***Richard Essner v. Commissioner of Internal Revenue, T. C. Memo. 2020-23 (U. S. Tax Court 2020)***

In Richard Essner v. Commissioner, the U. S. Tax Court upheld the IRS's determination of tax deficiencies and penalties against Essner, a California cancer surgeon, for failing to report income from inherited IRA distributions in 2014 and 2015. The court rejected Essner's claim that the IRS conducted an unnecessary second examination of his 2014 tax year, clarifying the scope of section 7605(b). This ruling underscores the necessity for taxpayers to accurately report inherited IRA distributions as income and the limited protections against IRS examinations under section 7605(b).

**Parties**

Richard Essner, the petitioner, represented himself pro se. The respondent, the Commissioner of Internal Revenue, was represented by Mark A. Nelson and Sarah A. Herson. The cases were consolidated under docket numbers 7013-17 and 1099-18 for trial and opinion.

**Facts**

Richard Essner, a cancer surgeon residing in California, inherited an IRA from his late mother, who had inherited it from his father. Essner received distributions from the IRA of $360,800 in 2014 and $148,084 in 2015. He researched the tax implications of these distributions on the IRS website and concluded they were not taxable. Essner engaged a return preparer for his 2014 and 2015 returns but did not inform the preparer of the IRA distributions. Consequently, Essner did not report these distributions as income on his tax returns. The IRS, having received Forms 1099-R reporting the distributions, initiated two separate processes to address the discrepancies: the Automated Underreporting (AUR) program and an individual examination by Tax Compliance Officer Hareshkumar Joshi.

**Procedural History**

The IRS's AUR program identified a discrepancy in Essner's 2014 return and issued a notice of deficiency on January 3, 2017, for $117,265, which Essner contested by filing a timely petition with the U. S. Tax Court under docket No. 7013-17. Concurrently, Officer Joshi examined Essner's 2014 and 2015 returns, focusing on other issues but not the IRA distributions. On October 23, 2017, the IRS issued another notice of deficiency for Essner's 2015 tax year, determining a deficiency of $101,750 and an accuracy-related penalty under section 6662(a) of $20,350, which Essner also contested under docket No. 1099-18. The Tax Court consolidated the cases for trial and opinion.

**Issue(s)**

Whether Essner failed to report distributions from an inherited IRA as income for

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2014 and 2015?

Whether the IRS subjected Essner to a duplicative inspection of his books and records relating to his 2014 tax year in violation of section 7605(b)?

Whether Essner is liable for the accuracy-related penalty under section 6662(a) for tax year 2015?

**Rule(s) of Law**

Section 61(a) of the Internal Revenue Code defines gross income as "all income from whatever source derived", including income from pensions under section 61(a)(11). Section 7605(b) limits the IRS to one inspection of a taxpayer's books of account per taxable year, unless the taxpayer requests otherwise or the Secretary notifies the taxpayer in writing of the need for an additional inspection. Section 6662(a) authorizes the imposition of a 20% accuracy-related penalty for substantial understatements of income tax, which can be excused if the taxpayer shows reasonable cause and good faith.

**Holding**

The Tax Court held that Essner failed to report the IRA distributions as income for 2014 and 2015, sustaining the IRS's deficiency determinations. The court also held that the IRS did not violate section 7605(b) by conducting a second examination of Essner's 2014 tax year, as the AUR program's actions did not constitute an examination of Essner's books and records. Finally, the court held Essner liable for the accuracy-related penalty for tax year 2015, finding that he did not act with reasonable cause and good faith.

**Reasoning**

The court reasoned that Essner's failure to report the IRA distributions as income was not supported by any evidence that a portion of the distributions represented a non-taxable return of his late father's original investment. Essner's inability to substantiate his claim due to lack of records from financial institutions did not relieve him of his burden of proof. Regarding section 7605(b), the court narrowly interpreted the statute, concluding that the AUR program's review of third-party information and Essner's filed tax returns did not constitute an examination of his books and records. Therefore, no second examination occurred, and the IRS's actions were not unnecessary. For the accuracy-related penalty, the court found that Essner's failure to consult his return preparer about the IRA distributions, despite his professional background and the size of the distributions, demonstrated a lack of reasonable cause and good faith.

**Disposition**

The Tax Court entered decisions sustaining the IRS's determinations of tax

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deficiencies for 2014 and 2015 and the accuracy-related penalty for 2015.

**Significance/Impact**

This case reaffirms the IRS's authority to require taxpayers to report inherited IRA distributions as income and clarifies the limited scope of section 7605(b) in protecting taxpayers from multiple examinations. It also highlights the importance of taxpayers seeking professional advice to ensure accurate tax reporting, particularly in complex situations involving inherited assets. The decision may influence future cases involving similar issues of tax reporting and IRS examination practices, emphasizing the need for clear communication and coordination within the IRS to avoid confusing taxpayers.

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