Mathews v. Commissioner, T. C. Memo. 2018-212, United States Tax Court, 2018

In Mathews v. Commissioner, the Tax Court ruled that the IRS failed to prove by clear and convincing evidence that Richard C. Mathews intended to evade taxes for the years 2007 and 2008. Despite Mathews' prior convictions for filing false returns, the court found his genuine confusion about the taxability of income from his multilevel marketing programs persuasive. This decision underscores the importance of proving specific intent to evade taxes, rather than merely demonstrating false reporting, in tax fraud cases.

Parties

Richard C. Mathews, the petitioner, represented himself pro se. The respondent, the Commissioner of Internal Revenue, was represented by William F. Castor and H. Elizabeth H. Downs.

Facts

Richard C. Mathews, a former U. S. Army serviceman, operated a multilevel marketing business through various online programs, including Wealth Team International Association (WTIA) and others under the name Mathews Multi-Service. Mathews received membership fees through online payment systems and remitted portions to member-recruiters, believing that 90% of the funds belonged to others and that he had deductible expenses. He filed separate tax returns for 2007 and 2008, reporting minimal income from his business activities. Mathews had previously been convicted of filing false returns for tax years 2004 through 2008, but the court found his understanding of his tax liabilities to be genuinely confused due to his lack of sophistication in tax matters.

Procedural History

The IRS conducted a civil examination of Mathews' 2005 return and later expanded it to include 2003, 2004, and 2006. Following a criminal investigation, Mathews was indicted and convicted of filing false returns for 2004 through 2008. The IRS then issued notices of deficiency for 2007 and 2008, asserting fraud penalties under section 6663. Mathews sought redetermination in the U. S. Tax Court, where a trial was held. The court determined that the IRS failed to meet its burden of proving fraudulent intent for 2007 and 2008, resulting in a decision for Mathews.

Issue(s)

Whether the IRS proved by clear and convincing evidence that Richard C. Mathews filed false and fraudulent returns with the intent to evade tax for the tax years 2007 and 2008?

Rule(s) of Law

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Section 6501(c)(1) of the Internal Revenue Code extends the period of limitation for assessment if a taxpayer files a false or fraudulent return with the intent to evade tax. The Commissioner bears the burden of proving by clear and convincing evidence that an underpayment exists and that the taxpayer intended to evade taxes known to be owing by conduct intended to conceal, mislead, or otherwise prevent the collection of taxes. Fraudulent intent must exist at the time the taxpayer files the return.

Holding

The Tax Court held that the IRS did not meet its burden of proving by clear and convincing evidence that Richard C. Mathews filed false and fraudulent returns with the intent to evade tax for the tax years 2007 and 2008. The court found Mathews' genuine confusion about the taxability of his multilevel marketing income credible, given his lack of sophistication and financial acumen.

Reasoning

The court's reasoning focused on several key points:

– Mathews' lack of sophistication and financial acumen was critical in assessing his intent. His background, including dropping out of high school and having no formal training in bookkeeping or taxation, contributed to his genuine confusion about his tax liabilities.

– The court considered Mathews' consistent statements about not knowing how to report income from his multilevel marketing programs, which were corroborated by notes from IRS agents during their investigations.

– Despite Mathews' prior convictions for filing false returns, the court noted that section 7206(1) convictions do not collaterally estop a taxpayer from denying fraudulent intent in a civil case, as intent to evade taxes is not an element of the crime.

– The court emphasized that the burden of proof lies with the Commissioner to negate the possibility that the underreporting was attributable to a misunderstanding, which in this case was Mathews' belief that most of the funds he received were owed to other members and that he had deductible expenses.

– The court reviewed the 'badges of fraud' but found that Mathews' conduct during the IRS investigations, while reprehensible, did not establish that his 2007 and 2008 returns were filed with fraudulent intent.

Disposition

The Tax Court entered decisions for Richard C. Mathews, denying the IRS the right to assess deficiencies and penalties for the tax years 2007 and 2008 due to the

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expiration of the statute of limitations under section 6501(a).

Significance/Impact

The Mathews decision highlights the importance of proving specific intent to evade taxes in civil fraud cases, particularly when the taxpayer demonstrates genuine confusion about their tax liabilities. It underscores that a conviction for filing false returns does not automatically establish fraudulent intent in a civil context. The ruling may influence how the IRS approaches similar cases, emphasizing the need for clear and convincing evidence of intent beyond mere false reporting. This case also illustrates the challenges the IRS faces in proving fraud against unsophisticated taxpayers and the necessity of considering the taxpayer's understanding and background when assessing intent.

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