Klemp v. Commissioner, 77 T. C. 201 (1981)

The filing of a nonfraudulent amended return after a fraudulent original return starts the running of the three-year statute of limitations for tax assessments.

Summary

The Klemps filed fraudulent original tax returns for 1970-1973, then filed nonfraudulent amended returns in 1974. The IRS issued a deficiency notice in 1979, over three years after the amended returns but within six years of the original 1973 return. The Tax Court held that the statute of limitations began running with the amended returns, not the fraudulent originals, thus barring the IRS's assessment. This decision emphasized the policy of providing the IRS sufficient time to investigate when at a disadvantage due to fraud, but also recognized that this need diminishes once accurate information is provided.

Facts

Raymond and Ann Klemp filed fraudulent joint income tax returns for the years 1970 through 1973. In July 1974, the IRS notified the Klemps of an audit concerning their 1973 return. On October 17, 1974, the Klemps met with an IRS representative and submitted nonfraudulent amended returns for those years. The IRS issued a notice of deficiency on July 9, 1979, which was more than three years after the amended returns were filed but within six years of the filing of the original 1973 return.

Procedural History

The Klemps filed a motion for summary judgment in the U. S. Tax Court, arguing that the statute of limitations barred the IRS's proposed assessment. The Tax Court granted the motion, ruling that the statute of limitations began running with the filing of the amended returns in 1974, thus expiring before the IRS issued the notice of deficiency in 1979.

Issue(s)

1. Whether the statute of limitations for assessing a tax deficiency begins to run from the filing of fraudulent original returns or from the filing of subsequent nonfraudulent amended returns.
2. Whether the six-year statute of limitations under section 6501(e) applies to the 1973 tax year despite the filing of a fraudulent original return.

Holding

1. No, because the three-year statute of limitations under section 6501(a) begins running from the filing of the nonfraudulent amended returns, not the fraudulent original returns.
2. No, because section 6501(e) does not apply when section 6501(c)(1) (pertaining

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to fraudulent returns) is applicable.

Court's Reasoning

The court reasoned that section 6501(c)(1) is not a statute of limitations but rather allows for assessment at any time when a fraudulent return is filed. However, the filing of a nonfraudulent amended return changes the situation, starting the three-year statute of limitations under section 6501(a). This interpretation aligns with the policy of giving the IRS adequate time to investigate when at a disadvantage due to fraud, but recognizes that this need lessens once accurate information is provided. The court cited *Dowell v. Commissioner* as persuasive authority and distinguished prior cases like *Goldring v. Commissioner* and *Houston v. Commissioner*, which dealt with the six-year statute under section 6501(e) but did not involve fraudulent returns. The court also addressed dissenting opinions, which argued that the statute should not be affected by amended returns and that the unlimited period under section 6501(c)(1) should continue to apply.

Practical Implications

This decision impacts how tax practitioners should approach cases involving fraudulent returns followed by amended returns. It establishes that the IRS must assess deficiencies within three years of a nonfraudulent amended return, even if the original return was fraudulent. This ruling may encourage taxpayers to correct fraudulent returns promptly to limit their exposure to IRS assessments. It also affects IRS practice, requiring more timely action once a nonfraudulent amended return is filed. Subsequent cases, such as *Dowell v. Commissioner*, have reinforced this principle, though the IRS may still challenge this interpretation in future cases or seek legislative changes to clarify the statute of limitations in fraud scenarios.

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