial planning arrangement whereby petitioner might reduce her taxable income."[191] The court explained: "Thus, while Larson's misdirected reliance on Palmer's claims about the legitimacy of his trust arrangement, combined with his misunderstanding of business expense deductions under section 162, connote negligence, his conduct in preparing Petitioner's 1993 tax return was not clearly and convincingly fraudulent."[192]

The Court looked at Larson's conduct in preparing the taxpayer's 1994–1995 returns in a very different light. It found he had mischaracterized payments made from her trust arrangement with Palmer, which, by then, Larson knew were being used to pay the taxpayer's personal expenses. The preparer was fully aware by 1994 that none of the taxpayer's trusts were filing tax returns and that the taxpayer was not paying any tax on that money.[193] The Court therefore held that Larson had fraudulently misrepresented Chiropractor Co.'s trust payments as legitimate business expenses in order to help the taxpayer evade taxation. Under *Allen*, the court authorized assessment for those years.

But the Tax Court also held that the IRS was barred from collecting taxes from 1993 because neither the taxpayer nor her preparer knew the trust scheme was fraudulent until 1994. Significantly, in *Ames-Mechelke*, the stipulated facts firmly established Palmer's intent to defraud the IRS by promoting an illegal tax shelter. But Palmer's fraud was not enough under *Allen*'s doctrine of preparer fraud, which now requires proof of fraud on the part of the return preparer in order to apply.

c) *City Wide Transit, Inc. v. Commissioner*, 102 T.C.M. (CCH) 542 (2011), *rev'd*, 709 F.3d 102 (2d Cir. 2013), introduced another plausible restriction on preparer where the taxpayer is the intended victim of an accountant's tax-fraud scheme but this limitation was rejected by the U.S. Court of Appeals for the Second Circuit.

City Wide arose out of an embezzlement scheme by an accountant, Manzoor Beg ("Beg"), who had used forged tax documents to cover up his defalcation of company

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[189] *Id.*

[190] *Ames-Mechelke*, 106 T.C.M. (CCH) 77, at *5.

[191] *Ames-Mechelke*, 106 T.C.M. (CCH) 77, at *6.

[192] *Id.*

[193] *Id.* at *7.

funds.[194] The petitioner in *City Wide Transit v. Commissioner* was a New York City bus company wholly-owned and managed by Ray Fouche ("Fouche"). Fouche owned a number of other companies in New York, including City Wide Transit, Inc. ("City Wide"). She had a payroll company to prepare City Wide's employment tax returns each quarter, including the quarterly tax returns at issue in the case. City Wide's payroll company had already filed returns for June 1997 and December 1998 when Fouche hired Beg to deal with tax liabilities related to her other companies.

Beg held himself out as an IRS enrolled agent, although he was not. Nor had he been hired by City Wide. Fouche had hired Beg to handle federal tax matters related to her other companies but she gave Beg a blank power of attorney to settle tax issues on behalf of those companies. She continued to rely on City Wide's payroll company to prepare the company's quarterly employment tax returns for 1999 and 2000, which the company continued to do truthfully and accurately. The parties stipulated that Fouche, City Wide, and City Wide's payroll company all acted with good faith and fair dealing toward the IRS.

But, in 2001, Beg convinced Fouche that he had worked a comprehensive tax settlement relating to her companies and would need to deliver City Wide's returns and tax payments to the IRS himself. These were lies. Fouche delivered checks to Beg made out on City Wide's behalf in the amount of employment taxes owed for each quarter. Beg, then, changed the payee of City Wide's tax checks to himself and filed false returns that neither Fouche nor the payroll service had ever seen, much less approved. Beg paid City Wide's reduced tax liability to the IRS and embezzled the remainder for himself. The IRS eventually discovered Beg's scheme but not before he had embezzled more than $370,000 worth of IRS payments from City Wide.[195]

In February 2007, the IRS finally assessed the payroll taxes against City Wide and threatened to collect over $370,000 by levy against the defrauded company.[196] City Wide filed a petition in the Tax Court to prevent the collection. Once again the matter was submitted to the court on stipulated facts where both parties agreed that Beg's return was "false or fraudulent" but disagreed about whether the fraudulent filer had the requisite "intent to evade tax" under Section 6501(c)(1)–(2).[197]

Before the Tax Court, the taxpayer raised the issue of City Wide's liability for Beg's conduct on grounds of agency but the company abandoned that argument in the

[194] *City Wide Transit, Inc. v. Comm'r*, 102 T.C.M. (CCH) 542, at *1–6 (2011), *rev'd* 709 F.3d 102 (2d Cir. 2013).

[195] *Opening Brief for the Appellant*, *City Wide Transit, Inc. v. Comm'r*, 709 F.3d 102 (2d Cir. 2013) (No. 12-1040), 2012 WL 2501145, at *14 (stating that the amount of City Wide's deficiency from Beg's fraudulent returns was $371,651.43).

[196] *Id*.

[197] The Tax Court and Second Circuit Court of Appeals both noted that the interpretations of the "intent to evade tax" in I.R.C. § 6501(c)(1) and (c)(2) were identical for purposes of the case at hand. The Tax Court explained that "[w]hile sec. 6501(c)(1) applies to any tax imposed under the Code, sec. 6501(c)(2) applies only to employment and excise taxes." *City Wide Transit, Inc.*, 102 T.C.M. (CCH) 542, at *3 n. 10.

Second Circuit Court of Appeal.[198] In both tribunals, however, the taxpayer claimed that the IRS had not proven by "clear and convincing" evidence that Beg had the specific intent to defraud the IRS by falsifying City Wide's returns.[199] The Tax Court found that the IRS had not met that burden because Beg's tax fraud was merely "an incidental consequence or secondary effect of his embezzlement scheme" against City Wide.[200] It ruled that the IRS's limitation on assessment and collection of taxes was not extended under Code § 6501(c) and was therefore time-barred.

On appeal, City Wide conceded Beg's authority to file his fraudulent original and amended returns on its behalf, and defended the Tax Court's decision only on grounds that the IRS had not proven fraud. Since the taxpayer never raised the issue of Beg's agency, and the Tax Court had not ruled on that basis, the Court of Appeals was asked to decide only (1) whether the doctrine of preparer fraud was a correct interpretation of Code § 6501(c)(1)–(2), and (2) if so, "whether, considering all of the evidence, the tax court made a mistake by concluding that the Commissioner failed to establish by clear and convincing evidence that Beg intended to evade City Wide's taxes through his embezzlement."[201]

The Second Circuit first held that "the limitations period of assessing [the taxpayer's] taxes is extended if the taxes were understated due to fraud of the preparer."[202] Given that ruling, the court of appeals concluded that the Tax Court had "clearly" erred in finding that Beg's scheme was not intended to evade City Wide's tax. The appeals court found that Beg's *motives* for committing tax fraud were irrelevant so long as one of the ways he intended to defraud City Wide was to file fraudulent tax returns. Since Beg's embezzlement scheme required tax fraud in order to work, the Second Circuit found "clear and convincing" evidence that Beg had intended to evade City Wide's taxes, reversed the Tax Court, and upheld the IRS's assessment against the defrauded company.[203]

Under the *Golsen* rule, the Tax Court is "bound to follow the Second Circuit's decision" in deficiency cases where appeal would lie there.[204] Thus, the Tax Court's effort to curb preparer fraud's unfair side-effects has had the unexpected result of dramatically expanding its reach. With the ruling by the U.S. Court of Appeals for the

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[198] The Second Circuit explained: "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 [and when asked by] each member of this panel . . . ." *City Wide Transit, Inc.*, 709 F.3d, at 107.

[199] *City Wide Transit, Inc.*, 102 T.C.M. (CCH) 542, at *15–16.

[200] *Id.* at *21–22.

[201] *City Wide Transit, Inc.*, 709 F.3d, at 107.

[202] *Id.*

[203] *Id.*

[204] *Dellacroce v. Comm'r*, 83 T.C. 269, 292 (1984), *citing*, *Golsen v. Commissioner*, 54 T.C. 742 (1970), *aff'd.*, 445 F.2d 985 (10th Cir. 1971), *cert. denied*, 404 U.S. 940 (1971).

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Federal Circuit in *BASR Partnership v. United States*[205] it is unlikely the conflict between deficiency litigation in the Tax Court and refund litigation in the Court of Federal Claims will be resolved without a Supreme Court ruling.

B. Refund Litigation

Compared with *Allen*'s slow erosion in the U.S. Tax Court, the decisions by the U.S. Court of Federal Claims and Federal Circuit Court of Appeals have entirely rejected the theory of third-party fraud as a grounds for tolling the statute of limitations under Code § 6501(c)(1). In *BASR Partnership*, the Claims Court held that the *taxpayer*'s fraud is required for the unlimited assessment period under Section 6501(c)(1) to apply.[206] This decision was subsequently upheld by a badly-divided panel of the U.S. Court of Appeals for the Federal Circuit, which expressly rejected the Tax Court's doctrine of preparer fraud, and implicitly the Second Circuit's ruling in *City Wide*.[207] As a result, taxpayers who can afford to pay their deficiency up front and litigate their matter in Claims Court may not be assessed for deficiencies after the statutory period has elapsed on the basis of the government's claim that someone else committed tax fraud, while those who cannot afford to pay may well be held liable in Tax Court.[208]

BASR Partnership was a refund action brought against a client of the now-defunct law firm of Jenkens & Gilchrist, which became the first national law firm in modern history to be shut down as a result of its promotion of tax shelters.[209] The taxpayer in the case was William F. Pettinati, Sr., who was the owner and manager of Page Printing Co. ("Page"), a commercial printing company, which Mr. Pettinati had purchased in 1982 and was looking to sell in 1999. Mr. Pettinati managed Page with his wife, Virginia Pettinati, and their two sons, William F. Pettinati, Jr. and Andrew Pettinati.

None of the Pettinatis had experience in preparing corporate tax returns and Page's returns were prepared by professionals. During the 1980s and early 1990s, Mr. Pettinati employed one Gus Hrncir to prepare Page's corporate tax returns but John

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[205] 795 F.3d 1338, 1339–1350 (Fed. Cir. 2015).

[206] *BASR P'ship*, 113 Fed.Cl., at 184.

[207] The Federal Circuit's decision attempts to distinguish the Second Circuit's decision in *City Wide Transit, Inc. v. Comm'r*, 709 F.3d 102 (2d Cir. 2013) from *Allen v. Comm'r*, 128 T.C. 37 (2007) on grounds that the Second Circuit "did not actually address the question of whether the tax preparer's intent was sufficient to trigger § 6501(c)(1)." *BASR P'ship*, 795 F.3d, at 1347. But this analysis of *City Wide* ignores the Second Circuit's express ruling that "the limitations period of assessing [the taxpayer's] taxes is extended if the taxes were understated due to fraud of the preparer." *City Wide Transit, Inc.*, 709 F.3d, at 107.

[208] *See BASR P'ship*, 113 Fed.Cl., at 192–194, *aff'd*, 795 F.3d 1338 (Fed. Cir. 2015).

[209] Benjamin Horney, *Ex-Jenkens & Gilchrist Att'y Seeks Probation for $7B Tax Fraud*, Law 360 http://www.law360.com/articles/560837/ex-jenkens-gilchrist-atty-seeks-probation-for-7b-tax-fraud (July 24, 2014) (describing the lawyer who structured BASR Partnership's transaction).

Malone ("Malone") of Malone & Bailey PLLC began to prepare the company's returns in the mid-1990s and continued to do so through 1999.[210]

In 1998, Mr. and Mrs. Pettinati created irrevocable trusts for their two children and transferred their interests in Page to the trusts. By 1999, Mr. Pettinati was looking to sell his printing business and he approached Jenkens & Gilchrist for tax advice.[211] Erwin Mayer ("Mayer"), who was then a tax partner at Jenkens & Gilchrist,[212] helped the Pettinatis to underreport their gain from the $7 million sale of their business by using a "Son of Boss" tax shelter, which the IRS has since characterized as a tax avoidance scheme that lacks economic substance.[213]

The "Son of Boss" tax shelters were designed to create an artificially-high basis under the stepped-up basis rules for partnerships in Code § 754. In Mayer's scheme, Mayer helped the Pettinatis form (1) a partnership (BASR Partnership), (2) an S Corporation (Cypress Investments, Inc.), and (3) four limited liability companies.[214] Each of the Pettinatis owned one of the LLCs, which were used to enter into short sales of U.S. treasury notes totaling $6,629,311. Investors enter into short sales when they believe a stock will go down in value by borrowing a security from a broker, which is sold for cash, under an obligation to provide a replacement security at some future date. By completing the first leg of the short sale, but not the second (i.e., the sale for cash but not the security repurchases), the Pettinatis were able to obtain cash that they contributed to BASR that increased their basis in the partnership under Code § 754. They did not however reduce their basis to account for their obligation to repay the broker in replacement securities on grounds that short sales are not "liabilities" within the meaning of Code § 752.[215]

This stepped-up basis in BASR Partnership was then used by the partners to offset their gains from the sale of the company. After obtaining the stepped-up basis, the Pettinatis and their irrevocable trusts contributed Page Company stock to BASR. The partners then transferred 99% of their partnership interests to the S Corporation (Cypress), made an election under Code § 754 to adjust the basis in the partnership's stock, and increased the adjusted basis in the Page stock by $6,629,311.

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[210] *Brief of the United States in Opposition to Plaintiff's Motion for Summary Judgment*, *BASR P'ship v. United States*, 113 Fed.Cl. 181 (2013) (No. 10-244 T), 2013 WL 9797020, at *11 (Jan. 22, 2013).

[211] *Brief of Appellees*, *BASR P'ship v. United States*, 795 F.3d 1338 (Fed. Cir. 2015) (No. 14-5037), 2014 WL 3586042, at *3–11 (July 8, 2013).

[212] Jenkens & Gilchrist's Chicago office was deeply involved in the promotion of "Son of Boss" tax shelters and was ultimately shut down as a result of the illegal actions of Erwin Mayer and other lawyers. *See generally* Karen Burke and Grayson McCouch, *COBRA Strikes Back: Anatomy of a Tax Shelter*, 62 Tax Lawyer 61, 64 n.19 (2008).

[213] I.R.S. Notice 2000-44, 2000-36 I.R.B. 255.

[214] *Brief of the United States in Opposition to Plaintiff's Motion for Summary Judgment, supra* note 210, at *11.

[215] This theory of short sales is incorrect as a matter of law. *See Marriott Int'l Resorts, L.P. v. United States*, 586 F.3d 962 (Fed. Cir. 2009)

As a result of these maneuvers, the Pettinatis purportedly recognized only a $268,934 gain when they sold their Page stock to the purchaser the month after Mayer set the "Son of Boss" transaction into motion. They should have recognized a gain of $6,898,245.[216]

Malone prepared tax returns on the basis of instructions provided him by an associate at Jenkens & Gilchrist. He believed the tax scheme Jenkens & Gilchrist had devised was legal but in fact it was not. Mayer and many of the lawyers in the Jenkens & Gilchrist Chicago office went to jail after an IRS investigation into their tax shelter practice in 2002.

Although Mayer never declared his intent to evade federal tax laws to the Pettinatis, and had no stake in the Pettinatis' refund claim, Mayer signed an affidavit for the IRS in *BASR Partnership* litigation that acknowledged:

> It was my intent, in implementing the short sale tax shelter for the Pettinatis and in providing them with tax opinion letters, to fraudulently evade the federal income tax they would otherwise owe on capital gains from the sale of their business, Page Printing, by falsely and artificially inflating the tax basis of its stock prior to its sale.[217]

From *Allen* to *City Wide* to *BASR Partnership*, the government has tried to extend preparer fraud beyond the bounds of agency to acts ever more remote from the taxpayer. The IRS argued *Allen* on grounds of agency and traces of that argument are discernable in the Tax Court's decision in that case. But the IRS argued *City Wide* on grounds that a thief's forging of a company's tax returns is sufficient to extend assessment indefinitely under Section 6501(c)(1). *BASR Partnership* pushed the doctrine of imputed fraud even further still to cover those persons whose advice may be incorporated into a fraudulent filing. But the Federal Circuit and Claims Court balked.

Although the Claims Court or Federal Circuit could have distinguished Mayer's case from *Allen* and *City Wide*'s preparer fraud doctrine both courts took the opportunity to reject it altogether.[218] The Claims Court's analysis is derived from the concept of a "fraudulent *return*" in Code § 6501(c)(1). According to the court, "I.R.C. § 6501(a) defines 'return' as 'the return [sic] to be filed by the taxpayer (and does not include a return of any person from whom the taxpayer received an item of income, gain, loss, deduction, or credit)."[219] From this, the Claims Court concludes that "because the language of 6501(a) is expressly limited to a return filed by the 'taxpayer,' the fraudulent

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[216] *Brief of the United States in Opposition to Plaintiff's Motion for Summary Judgment, supra* note 210, at *11.

[217] *Id.*

[218] *BASR P'ship*, 113 Fed.Cl., at 192–194.

[219] *Id.* at 192 (misquoting I.R.C. § 6501(a)) (emphasis original).

intent referenced in I.R.C. § 6501(c) is by implication limited to fraud by the taxpayer."[220]

But the Claims Court misreads Code § 6501(a). The "return" in that provision is not defined as one "*to be filed* by the taxpayer,"[221] but as "the return *required to be filed* by the taxpayer."[222] Intentionally or not, the court's omission of the word "required" from § 6501(a) substantially changes its meaning. The law can require the taxpayer to file a return without specifying *who* files it. That question of who must file a fraudulent return for the return to be fraudulent under Code § 6501(c)(1) is the only one that counts for our purposes and it is left unanswered by § 6501(a)'s definition of a return.

Perhaps for this reason, none of the judges on the Federal Circuit panel that rejected *Allen* relied on the Claims Court's statutory interpretation.[223] Instead, each of three judges on the panel issued a separate opinion with only Judge Raymond Chen's holding that "under I.R.C. § 6501(c)(1), it is the taxpayer (or possibly his authorized agent) who must have the requisite 'intent to evade tax' before the IRS is authorized to go beyond the three year statute of limitations in § 6501."[224] Judge Kathleen O'Malley, who joined Judge Chen's opinion, wrote separately to make clear that, in her view, "§ 6501 does not control the time in which the IRS has to assess taxes attributable to partnership items without consideration of the specific rules set forth in § 6229" for fraudulent partnership items.[225]

Both Judge Chen and Judge O'Malley separately emphasized the significance of the fact that the IRS had not alleged that Mayer's fraud was attributable to the partnership under the laws of agency.[226] Judge Chen wrote, "[i]mportantly, we need not decide whether the term 'taxpayer,' as used in § 6501(c)(1), can be interpreted to encompass the actions of a taxpayer's authorized agent" since Mayer was not alleged to have been BASR's agent or made statements to the IRS on the partnership's behalf.[227] Judge O'Malley "agree[d] with both BASR and the majority that, under § 6501(c)(1), it is the taxpayer (or possibly his authorized agent) who must have the requisite 'intent to evade tax' before the IRS is authorized to go beyond the three year statute of limitations in § 6501."[228]

While Judge Chen and Judge O'Malley differed in their views of which section applied to BASR's case, they agreed that traditional rules of agency should govern when the taxpayer is liable for someone else's tax fraud under Code § 6501(c)(1). This view is

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[220] *Id.*

[221] *BASR P'ship*, 113 Fed.Cl., at 192 (misquoting I.R.C. § 6501(a)) (emphasis added).

[222] I.R.C. § 6501(a) (emphasis added).

[223] *BASR P'ship*, 795 F.3d, at 1343 n. 4.

[224] *Id.* at 1351 (J. O'Malley concurring) (describing Judge Chen's analysis).

[225] *Id.*

[226] *Compare BASR P'ship*, 795 F.3d, at 1342 n.3 (J. Chen), *with id.* at 1351(J. O'Malley concurring).

[227] *Id.* at 1342 n. 3.

[228] *Id.* at 1351.

consistent with the long history of the fraudulent-return extension discussed above and provides a way of going forward with a doctrine that draws a more appropriate balance between interests of individuals and government than *Allen* does.

The current situation is untenable because it makes the statute of limitation in "preparer fraud" cases depend on the taxpayer's ability to pay. Taxpayers who can afford to litigate their preparer fraud case in Claims Court can bar the IRS from collecting that can be made against taxpayers relegated to Tax Court because they cannot pay their deficiency up front.[229]

III. THE FUTURE OF PREPARER FRAUD

The Code's fraudulent-return extension for assessment of unpaid taxes reflects the simultaneous urge to combat tax evasion without punishing the innocent. When Congress enacted Section 6501(c)(1) into law as part of the Internal Revenue Code of 1954, the vast majority of Americans prepared and filed their returns themselves.[230] But, as U.S. income taxation has grown increasingly complex, most taxpayers have opted for the perceived security of professional return preparers.[231] For taxpayers who mistakenly hire one of 0.097% of preparers who commit tax fraud, however, the cost can be enormous, since compound interest on unpaid taxes quickly eclipses the principal amount owed.[232]

Congress has never eliminated repose for taxpayers who file a false return unless the taxpayer's omission was intentional. In 1934, the Senate refused on fairness grounds to authorize unlimited assessments of taxpayers who mistakenly filed a false return, although such assessments are now allowed in deficiency court by judicial fiat.[233]

The *Allen* doctrine of preparer fraud is objectionable on grounds of policy as well as precedent. Cases of preparer fraud only arise under Code § 6501(c)(1) when (1) the taxpayer's preparer has committed fraud against the IRS, (2) which resulted in an underpayment of taxes owed by the taxpayer, and (3) which was not assessed by the IRS within three years of the date the taxpayer's return was filed.[234] Moreover, since federal courts uniformly impute an agent's tax fraud to a principal under Code § 6501(c)(1), differences between the Tax and Claims Courts only arise when preparers who are *not* agents like Beg in *City Wide* fraudulently file the taxpayer's return.[235]

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[229] *See generally* David B. Porter, *Where Can You Litigate Your Federal Tax Case?*, 98 Tax Notes 558 (2003) (describing the procedures for getting into Tax Court and the Court of Federal Claims).

[230] I.R.S., *Return Preparer Review*, *supra* note 5, at *6 (describing the beginning of commercial tax preparation during in the early 1960s).

[231] IRS studies indicates that nearly two-thirds of taxpayers "follow their tax return preparer's advice all of the time." I.R.S., *Return Preparer Review*, *supra* note 5, at *7.

[232] *See* S. Rep. No. 73-558, 73d Cong., 2d Sess., at 43–44.

[233] S. Rep. No. 73-558, 73d Cong., 2d Sess., at 43–44.

[234] I.R.C. § 6501(a), (c)(1).

[235] *Compare Allen*, 128 T.C., at 37–38 (assuming the taxpayer could be held liable for his preparer's fraud because the fraudulent nature of the return is the only requirement of I.R.C. § 6501(c)(1)), *with BASR*

It is far from clear that punishing taxpayers for acts of others not under their control efficiently deters tax evasion. And while the Tax Court's rule of strict liability may once have been administratively efficient, since the Claims Court and Federal Circuit have rejected the doctrine of preparer fraud, the rule now subsists as a trap for the unwary, which filters taxpayers on their ability to pay.

Nor is such an unfair standard necessary to solve cases of preparer fraud. Recent statistics indicate that U.S. tax evasion is nearly half the worldwide rate and that tax return preparers are more likely part of the solution than part of the problem.[236]

For the Tax Court's doctrine of preparer fraud to make economic sense returns filed by commercial preparers must be no more accurate than those filed by individuals without professional assistance. For if commercial tax preparation actually decreased tax evasion then a doctrine like preparer fraud could actually diminish federal revenues by pricing taxpayers out of the industry.[237] Testing this hypothesis on a sample of more than 7,000 cases of tax fraud revealed to a near statistical certainty that professional preparers file fewer fraudulent returns than individual filers, which largely undermines *Allen*'s efficacy.[238]

P'ship, 795 F.3d, at 1351 (J. O'Malley concurring) (stating, in dicta, that it would be a different case if the fraudulent tax planner had been the taxpayer's authorized agent).

[236] Table A of the Tax Justice Network's *Report on the Cost of Tax Abuse* (Nov. 2011) reports that in 2011, the U.S. had a population of 312,582,000, a GDP per capita of $46,651, a tax burden of 26%, and a tax-evasion cost of $337,349,000. This translates into an 8.6% rate of tax evasion, which equals: (Tax-Evasion Cost) ÷ (Population x GDP Per Capita x Average Tax Burden). Since the Tax Justice Network also reports that tax evasion swallows up 16.67% of worldwide tax revenues, the cost of U.S. tax evasion is 48.4% lower than the worldwide average. Tax Justice Network, *The Cost of Tax Abuse: A Briefing Paper on the Cost of Tax Evasion*, at *6 (Nov. 2011), available at http://www.taxjustice.net/wp-content/uploads/2014/04/Cost-of-Tax-Abuse-TJN-2011.pdf.

[237] This assumes, of course, that fraudulent underpayments would equal or exceed relatively-modest gains in collection under *Allen*, 128 T.C. 37 (2007).

[238] The Criminal Investigation Division of the IRS ("IRS-CI") has published statistics on cases of preparer fraud for the years 2013–2014. During that period, IRS-CI investigated 9,611 total cases, including 614 cases of preparer fraud (6.4%), and indicted 7,137 suspected tax criminals, including 463 preparers (6.5%).

While IRS-CI investigations depend on no quanta of proof, indictments for tax evasion must be supported by "probable cause" of willful tax evasion, or attempted evasion, by defendant(s). *See* Fed. R. Crim. P. 4(a). Taxpayers and professionals should be indicted for fraud in approximately the same proportions as they prepare tax returns, all things being equal, since only willfully false statements on tax returns are violations of I.R.C. §§ 7201–7211. For this reason, tax professionals who prepare more than half of U.S. returns should account for at least 50% of indictments for tax fraud if their rate of filing fraudulent returns on behalf of taxpayers is as high as individual filers' fraudulent-return rates.

To test this hypothesis, which *Allen* requires to justify its cost, the author tested the likelihood that rates of preparer fraud equaled or exceeded rates of fraud in a population of 7,137 indictments for tax fraud from 2013–2014, including 6,674 against individual filers and 463 against professional preparers. Z-Testing was used to analyze this sample with a null hypothesis that tax preparers are indicted for tax crimes at least 50% of the time, which yielded a p-value and probability of 0. This proposition must be rejected and provides strong evidence that third-party preparers submit fraudulent federal returns less often than individual filers, as a proportion of total returns filed by each group. I.R.S., *Statistical Data: Abusive Return Preparers*, https://www.irs.gov/uac/Statistical-Data-Abusive-Return-Preparers (Oct. 13, 2015); I.R.S., *Data Book*

At least 80% of U.S. small business filers and 58% of U.S. individual income tax filers hire professionals to prepare their federal returns.[239] IRS statistics show that these numbers have grown exponentially over the last 20 years with the increasingly complex U.S. tax code.[240] Less than 6% of Americans needed professional help to prepare their 1932 returns when federal tax laws were 80 pages shorter than the *instructions* for Form 1040 today.[241]

It is no wonder that six out of ten Americans now outsource their tax preparation to professionals.[242] Studies indicate that taxpayers with the most complex tax returns are most likely to seek professional assistance.[243] That is, there is a direct correlation between the complexity of a taxpayer's return and his or her use of tax preparation services.[244] For this reason, 94% of taxpayers who hire tax professionals to prepare their returns follow their preparer's advice.[245]

Recent IRS data suggests that approximately 0.097% of return preparers commit tax fraud.[246] Studies also indicate that effective government regulation of return preparers can effectively curb tax fraud.[247] The U.S. Government Accountability Office ("GAO") found that preparers subject to extensive regulatory requirements were substantially more likely to report their clients' income accurately than those under less restrictive regimes.[248]

The different rules of "preparer fraud" in Tax and Claims Court result in different economics.[249] When preparers commit tax fraud without the taxpayer's express or

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Table No. 18, https://www.irs.gov/uac/SOI-Tax-Stats-Criminal-Investigation-Program-by-Status-or-Disposition-IRS-Data-Book-Table-18 (Mar. 24, 2015).

[239] Nat'l Taxpayer Advocate, 1 *2009 Annual Report to Congress* 41 (Dec. 31, 2009), *available at* https://www.irs.gov/pub/tas/1_09_tas_arc_vol_1_preface_toc_msp.pdf.

[240] I.R.S., *Return Preparer Review*, *supra* note 5, at *6–9.

[241] *See id.* at *6; Revenue Act of 1932, Pub. L. No. 72-154, 47 Stat. 169, at 169–290 (June 6, 1932).

[242] *Id.*

[243] James E. Long and Steven B. Caudill, *The Usage and Benefits of Paid Tax Return Preparation*, 40 Nat'l Tax J. 35, 35 (1987) ("We also find that professional tax assistance is directly related to the complexity of tax return and the marginal tax rate on income.").

[244] *Id.*

[245] I.R.S., *Return Preparer Review*, *supra* note 5, at *9.

[246] *See* I.R.S., *Statistical Data – Abusive Return Preparers*, https://www.irs.gov/uac/Statistical-Data-Abusive-Return-Preparers (Oct. 13, 2015). (880 total investigations of preparers for fraud between 2013–2015); I.R.S., *Return Preparer Review*, *supra* note 5, at *9 (stating that an estimated 900,000–1,200,000 tax-return preparers worked in U.S. during the 2007 tax year).

[247] *See* U.S. Gov't. Accountability Office, *Tax Preparers: Oregon's Regulatory Regime May Lead to Improved Federal Tax Return Accuracy and Provides a Possible Model for National Regulation*, GAO-08-781 (Aug. 15, 2008), at *16–17 [hereinafter *GAO Study on Tax Preparers*].

[248] *Id.* at *16 (using a multivariate logistic regression to suggest that, after controlling for other factors, Oregon's method of rigorously testing tax-return preparers significantly increased their reliability as compared to the national average and California, which does not mandate preparer testing.)

[249] *Compare Allen*, 128 T.C., at 42, *with BASR P'ship*, 113 Fed.Cl., at 193–194.

implied authority, the Tax Court holds the taxpayer perpetually and strictly liable, while the Claims Court does not.[250] Although the U.S. Government can recoup its losses from the preparer in either case, the taxpayer bears the burden of the government's loss in the Tax Court , while the government bears the loss in Claims Court.[251] Which allocation is appropriate depends on the ways each serves the twin goals of promoting tax compliance and procedural fairness.[252]

Allen and its progeny hold taxpayers who would have paid their tax on time liable for taxes and compound interest whenever the government decides to assess them. As the Tax Court put it: "We do not find it unduly burdensome for taxpayers to review their returns for items that are obviously false or incorrect. It is every taxpayer's obligation."[253] Although the Tax Court considers the "special disadvantage to the Commissioner in investigating fraudulent returns," it does not appear to have considered the taxpayer's informational disadvantage as compared to tax professionals. While taxpayers may know what expenses they incurred during the tax year, they rarely know precisely which ones are deductible. If they did, taxpayers like those in *Allen*, *Browning*, *Ames-Mechelke*, *City Wide*, and *BASR Partnership* would have no reason to obtain professional advice in the first place.

It is unlikely that taxpayers could resolve their information disadvantage on matters of tax preparation without hiring another professional for a second opinion. Since the risk of hiring a fraudulent tax preparer is only 0.097% taxpayers will not insure against the infinitesimal risk created by *Allen* that both (1) their tax returns will be fraudulently prepared and (2) not assessed within three years, so that substantial compound interest will accrue.[254] Moreover, *Allen* gives the IRS no incentive to quickly assess taxes against the taxpayer once fraud on the part of the taxpayer's preparer is discovered because the government can always collect principal and compound interest on the deficiency.[255]

Since the *Allen* doctrine of preparer fraud imposes uninsurable costs on taxpayers, which can only be avoided by reducing reliance on tax preparation services, the doctrine is not only unfair from the taxpayer's perspective but inefficient from the perspective of collecting tax revenues. The doctrine distorts market choices by making it less likely that taxpayers will seek tax advice, which is statistically certain to increase truthful filings.[256]

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[250] *BASR P'ship*, 795 F.3d, at 1351

[251] *Compare Allen*, 128 T.C., at 42, *with BASR P'ship*, 113 Fed.Cl., at 193–194.

[252] *See* Guido Calabresi, *The Cost of Accidents: A Legal and Economic Analysis* 24 (Yale 1970) (describing the primary goals of tort law as fairness and cost-reduction).

[253] *Allen*, 128 T.C., at 41.

[254] *See* I.R.S. FS-2008-10 (Jan. 2008) (218 investigations initiated by IRS-CI in tax year 2007); I.R.S., *Return Preparer Review*, *supra* note 5, at *9 (stating that an estimated 900,000–1,200,000 tax-return preparers worked in U.S. during the 2007 tax year).

[255] In both *Allen* and *City Wide*, the IRS could have collected some of the taxes in a timely manner but neglected to do so for reasons that are not clear.

[256] *See supra* note 238.

Consider the case of an honest taxpayer who is unsure whether his $500 business suit is deductible. Assume for purposes of this example that if the taxpayer self-prepares, he will deduct the business suit 50% of the time and that if he hires a CPA the preparer will *know* that the business suit is not deductible 52% of time. Further assume that the CPA will commit fraud 1% and that the taxpayer will never do so.[257] Finally assume an interest rate of 5%, a marginal tax rate of 35%, and that the IRS will not discover the taxpayer's erroneous deduction of his business suit for 10 years.[258] If the taxpayer self-prepares his return, he will understate his income tax liability by $175 half the time and none of the understatement will be collected, so he will pay tax of $87.50 and the government will lose $87.50, on average. Since the CPA is 1% more likely to disallow the taxpayer's business-suit deduction, the government is $1.75 better off.

Under *Allen*, however, the increased transaction costs of hiring a tax preparer makes everyone worse off, since those whose returns would be more honest if they could hire a professional preparer may not be able to afford one. Rules of agency that guided fraudulent-return jurisprudence for generations are sufficient to prevent taxpayers from "hiding behind the[ir] preparer."[259] The doctrine of preparer fraud under Section § 6501(c)(1) was invented by the Tax Court eight years ago in order to correct a perceived injustice of allowing taxpayers with accountants to hide behind their return preparer's fraud. But the doctrine's unintended consequence has been to diminish taxpayers' reliance on professionals who tend to decrease the incidence of fraud in the U.S. tax system. As there is no reason in the history, text, or policy of Section 6501(c)(1) to keep such a counterproductive doctrine, *Allen*'s next appearance should be its swan song.

[257] *Id.* at *16 (discussing the rate of error for regulated Oregon tax preparers who, like CPAs, have rigorous testing requirements).

[258] Tax return preparers in Oregon who are subject to rigorous testing like a CPA undergoes get the returns correct 74% of the time, compared to 56% for self-preparers, which is an 18% difference. *GAO Study on Tax Preparers*, *supra* note 249, at *6, *16.

[259] *Id*. at 42.