48 T.C. 929 (1967)

Fraud penalties for tax underpayment cannot be applied to a deceased taxpayer when the fraudulent intent to evade tax cannot be attributed to the individuals who signed and filed the tax return on behalf of the deceased's estate.

Summary

The Estate of William Kahr contested the Commissioner's determination of fraud penalties for underpayment of income taxes for 1958 and 1959. William Kahr had systematically embezzled partnership income in both years. For 1958, Kahr signed and filed the tax return. For 1959, Kahr died before filing, and his executor signed and filed the return. The Tax Court upheld the fraud penalty for 1958, finding Kahr acted fraudulently. However, it overturned the fraud penalty for 1959, reasoning that the fraudulent intent of the deceased could not be imputed to the executor who filed the return. The court held that fraud requires a fraudulent intent at the time of filing the return, and since Kahr was deceased and the executor had no fraudulent intent, the penalty was inappropriate for 1959.

Facts

William Kahr was a 50% partner in Hamilton News Co. He managed the business and devised a scheme to embezzle partnership income in 1958 and 1959 with the help of the company manager, Charles Fruscione. Kahr instructed Fruscione to intercept checks from key clients before they were recorded in company books. Fruscione cashed these checks and gave the proceeds to Kahr, who did not report this income. Kahr signed the 1958 partnership and personal income tax returns, which understated his income. Kahr died in January 1960. The 1959 partnership return was signed by the other partner, Leon Mohill, and the 1959 joint income tax return was signed by Kahr's executor, James Dalton, and his wife, Mary Kahr, and filed after his death.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in William Kahr's income taxes and additions for fraud penalties for 1958 and 1959. The Estate of William Kahr petitioned the Tax Court to contest this determination.

Issue(s)

1. Whether William Kahr understated his taxable income for 1958 and 1959 by omitting embezzled partnership income and a portion of his distributive share of partnership income.
2. Whether any part of the deficiency for 1958 was due to fraud with intent to evade tax.
3. Whether any part of the deficiency for 1959 was due to fraud with intent to evade tax.

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Holding

1. Yes, because the evidence clearly showed Kahr diverted partnership funds and did not report them as income.
2. Yes, because Kahr knowingly understated his income on the 1958 return with the intent to evade tax.
3. No, because the fraudulent intent of the deceased taxpayer cannot be imputed to the executor who filed the 1959 return. Fraudulent intent must exist at the time of filing, and the executor lacked such intent.

Court's Reasoning

For 1958, the court found clear and convincing evidence of fraud. Kahr systematically diverted partnership income, concealed it from company records, and signed a return he knew understated his income. The court stated, "Determination of fraud is a question of fact and the above facts clearly support a finding of fraud".

For 1959, while acknowledging Kahr's fraudulent actions before his death, the court focused on who filed the return. The court reasoned that fraud requires "a deliberate and calculated intention on the part of the taxpayer *at the time the returns in question were filed* fraudulently to evade the tax due." Since Kahr did not file the 1959 return, and his executor, who did file it, was not shown to have any fraudulent intent, the court concluded that fraud could not be established for 1959. The court emphasized that "fraud implies bad faith, intentional wrongdoing and a sinister motive. It is *never imputed or presumed*". The dissenting opinion argued that Kahr's fraud was the proximate cause of the underpayment, regardless of who signed the return, and that the statute only requires the "underpayment" to be "due to fraud," not that the filer be fraudulent.

Practical Implications

Estate of William Kahr clarifies that fraud penalties under 26 U.S.C. § 6653(b) require fraudulent intent at the time of filing the tax return. This case highlights that the fraudulent actions of a taxpayer prior to death, while leading to an underpayment, are not sufficient to impose fraud penalties on their estate if the individuals filing the return for the estate lack fraudulent intent. Practitioners should note that while the underlying tax deficiency may still be assessed against the estate, the more severe civil fraud penalties are unlikely to apply in similar situations where the return is filed by a fiduciary without fraudulent intent. This case emphasizes the importance of focusing on the intent of the filer at the time of filing when assessing fraud penalties, particularly in estate cases.

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