Breman v. Commissioner, 66 T.C. 61 (1976)

A prior Tax Court decision does not bar the IRS from issuing a second deficiency notice for the same tax year if fraud is discovered later, as fraud is a statutory exception to the doctrine of res judicata in tax law.

Summary

The Bremans had a prior Tax Court case for their 1964 tax year, which was settled by stipulation. Subsequently, the IRS discovered unreported dividend income and issued a second deficiency notice alleging fraud. The Tax Court held that the second notice was valid because the Internal Revenue Code allows for a second notice in cases of fraud, even after a prior decision. The court reasoned that the fraud exception in tax law overrides res judicata, permitting the IRS to reassess tax liability when fraud is discovered post-judgment. The addition to tax for fraud was correctly computed based on the difference between the correct tax liability and the tax shown on the original return.

Facts

Petitioners, M. William and Sylvia Breman, filed a joint federal income tax return for the fiscal year ended November 30, 1964. In 1966, the IRS issued a deficiency notice concerning dividend income from Georgia Screw Products Corp. The Bremans petitioned the Tax Court, and in 1968, a decision was entered based on a stipulated settlement. Later, the IRS discovered that Mr. Breman had received unreported dividend income from Breman Steel Co., Inc. during 1964, which was not disclosed in the original return or the first deficiency notice. This omission was not known to the IRS during the first case. In 1974, the IRS issued a second deficiency notice for the unreported dividend income and assessed a fraud penalty against Mr. Breman. The Bremans conceded the fraud but argued that the prior Tax Court decision barred the second deficiency notice under res judicata.

Procedural History

1. **1966**: The IRS issued an initial statutory notice of deficiency for the 1964 tax year regarding dividend income from Georgia Screw Products Corp.

2. **1968**: The Tax Court entered a decision in Docket No. 1883-66, based on a stipulated settlement between the Bremans and the IRS, determining a deficiency for the 1964 tax year.

3. **1974**: The IRS issued a second statutory notice of deficiency for the same 1964 tax year, based on newly discovered unreported dividend income from Breman Steel Co., Inc., and determined an addition to tax for fraud.

4. **Present Case**: The Bremans petitioned the Tax Court in response to the second deficiency notice (Docket No. 6390-74), arguing that the prior decision was res

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judicata and barred the second notice.

Issue(s)

1. Whether the prior Tax Court decision for petitioners' fiscal year 1964, based on a stipulation, bars a subsequent deficiency notice for the same year under the doctrine of res judicata.

2. If the doctrine of res judicata does not bar the second notice, whether the IRS is permitted to determine both a deficiency in tax and an addition to tax for fraud in the second notice.

3. Whether the addition to tax for fraud should be computed based only on the deficiency asserted in the second notice or on the difference between petitioners' correct income tax liability and the tax shown on their original return for 1964.

Holding

1. No, because Section 6212(c)(1) of the Internal Revenue Code provides an exception to the restriction on further deficiency letters in the case of fraud.

2. Yes, the IRS is authorized to determine both a deficiency in tax and an addition to tax for fraud in a second notice issued under the fraud exception of Section 6212(c)(1).

3. The addition to tax for fraud should be computed on the difference between petitioners' correct income tax liability and the tax as shown on their original income tax return for the taxable year ended November 30, 1964.

Court's Reasoning

The Tax Court reasoned that Section 6212(c)(1) of the Internal Revenue Code explicitly allows for the issuance of a second deficiency notice if fraud is discovered, even after a prior Tax Court decision for the same taxable year. The legislative history of this section and its predecessors clearly indicates Congress's intent to permit re-examination of tax liability in cases of fraud, notwithstanding the principle of finality usually afforded by res judicata. The court emphasized that its jurisdiction is statutorily defined and that Section 6213 grants jurisdiction when a petition is filed in response to a deficiency notice authorized under Section 6212, which includes notices issued under the fraud exception. The court cited legislative history stating, "Finality is the end sought to be attained by these provisions of the bill, and the committee is convinced that to allow the reopening of the question of the tax for the year involved either by the taxpayer or by the Commissioner (save in the sole case of fraud) would be highly undesirable."

Regarding the computation of the fraud penalty, the court determined that Section 6653(b), similar to its predecessor Section 293(b) of the 1939 Code, mandates that

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the fraud penalty be 50 percent of the ‘underpayment,’ which is defined as the ‘deficiency.’ The deficiency, in this context, is the difference between the taxpayer’s correct tax liability and the tax shown on the original return. The court referenced *Papa v. Commissioner*, 464 F.2d 150 (2d Cir. 1972), and *Levinson v. United States*, 496 F.2d 651 (3d Cir. 1974), which support calculating the fraud penalty on the original underpayment, regardless of subsequent payments or prior settlements. The court concluded that there was no substantive difference between Section 6653(b) of the 1954 Code and Section 293(b) of the 1939 Code in this regard.

Practical Implications

Breman v. Commissioner establishes a critical exception to the doctrine of res judicata in tax law. It clarifies that a prior Tax Court decision does not shield taxpayers from further tax assessments for the same year if the IRS subsequently discovers fraud. This case empowers the IRS to issue second deficiency notices and pursue additional taxes and fraud penalties even after a case has been previously adjudicated, provided the new assessment is based on fraud not considered in the prior proceeding. For legal practitioners, this case underscores the importance of advising clients about the enduring risk of fraud penalties and further tax scrutiny, even after settling tax disputes. It highlights that finality in tax litigation is not absolute and is explicitly qualified by the fraud exception, ensuring that fraudulent tax conduct can be addressed whenever discovered. The decision also reinforces that fraud penalties are calculated based on the original underpayment of tax, providing a consistent method for penalty computation in fraud cases, irrespective of interim tax payments or settlements.