Stewart v. Commissioner, 66 T. C. 54 (1976)

The fraud penalty under section 6653(b) of the Internal Revenue Code is calculated based on the difference between the correct tax due and the tax shown on the original, timely filed return.

Summary

In Stewart v. Commissioner, the U. S. Tax Court upheld the IRS's method of calculating the fraud penalty under section 6653(b) of the Internal Revenue Code. The case involved Bennie and Dorothy Stewart, who had underreported their income for 1962 and 1963. After an audit began, they paid the additional taxes owed before the IRS issued a notice of deficiency. The court ruled that the fraud penalty should be applied to the difference between the correct tax liability and the tax shown on their original timely returns, not reduced by subsequent payments made after the audit commenced. This decision reinforces the principle that taxpayers cannot avoid fraud penalties by paying additional taxes after fraud is discovered.

Facts

Bennie and Dorothy Stewart filed joint federal income tax returns for 1962 and 1963, understating their income and tax liabilities. An IRS audit began in 1966, and in 1970, the Stewarts paid the additional taxes owed for those years. In 1972, the IRS assessed these payments and issued a notice of deficiency, imposing fraud penalties under section 6653(b) based on the difference between the correct tax liability and the tax reported on the original returns.

Procedural History

The Stewarts petitioned the U. S. Tax Court after receiving the notice of deficiency. The court reviewed the case, focusing on whether the fraud penalty should be calculated using the tax shown on the original timely returns or the tax paid after the audit began.

Issue(s)

1. Whether the fraud penalty under section 6653(b) should be calculated based on the difference between the correct tax liability and the tax shown on the original timely return, or should it account for subsequent payments made after the audit commenced?

Holding

1. Yes, because the fraud penalty under section 6653(b) is to be applied to the difference between the correct tax due and the tax shown on the original timely return, not reduced by subsequent payments made after the audit began.

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Court’s Reasoning

The court reasoned that the fraud penalty under section 6653(b) should be calculated based on the difference between the correct tax liability and the tax shown on the original timely return, consistent with the judicial interpretation of the 1939 and 1954 Codes. The court emphasized that allowing taxpayers to reduce the fraud penalty by paying additional taxes after an audit would undermine the purpose of the penalty. The decision relied on previous case law, such as Papa v. Commissioner and Levinson v. United States, which upheld the same method of calculation. The court also noted that the legislative history of section 6653(b) and section 6211 did not indicate any intent to change the established practice.

Practical Implications

This decision clarifies that the fraud penalty is calculated based on the original timely return, not affected by subsequent payments made after an audit begins. Tax practitioners must advise clients that attempting to mitigate fraud penalties by paying additional taxes after an audit is initiated will not be effective. This ruling reinforces the IRS’s ability to enforce fraud penalties and may deter taxpayers from engaging in fraudulent underreporting with the hope of avoiding penalties through later payments. Subsequent cases, such as Papa and Levinson, have followed this precedent, ensuring consistency in the application of fraud penalties.

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