

IRS Loses on Statute of Limitations: Lawyer's Fraud Not Imputed to Taxpayer

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When it comes to tax disputes, there are three different forums in which to bring a lawsuit, and sometimes the choice makes a difference in the result.

Virtually all taxpayers choose Tax Court because they need not pay the tax to have their day in court. But one problem with Tax Court is that all of the judges are former tax lawyers, and these judges often dismiss technical arguments offered by taxpayers who don't want to pay the tax.

In contrast, wealthy taxpayers often choose to pay the tax and then sue in Federal District Court for a refund. Why? They prefer, as a judge, a former federal prosecutor who is less likely to be deferential to the IRS. The third option is taken by a small minority of taxpayers: paying the tax and suing for a refund in the Court of Federal Claims in Washington, D.C. That occurs when that unique court has favorable precedent that sets it apart from the other courts or, at least, lacks unfavorable precedent.



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The Sept. 30, 2013, decision by the United States Court of Federal Claims in *BASR Partnership v. U.S.*, 112 AFTR 2d 2013-XXXX, is interesting to tax practitioners for that reason and two others. Second, *BASR Partnership* is a wonderful example of Chuck Rettig's wry observation that "Every taxpayer is entitled to his decade in court." This 2013 decision involves the taxpayer's 1999 tax year!

Third, this case is almost certainly one of the last gasps to be heard from the roaring tax shelter era that was noteworthy for acronyms like "Son of BOSS," "CARDS," "SC2," "TRACT," and "DAD," and which resulted in the demise of a national law firm and a national accounting

firm.

The individual taxpayer in *BASR Partnership* was interested in selling his printing company. To minimize the tax consequences of the eventual sale, the taxpayer's accountant and a well-known, now defunct law firm helped the taxpayer create a structure, which included a family partnership that purported to increase the basis in the stock of the printing company. The tax returns for the partnership and for the taxpayer for 1999 were filed on time.

The IRS initiated an audit of the partnership's returns in 2006 and, in 2010, issued a Final Partnership Administrative Adjustment, or FPAA, for the partnership's tax years ended June 12, 1999 and Dec. 22, 1999. The IRS determined, among other points, that the transactions giving rise to the basis in the stock of the printing company had no business purpose other than tax avoidance; lacked economic substance; and constituted an economic sham; it

violated the intent of Subchapter K of the Code and should be disregarded; and the adjustments of partnership items were attributable to a tax shelter for which no substantial authority existed.

The individual taxpayer, in his capacity as the partnership's Tax Matters Partner, filed a complaint in the U.S. Court of Federal Claims seeking a \$750,000 refund because the IRS's disallowance was untimely pursuant to Internal Revenue Code Section 6501, the general statute of limitations, and Internal Revenue Code Section 6229, the special statute of limitations for partnership items.

The government argued that the general three-year statute of limitations of Section 6501(a) did not apply. Instead, the special statute of limitations for fraud of Section 6501(c)(1) was applicable: "In the case of a false or fraudulent return with the intent to evade tax, the tax may be assessed...at any time."

In contrast, the Tax Matters Partner argued that the special statute of limitations for fraud in the partnership rules applied: "If any partner has, with the intent to evade tax, signed or participated directly or indirectly in the preparation of a partnership return includes a false or fraudulent item (A) in the case of partners so signing or participating in the preparation of the return, any tax...may be assessed at any time..." according to Section 6229(c)(1) of the Tax Code. Note the difference between the two fraud provisions. Under Section 6501, there need only be fraud *by someone*. Under the partnership statute of limitations there must be fraud *by a partner*. That difference caused a problem for the government because it did not argue that a BASR partner intended to evade taxes. It argued that the fraud was committed by the tax lawyer.

The government's view argued that the fraudulent intent of the taxpayer's agent should trigger Section 6501(c)(1) because the taxpayer is responsible for filing a return and paying any tax due. The government's position found support in a decision of the United States Court of Appeals for the Second Circuit. However, the Court of Claims came up with its own way to interpret the two statutes.

First, Section 6501 refers to "the return 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)." Therefore, the fraudulent intent referenced in Section 6501(c) is limited to the taxpayer's fraud, giving the IRS three years unless (i) the taxpayer has the fraudulent intent or (ii) Section 6229 applies.

The partnership statute of limitations in Section 6229 limits the availability of the extended statute to an action by a partner. Again, in this case, the government did not contend that the taxpayers themselves possessed an "intent to evade tax." Therefore, the court held that the government's action against the partnership was barred by the statute of limitations. The court complimented the government on its policy arguments but suggested that the proper approach was to have Congress change the law.

Statutory interpretation is tricky business. The government might have won had it issued a regulation supporting its view, even if the regulation had been issued during the course of the litigation, as in the case of *Mayo Foundation for Medical Education & Research v. U.S.*, 107 AFTR 2d 2011-341 (Jan. 11, 2011).

The *BASR Partnership* case may get overturned on appeal. However, until then, it is a testament to the wisdom of the taxpayer's lawyer in, among other points, selecting the right forum for the dispute.

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