Rose v. Commissioner, 70 T. C. 558 (1978)

A notice of deficiency is not void when the IRS uses an alternative method to determine income after a taxpayer refuses a second examination of their records.

Summary

In Rose v. Commissioner, the IRS examined the taxpayers' records for eight months before returning them upon request. When the IRS later sought to reexamine the records, the taxpayers refused, citing Section 7605(b). The IRS then used the bank deposits plus expenditures method to determine deficiencies, which the taxpayers contested. The Tax Court held that the IRS did not violate Section 7605(b) by not reexamining the records and that the notice of deficiency was valid, even though it was not based on the taxpayers' records.

Facts

Albert E. and Edwina Rose, residents of Helena, Montana, were audited by the IRS for their 1970 and 1971 tax years. The IRS initially examined their records for eight months before returning them at the taxpayers' request. Later, the IRS sought to reexamine these records, but the Roses refused, relying on Section 7605(b), which prohibits a second examination without written notice. The IRS then used the bank deposits plus expenditures method to determine deficiencies, which the Roses stipulated were correct in amount.

Procedural History

The Roses filed a petition in the United States Tax Court contesting the notice of deficiency issued by the IRS. The Tax Court addressed whether the IRS violated Section 7605(b) by not reexamining the records and whether the notice of deficiency was void because it was determined using an alternative method.

Issue(s)

1. Whether the IRS violated Section 7605(b) by not reexamining the taxpayers' records after their initial return.
2. Whether a notice of deficiency determined by an alternative method (bank deposits plus expenditures) is void when taxpayers maintain adequate records.

Holding

1. No, because the IRS did not reexamine the records, there was no violation of Section 7605(b).
2. No, because the notice of deficiency is not void even when determined by an alternative method when taxpayers refuse a second examination.

Court's Reasoning

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The Tax Court relied on United States Holding Co. v. Commissioner, which held that no second examination occurred when taxpayers refused to provide records for reexamination. The court emphasized that the notice of deficiency was not arbitrary or void, as the IRS was not required to reexamine the records to issue a valid notice. The court distinguished cases that dealt with the determination of income from those addressing the validity of the notice of deficiency, noting that the notice's validity is a jurisdictional issue. The court also referenced Suarez v. Commissioner, where a notice based on inadmissible evidence was upheld, reinforcing that the notice's validity is separate from the evidence used to determine income. The court concluded that even if the IRS's method was arbitrary, the taxpayers' stipulation that the deficiencies were correct in amount shifted the burden of proof, which the IRS met.

Practical Implications

Rose v. Commissioner clarifies that the IRS can issue a valid notice of deficiency using alternative methods when taxpayers refuse a second examination of their records. This ruling allows the IRS flexibility in audits, reinforcing its authority to determine deficiencies based on available information. For taxpayers, it underscores the importance of cooperating with IRS requests for records, as refusal may lead to determinations based on alternative methods. The decision also impacts legal practice by clarifying that the validity of a notice of deficiency is distinct from the method used to determine income. Subsequent cases have applied this ruling in similar contexts, reinforcing the IRS's procedural authority in tax audits.

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