T.C. Memo. 1982-66

Hypnotically refreshed testimony is generally inadmissible or given little weight in tax court, particularly when procedural safeguards are lacking and the testimony is inconsistent with other evidence of record; furthermore, a pattern of failing to file tax returns, coupled with indicia of fraudulent intent, constitutes tax fraud.

Summary

Stanley Grosshandler, an attorney, faced tax deficiencies and fraud penalties for failing to file federal income tax returns from 1963 to 1969. Grosshandler claimed he had filed for 1963-1965, introducing hypnotically 'refreshed' testimony to support his claim. The Tax Court disallowed the hypnotically-aided testimony due to procedural flaws and inconsistencies. The court found Grosshandler had not filed returns for any of the years and that his underpayment was due to fraud, citing his awareness of filing obligations, false statements to IRS agents, inadequate records, and a pattern of non-filing. The court upheld fraud penalties and additions for failure to pay estimated taxes.

Facts

1. Grosshandler was a practicing attorney from 1963-1969 with substantial gross receipts each year.
2. He had filed tax returns in prior years and was aware of his obligation to file and pay taxes.
3. IRS records showed no returns filed by Grosshandler for 1963-1969, nor any tax payments beyond withholdings in a few years.
4. Grosshandler made inconsistent statements to IRS agents about filing and payments, initially claiming to have filed and even received a refund.
5. He claimed some records were destroyed and later that records were inaccessible, but did not cooperate in providing available records.
6. Facing criminal charges for failure to file for 1966-1967, Grosshandler was convicted in 1972.
7. In 1979, shortly before the Tax Court trial, Grosshandler underwent hypnosis to 'refresh' his memory about filing returns for 1963-1965.
8. Under hypnosis, he provided specific details about preparing and filing returns for those years, claiming to have given one to a train conductor for mailing.

Procedural History

1. The IRS issued a notice of deficiency for tax years 1963-1969, including fraud penalties and additions to tax.
2. Grosshandler petitioned the Tax Court, contesting the deficiencies and penalties.
3. The case proceeded to trial in the Tax Court.

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Issue(s)

1. Whether the portion of petitioner's direct testimony relating to his memory, as allegedly refreshed by hypnosis, is admissible and what weight should be given to it.
2. Whether the petitioner failed to file Federal income tax returns for the years 1963, 1964, and 1965.
3. Whether the assessment and collection of petitioner's Federal income taxes for each of the taxable years 1963, 1964, and 1965 are barred by the statute of limitations.
4. Whether any part of the underpayment of income tax for each of the years 1963 through 1969 was due to petitioner's fraud with intent to evade tax.
5. Whether, alternatively, the petitioner is liable for additions to tax for delinquency and negligence for the years 1963 through 1969.
6. Whether the petitioner is liable for additions to tax for failure to make estimated tax payments for each of the years 1964 through 1969.

Holding

1. No. Hypnotically refreshed testimony was deemed inadmissible or given no weight because of flawed procedures and lack of credibility.
2. Yes. The court held that Grosshandler failed to file federal income tax returns for 1963, 1964, and 1965.
3. No. Because no returns were filed, the statute of limitations does not bar assessment and collection.
4. Yes. Part of the underpayment for each year was due to fraud with intent to evade tax.
5. Not addressed directly, as fraud penalties were upheld, making negligence and delinquency penalties moot.
6. Yes. Grosshandler is liable for additions to tax for failure to make estimated tax payments.

Court's Reasoning

The court reasoned as follows:

- **Hypnotically Refreshed Testimony:** The court found the hypnosis sessions lacked safeguards (no recordings of initial sessions, suggestive questioning). The testimony was inconsistent with prior statements and other evidence, making it unreliable and inadmissible. The court likened it to polygraph or truth serum evidence, generally inadmissible.
- **Failure to File:** IRS records of non-filing for multiple consecutive years were compelling evidence. This was corroborated by the lack of Social Security self-employment tax records, his failure to pay estimated taxes, prior filing history, and inconsistent and unbelievable testimony. The court found his self-serving statements and hypnotically 'refreshed' testimony unconvincing.

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- **Statute of Limitations:** Because no returns were filed, the statute of limitations for assessment and collection remained open under section 6501(c)(3) of the IRC.
- **Fraud:** The court found clear and convincing evidence of fraud based on several indicia: Grosshandler's awareness of filing obligations as an attorney; his false and inconsistent statements to IRS agents; his lack of cooperation with investigations; his failure to maintain adequate records; and his pattern of non-filing after 1962. The court noted, "One obvious reason for continued failure to file returns is the attempt to conceal defalcations for prior years."
- **Estimated Tax Penalties:** The addition to tax under section 6654 is mandatory and does not consider reasonable cause or lack of willful neglect. Grosshandler did not demonstrate he fell within any exception.

Practical Implications

Grosshandler serves as a practical reminder of several key points for tax practitioners and taxpayers:

- **Hypnosis in Court:** This case highlights the skepticism of courts, particularly the Tax Court, towards hypnotically refreshed testimony, especially without rigorous procedural safeguards. It cautions against relying on such evidence in tax litigation.
- **Importance of Filing:** Failure to file tax returns has severe consequences, including the indefinite extension of the statute of limitations and the potential for fraud penalties. This case underscores the critical importance of timely filing, even if unable to pay.
- **Indicia of Fraud:** The case provides a useful checklist of factors courts consider when determining tax fraud: taxpayer's knowledge, false statements, lack of cooperation, inadequate records, and a pattern of non-compliance. Attorneys can use these factors to assess fraud risk in client situations.
- **Record Keeping:** Maintaining adequate books and records is not just a best practice but a legal obligation. Failure to do so can be used as evidence of fraud.
- **Estimated Taxes:** Penalties for underpayment of estimated taxes are strictly applied. Taxpayers must understand and comply with estimated tax payment requirements to avoid these penalties.

This case is frequently cited in tax court for propositions related to the admissibility of evidence, the burden of proof in fraud cases, and the indicia of fraudulent intent in failure to file cases. Later cases have distinguished *Grosshandler* on the facts but consistently apply its principles regarding evidence and fraud determinations.

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