*14 T.C. 1453 (1950)*

A taxpayer is not liable for a fraud penalty when a false and fraudulent tax return is filed by a tax preparer without the taxpayer's knowledge or intent to evade taxes, even if the deductions claimed are baseless.

**Summary**

Dale Fulton hired a tax preparer, Nimro, who filed a fraudulent return on Fulton's behalf, claiming inflated deductions. Fulton did not sign or see the return before it was filed and was unaware of the false deductions. The IRS assessed a deficiency and a fraud penalty. The Tax Court held that Fulton was liable for the deficiency but not the fraud penalty, because the IRS failed to prove that Fulton had knowledge of, or participated in, the fraud perpetrated by Nimro. The court emphasized that fraud is personal and must be proven by clear and convincing evidence, which was lacking in this case.

**Facts**

Dale Fulton, a pilot for Transcontinental Western Airways (TWA), was stationed at National Airport in Washington, D.C. TWA reimbursed Fulton for some travel expenses. Fulton sought tax preparation services from Bernard Nimro based on recommendations from friends. Fulton provided Nimro with limited information and understood that Nimro would obtain additional information from TWA. A tax return bearing Fulton's name was filed, but Fulton never signed it and only saw it later during an IRS investigation. The return contained deductions for travel expenses that Fulton did not incur, including expenses for travel within the U.S., despite Fulton's travel being solely international during the tax year.

**Procedural History**

The Commissioner of Internal Revenue determined a deficiency in Fulton's 1945 income tax, along with a 50% fraud penalty. Fulton contested the disallowance of certain expenses and the fraud penalty in the Tax Court.

**Issue(s)**

Whether the taxpayer, Fulton, filed a false and fraudulent tax return for 1945 with the intent to evade taxes, thereby justifying the imposition of a fraud penalty.

**Holding**

No, because the IRS failed to prove by clear and convincing evidence that Fulton had knowledge of, or participated in, the fraudulent deductions claimed on his tax return prepared and filed by Nimro.

**Court's Reasoning**

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The Tax Court emphasized that fraud is a personal matter that must be brought home to the individual charged. While acknowledging Fulton's duty to file a fair and honest return, the court found that the IRS, bearing the burden of proof, failed to demonstrate that Fulton was consciously indifferent to his duties or that it was within the actual or apparent scope of Nimro's authority to prepare and file a false return. The court noted that Fulton spent only a brief time with Nimro, provided limited information, and did not sign or see the return before it was filed. The Court stated, "Under the law the proof of fraud must be clear and convincing. There is no such proof here. Petitioner may have been negligent but there is no proof of intention of petitioner to defraud the Government of taxes due." The court found the IRS's evidence insufficient to prove Fulton's intent to defraud.

**Practical Implications**

This case illustrates that a taxpayer is not automatically liable for fraud penalties when a tax preparer falsifies a return without the taxpayer's knowledge or intent. The IRS must provide clear and convincing evidence of the taxpayer's fraudulent intent. Taxpayers who unknowingly use unscrupulous preparers can avoid fraud penalties if they can demonstrate their lack of knowledge and intent. This decision emphasizes the importance of due diligence in selecting a tax preparer and reviewing the prepared return, to the extent possible, but it also provides a defense for taxpayers who are victims of preparer fraud. This case is frequently cited in cases involving the fraud penalty to determine whether the IRS has met its burden of proof.

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