Woodsum v. Commissioner of Internal Revenue, 136 T. C. 585 (U. S. Tax Court 2011)

In Woodsum v. Commissioner, the U. S. Tax Court ruled that taxpayers cannot rely on a preparer's error to avoid accuracy-related penalties under IRC section 6662. Stephen Woodsum and Anne Lovett omitted $3. 4 million from their 2006 tax return, despite receiving a Form 1099-MISC. The court held that their failure to review their return and ensure all income was reported negated the 'reasonable cause' defense, emphasizing taxpayers' responsibility to verify their returns, especially for significant income items.

Parties

Stephen G. Woodsum and Anne R. Lovett were the petitioners. The Commissioner of Internal Revenue was the respondent. The case originated in the United States Tax Court, with petitioners seeking redetermination of an accuracy-related penalty assessed by the IRS for the tax year 2006.

Facts

In 2006, Stephen Woodsum, a financially sophisticated individual and founding managing director of Summit Partners, terminated a ten-year total return limited partnership linked swap transaction, resulting in a net payout of $3,367,611. 50, which was reported by Deutsche Bank on a Form 1099-MISC as income. Woodsum and Lovett, who had a total adjusted gross income of nearly $33 million for that year, provided over 160 information returns, including the Deutsche Bank Form 1099-MISC, to their tax preparer, Venture Tax Services, Inc. (VTS). VTS, supervised by David H. Hopfenberg, prepared a 115-page return that omitted the $3. 4 million from the swap termination. Despite a meeting with Hopfenberg to review the return, petitioners did not recall discussing specific items or comparing the return with the information returns provided. They signed and filed the return, which did not include the swap income, leading to a tax deficiency and an accuracy-related penalty assessed by the IRS.

Procedural History

The IRS assessed a tax deficiency of $521,473 and an accuracy-related penalty of $104,295 against Woodsum and Lovett for the 2006 tax year. Petitioners conceded the tax deficiency and paid it, but disputed the penalty, arguing they had reasonable cause under IRC section 6664(c)(1). The case was submitted to the U. S. Tax Court fully stipulated under Rule 122, with the court considering only the issue of the penalty's applicability.

Issue(s)

Whether Woodsum and Lovett had "reasonable cause" under IRC section 6664(c)(1) for omitting $3. 4 million of income from their 2006 joint Federal income tax return,

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thereby avoiding the accuracy-related penalty under IRC section 6662(a)?

Rule(s) of Law

IRC section 6662(a) and (b)(2) impose a 20 percent accuracy-related penalty for a substantial understatement of income tax, defined as an understatement exceeding the greater of $5,000 or 10 percent of the tax required to be shown on the return. Under IRC section 6664(c)(1), a taxpayer may avoid this penalty if they can show reasonable cause and good faith for the underpayment. 26 C. F. R. section 1. 6664-4(b)(1) states that the determination of reasonable cause and good faith is made on a case-by-case basis, considering the taxpayer's efforts to assess proper tax liability, their knowledge and experience, and reliance on professional advice.

Holding

The U. S. Tax Court held that Woodsum and Lovett did not have reasonable cause for omitting the $3. 4 million income item from their 2006 tax return. The court found that their reliance on their tax preparer did not constitute reasonable cause, as they failed to adequately review the return to ensure all income items were reported.

Reasoning

The court reasoned that the taxpayers knew the swap termination income should have been included on their return, as evidenced by the Form 1099-MISC they received and provided to their tax preparer. The court emphasized that reliance on a professional to prepare a return does not absolve a taxpayer of the responsibility to review the return and ensure its accuracy, particularly for significant income items. The court cited United States v. Boyle, 469 U. S. 241 (1985), which established that taxpayers cannot rely on a preparer's error when they know or should know the correct treatment of an income item. The court also noted that the taxpayers' review of the return was insufficient, as they did not recall the specifics of their review or compare the return to the information returns provided. The court concluded that the taxpayers' lack of effort to ensure the accuracy of their return precluded a finding of reasonable cause and good faith under IRC section 6664(c)(1).

Disposition

The U. S. Tax Court entered a decision for the respondent, upholding the accuracy-related penalty assessed against Woodsum and Lovett.

Significance/Impact

Woodsum v. Commissioner reinforces the principle that taxpayers bear the responsibility to review their tax returns and ensure all income items are reported, even when using a professional tax preparer. The case underscores the limitations of the 'reasonable cause' defense to accuracy-related penalties, particularly when

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taxpayers fail to adequately review their returns. This decision may impact how taxpayers approach the preparation and review of their tax returns, emphasizing the need for diligence in verifying the accuracy of reported income, especially for significant amounts. The case also highlights the importance of maintaining records of the review process, as the taxpayers' inability to recall the specifics of their review contributed to the court's finding against them.

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