Estate of W. Marion Hendry, Deceased, Ruth T. Hendry, and William M. Hendry III, Co-Executors, and Ruth T. Hendry, Petitioners v. Commissioner of Internal Revenue, Respondent, 63 T. C. 289 (1974)

Fraudulent intent in tax evasion can apply to underpayments resulting from the failure to report income on either individual or fiduciary returns, and such fraud can suspend the statute of limitations.

Summary

W. Marion Hendry, co-executor and beneficiary of the Emerson estate, failed to report income from the estate on both fiduciary and individual tax returns. The IRS determined that Hendry's underpayment of taxes was due to fraud, warranting a 50% penalty under section 6653(b) and suspending the statute of limitations under section 6501(c)(1). The Tax Court upheld these findings, emphasizing Hendry's complete control over the estate's financial affairs and his deliberate concealment of income, which demonstrated a clear intent to evade taxes. This case illustrates that fraudulent intent can be inferred from a taxpayer's overall conduct and that such intent can extend to both fiduciary and individual tax obligations.

Facts

W. Marion Hendry and J. H. Chastain were co-executors and beneficiaries of the estate of Alexander V. Emerson. From 1962 to 1967, Hendry received income from the estate but did not report it on either the estate's fiduciary returns or his individual returns. Hendry had full control over the estate's records and finances, including directing his clerk to cash checks payable to the estate without recording them. Hendry also failed to file required state probate returns for the estate after 1962. The IRS initiated an investigation, leading to the discovery of the unreported income, and Hendry committed suicide during the investigation.

Procedural History

The IRS issued a notice of deficiency to Hendry's estate and Ruth T. Hendry, determining underpayments due to fraud for the years 1963-1967 and seeking to assess a deficiency for 1965 beyond the statute of limitations. Hendry's estate paid the deficiencies for 1963, 1964, 1966, and 1967, but contested the fraud penalty and the assessment for 1965. The case was heard by the United States Tax Court, which found for the Commissioner, upholding the fraud penalties and the suspension of the statute of limitations.

Issue(s)

1. Whether any part of the underpayments of tax for the years 1963-1967 was due to fraud, invoking the 50% addition to tax under section 6653(b).
2. Whether Hendry's return for 1965 was false or fraudulent with the intent to evade tax, thus suspending the statute of limitations under section 6501(c)(1).

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Holding

1. Yes, because the evidence clearly and convincingly showed Hendry's fraudulent intent to evade taxes by not reporting income on either the estate's or his individual returns.
2. Yes, because Hendry's overall intent to evade taxes through false returns suspended the statute of limitations for the 1965 tax year.

Court's Reasoning

The Tax Court found that Hendry's actions demonstrated a clear intent to evade taxes. Hendry's exclusive control over the estate's finances, his failure to file required returns, and his concealment of income indicated a deliberate scheme to avoid taxation. The court rejected the argument that Hendry might have believed the income was taxable to the estate, noting his failure to consult with professionals or disclose the income during the investigation. The court also considered Hendry's false farm loss deductions as additional evidence of fraud. The court held that the fraud penalty could apply to underpayments resulting from unreported income on either fiduciary or individual returns, and that Hendry's overall fraudulent intent suspended the statute of limitations for the 1965 tax year.

Practical Implications

This decision reinforces the importance of reporting income on the appropriate tax returns, whether fiduciary or individual. It highlights that fraudulent intent can be inferred from a taxpayer's overall conduct, even in the absence of direct evidence of specific knowledge of tax law. Practitioners should advise clients to disclose all income sources and consult with tax professionals when dealing with estate income to avoid penalties. This case also underscores the IRS's ability to assess deficiencies beyond the statute of limitations when fraud is involved, emphasizing the need for accurate and complete tax reporting. Subsequent cases have cited Estate of Hendry for its broad interpretation of fraudulent intent and its application to both fiduciary and individual tax obligations.

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