M. William Breman and Sylvia G. Breman v. Commissioner, 66 T. C. 61 (1976)

The IRS can issue a second notice of deficiency for fraud even after a final decision has been entered for the same taxable year.

Summary

In Breman v. Commissioner, the IRS issued a second deficiency notice for the tax year 1964 after discovering unreported dividend income not included in a prior settlement. The key issue was whether the IRS could legally issue this second notice and assert additional taxes and penalties for fraud, given a prior final court decision for the same year. The Tax Court held that under the fraud exception in Section 6212(c)(1), the IRS was authorized to issue the second notice, and the addition to tax for fraud should be calculated based on the difference between the correct tax liability and the tax reported on the original return.

Facts

The Bremans filed a joint federal income tax return for their fiscal year ending November 30, 1964. The IRS issued a deficiency notice in 1966, which was settled in 1968, resulting in a stipulated deficiency. In 1974, the IRS discovered unreported dividend income from 1964 and issued a second deficiency notice, asserting additional taxes and a fraud penalty against Mr. Breman. The Bremans contested the IRS's authority to issue this second notice after a final decision had been entered for the same year.

Procedural History

The IRS issued a deficiency notice in January 1966, which was settled in April 1968, resulting in a stipulated decision by the Tax Court. In 1974, after discovering unreported income, the IRS issued a second notice of deficiency. The Bremans filed a petition challenging the IRS's authority to issue this second notice, leading to the case before the Tax Court.

Issue(s)

1. Whether the IRS can issue a second notice of deficiency for fraud after a final decision has been entered for the same taxable year.
2. If so, whether the addition to tax for fraud should be computed based on the deficiency asserted in the second notice or the difference between the correct tax liability and the tax reported on the original return.

Holding

1. Yes, because Section 6212(c)(1) allows the IRS to issue a second notice of deficiency in cases of fraud, even after a final decision has been entered for the

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same taxable year.
2. No, because the addition to tax for fraud should be computed based on the difference between the correct tax liability and the tax reported on the original return, not just the deficiency in the second notice.

Court’s Reasoning

The Tax Court interpreted Section 6212(c)(1) as permitting a second deficiency notice in cases of fraud, consistent with legislative history indicating Congress’s intent to allow such notices. The court emphasized that the fraud exception to res judicata allows the IRS to assert additional deficiencies and penalties when fraud is discovered post-judgment. The court also relied on case law and committee reports to conclude that the fraud penalty under Section 6653(b) should be calculated based on the difference between the correct tax and the tax reported on the original return, aligning with prior interpretations of similar provisions in the 1939 Code.

Practical Implications

This decision clarifies that the IRS has the authority to issue a second deficiency notice when fraud is discovered after a final tax decision, impacting how tax practitioners handle cases involving potential fraud. It also affects how fraud penalties are calculated, ensuring they are based on the total underpayment rather than just the deficiency in the second notice. This ruling has implications for tax planning and compliance, as taxpayers must be aware that unreported income discovered post-judgment can lead to significant penalties. Subsequent cases, such as Papa v. Commissioner, have followed this interpretation, reinforcing its application in tax law.

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