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Tax Court Reinforces Need for Care in Choosing Return Preparer

The Tax Court recently held for the first time in *Allen v. Commissioner* that fraudulent intent on the part of a return preparer is sufficient to extend the statute of limitations on the assertion of deficiencies even where the taxpayer himself lacks such fraudulent intent. According to the Tax Court, a taxpayer "cannot hide behind an agent's fraudulent preparation of his returns and escape paying tax if the Government is unable to investigate fully the fraud within the limitations period."¹

The taxpayer, Allen, was a UPS truck driver who hired an unethical agent to prepare his personal income tax returns. The parties agreed that the taxpayer provided authentic tax documentation to the return preparer and had no fraudulent intent in signing the return that was prepared. The return preparer, however, was convicted of claiming false deductions for charitable contributions, meals and entertainment, as well as other various deductions on the taxpayer's return. In light of the resulting understatement of income, the IRS attempted to assert a tax deficiency against the taxpayer even though the standard three-year statute of limitations on assessing such deficiencies had expired.

As a general rule the IRS must assess a tax deficiency within three years of the date the taxpayer files his return.² There is no statute of limitations, however, "in the case of a false or fraudulent return with the intent to evade tax."³ In *Allen*, the taxpayer argued that only the fraudulent intent of the taxpayer himself, and not that of a return preparer, can operate to extend the three-year statute of limitations on assessment.

In considering the taxpayer's argument, the court noted that as a general rule statutes of limitations are strictly construed in favor of the Government.⁴ The court then reaffirmed its previous rulings: that taxpayers are generally



charged with the knowledge, awareness, and responsibility for their returns;⁵ that the taxpayer and not the preparer has the ultimate responsibility to the Commissioner;⁶ and that this duty cannot be avoided through reliance on an agent.⁷ Relying on this foundation, the court ruled that it was "not unduly burdensome for taxpayers to review their returns for items that are obviously false or incorrect."⁸ Accordingly, the court held that in the case of a fraudulent return, the fraud does not have to be committed by the taxpayer himself in order for the statute of limitations to be extended indefinitely.

The statute of limitations on assessment of tax deficiencies is generally intended to protect taxpayers by relieving them of the burden of indefinitely maintaining records that may be needed to defend against potential IRS claims years in the future. By removing this protection in the case of preparer fraud, the IRS has placed even more emphasis on taxpayers' need to show extreme caution when choosing a return preparer.

This is not only a potential issue with respect to "fly by night" return preparers. The IRS has recently taken the position in prominent cases that certain tax shelters marketed by major accounting firms were fraudulent. If the IRS has allowed the statute of limitations to run against investors in such shelters, it could use *Allen* to argue that those returns are still open for adjustment because of the preparer's fraud.

In addition to the court's ruling in *Allen*, the IRS has further accentuated the current focus on preparer fraud through its recent issuance of field service guidance to its agents.⁹ The IRS offered the following guidance in choosing a return preparer:

- Be careful with tax preparers who claim they can obtain larger refunds than other preparers.
- Avoid preparers who base their fee on a percentage of the amount of the refund.
- Stay away from preparers who claim that many, if not most, phone customers can get hundreds of dollars or more back under the telephone tax refund program.
- Use a reputable tax professional who signs your tax return and provides you with a copy for your records.
- Consider whether the individual or firm will be around to answer questions about the preparation of your tax return months, or even years, after the return has been filed.

- Review your return before you sign it and ask questions on entries you do not understand.
- Never sign a blank tax form.
- Find out the person's credentials. Only attorneys, CPAs and enrolled agents can represent taxpayers before the IRS in all matters including audits, collection and appeals. Other return preparers may only represent taxpayers for audits of returns they actually prepared.
- Find out if the preparer is affiliated with a professional organization that provides its members with continuing education and resources and holds them to a code of ethics.
- Ask others who have used the tax professional if they were satisfied with the service they received.

¹Allen v. Comm'r, 128 T.C. No. 4, n.5 (03/5/2007).

²I.R.C. § 6501(a).

³I.R.C. § 6501(c)(1).

⁴Badaracco v. Comm'r, 464 U.S. 386, 391 (1984).

⁵Magill v. Comm'r, 70 T.C. 465, 479-480 (1978).

⁶Kooyers v. Comm'r, T.C. Memo. 2004-281.

⁷Estate of Clause v. Comm'r, 122 T.C. 115, 123-124 (2004)

⁸Allen at n. 5.

⁹FS-2007-12 (January 2007), available at

<http://www.irs.gov/newsroom/article/0,,id=167391,00.html>

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