

Whose Fraud Is It Anyway? The Expanding Reach of the Fraud Exception to the Statute of Limitations on Tax Assessment

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Earlier this year, we unpacked the elements of tax fraud, how the Internal Revenue Service (IRS) approaches fraud in civil and criminal settings, and the penalties and consequences that can follow. That discussion focused on taxpayer misconduct. But what if the fraud at issue is not the taxpayer's—for instance, if the accountant or return preparer engages in fraudulent behavior that touches the taxpayer's return? Can another's fraud lead to adverse consequences for the taxpayer?

In a recent Third Circuit decision, *Murrin*,¹ the court said “yes,” holding that a return preparer's fraud can leave the IRS' tax assessment period against the preparer's client open indefinitely, even if the taxpayer had no knowledge of or involvement in the fraud. Below, we examine the fraud exception to the statute of limitations on tax assessment, how courts have interpreted that exception, and what *Murrin* (and cases following a similar logic) means for taxpayers and their advisors.

The Fraud Exception to the Statute of Limitations

In our first article, we discussed how a fraud determination can lead to reverberating outcomes for a taxpayer, from the imposition of a fraud penalty under Code Sec. 6663 to foreclosing discharge of the resulting tax debt in bankruptcy.² One of the consequences we discussed was the fraud exception to the general three-year statute of limitations on the IRS' ability to assess tax after a return is filed. As a baseline, Code Sec. 6501(a) generally provides the IRS with three years after a return is filed to assess tax. But Code Sec. 6501(c)(1) changes the calculus dramatically where fraud is present. If a return is “false or fraudulent” with the “intent to evade tax,” the statute

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never closes. As such, when the IRS can establish the requisite fraud and intent, a taxpayer cannot rely on the statute of limitations as a defense to a belated tax assessment.

An amended return cannot “cleanse” fraud embedded in the original filing, and self-correction does not start or shorten the assessment limitations period. The Supreme Court said as much in *Badaracco*, holding that a taxpayer cannot undo the fraud consequences for statute of limitations purposes by filing an amended return after the due date.³ At the same time, the text of Code Sec. 6501(c)(1) is far-reaching: once a return is determined to be tainted with fraud, the extended assessment period applies to the return as a whole. “[W]here fraud is alleged and proven, [the IRS] is free to determine a deficiency with respect to all items for the particular taxable year without regard to the period of limitations.”⁴ What the statute does not specify, however, is whose fraud is sufficient to keep the statute open. On that point—whether the requisite fraud may be that of the taxpayer, return preparer, or someone else—courts have split, as discussed below.

Whose Fraud Matters?

Until the early 2000s, the IRS generally did not argue that fraud committed by someone other than the taxpayer, such as a return preparer, triggered the indefinite limitations period under Code Sec. 6501(c)(1).⁵ That position shifted in 2001, when IRS Chief Counsel issued a memorandum that departed from prior administrative guidance and practice. That memorandum stated that a return preparer’s fraudulent intent, as the taxpayer’s agent, could taint the return and thereby extend the assessment statute indefinitely.⁶ From 2001 onward, the IRS has consistently argued for this broader application of the fraud exception under Code Sec. 6501(c)(1).

Since the IRS issued that advice, courts have diverged on the question of whose fraud matters. The Tax Court,⁷ Second Circuit,⁸ and Third Circuit⁹ focus on the fraudulent nature of the return, not the person committing the fraud, in determining whether to apply Code Sec. 6501(c)(1)’s exception to the statute of limitations. On the other hand, the Federal Circuit has held that only the taxpayer’s fraudulent intent may trigger the fraud exception to the statute of limitations, though the court reserved judgment on whether the taxpayer’s authorized agent could be treated as the “taxpayer” for purposes of Code Sec. 6501(c)(1).¹⁰

Courts Adopting the IRS-Friendly Stance: A Return Preparer’s Fraud Is Sufficient to Trigger the Fraud Exception to the Statute of Limitations on Tax Assessment

In *Allen*,¹¹ the taxpayer’s return preparer included a series of false and fraudulent deductions for charitable contributions, meals and entertainment, and computer expenses, *inter alia*, on the taxpayer’s returns and filed the returns on the taxpayer’s behalf. The Tax Court held that the fraudulent intent of the return preparer justified allowing the IRS unlimited time to assess a tax, reasoning that, under *Badaracco*, statutes of limitation must be strictly construed in favor of the government; the language of Code Sec. 6501(c)(1) hinges on the fraudulent nature of the return, not the taxpayer; the IRS is equally disadvantaged regardless of whether the intent is that of the return preparer or taxpayer; it was not unduly burdensome for a taxpayer to review their returns for obviously false or incorrect items; and that taxpayers are ultimately responsible for the content of the information on their tax returns. The Tax Court now routinely holds that the fraudulent intent of the return preparer is sufficient to trigger the fraud exception to the statute of limitations under Code Sec. 6501(c)(1).¹²

In *City Wide Transit, Inc.*,¹³ a taxpayer with significant unpaid payroll taxes retained an individual (the “return preparer”), who falsely claimed to be a certified public accountant, and granted him a power of attorney. The taxpayer engaged the return preparer primarily to negotiate a resolution of outstanding payroll tax liabilities, but also provided him with unfiled quarterly payroll tax returns (prepared by a third-party payroll service) and checks for the amounts shown on those returns, instructing the return preparer to deliver both the returns and the checks to the revenue officer assigned to the case. Instead of transmitting the taxpayer’s payroll tax returns, the preparer prepared, signed, and filed different returns that falsely claimed advance earned income credit amounts, thereby reducing the taxpayer’s reported tax liabilities. The return preparer then altered the taxpayer’s checks and embezzled the funds. After the general three-year statute of limitations had expired, the IRS assessed the unpaid payroll taxes against the taxpayer by invoking the fraud exception under Code Sec. 6501(c)(1).

The Tax Court held that the IRS had not shown that the taxpayer had the specific intent to avoid taxes; instead, it

found that the fraudulent nature of the returns was merely a byproduct of the return preparer's attempt to conceal his embezzlement scheme.

On appeal, the taxpayer conceded that the return preparer filed false or fraudulent returns, and that the statute of limitations would be tolled if the returns were filed with an intent to evade tax. The Second Circuit reversed the Tax Court, holding that the return preparer's primary motive to hide his embezzlement was not inconsistent with an intent to evade taxes, and, relying on *Allen* and its progeny, concluded that the fraud exception to the statute of limitations applies when an understatement results from the preparer's fraud.

Most recently, in *Murrin*, the taxpayer underpaid her taxes for several years because her returns contained false or fraudulent entries. The fraud was committed by the return preparer; the taxpayer herself did not intend to evade tax. More than 20 years later, well beyond the general three-year assessment period in Code Sec. 6501(a), the IRS issued a notice of deficiency for those years. The taxpayer petitioned the Tax Court, which held that the return preparer's fraud was sufficient to trigger the unlimited assessment period in Code Sec. 6501(c)(1).

The Third Circuit affirmed the Tax Court. It did so despite the absence of any allegation that the taxpayer acted fraudulently and despite acknowledging the "financial pain" the taxpayer would face as a result. The court emphasized the statute's text, noting the absence of any explicit requirement that the taxpayer herself possess fraudulent intent, and it read the broader statutory context to allow return preparer fraud to extend the limitations period. The taxpayer petitioned the Third Circuit for an *en banc* rehearing to reconsider its decision, but the court denied the petition in October 2025.

A Taxpayer-Friendly Interpretation of the Fraud Exception to the Tax Assessment Statute of Limitations

In contrast to the cases discussed above, a divided panel of the Federal Circuit held that only the taxpayer's fraudulent intent can trigger the fraud exception under Code Sec. 6501(c)(1). In *BASR Partnership*,¹⁴ a family formed a partnership and entered into a series of transactions recommended by an attorney as a "tax-advantaged investment opportunity." The family's return preparer, who was not associated with the attorney or his law firm, prepared and filed returns reflecting the claimed tax benefits from these transactions.

The attorney pleaded guilty to conspiracy and tax evasion charges arising from his role in designing and promoting fraudulent tax shelters. The IRS subsequently obtained a list of the law firm's clients and issued a final partnership administrative adjustment to the partnership after the general statute of limitations had expired. The IRS conceded that the family did not intend to evade tax and made no allegation that the return preparer had fraudulent intent. Nonetheless, the IRS argued that the attorney's fraudulent intent was sufficient to invoke the unlimited statute of limitations under Code Sec. 6501(c)(1).

After examining the statutory structure, relevant caselaw, and legislative history, the Federal Circuit held that only the taxpayer's intent is relevant for purposes of applying the fraud exception under Code Sec. 6501(c)(1). The majority emphasized that other fraud-related provisions in the Code generally contemplate fraud by the taxpayer. The court further characterized *Allen* as having conducted only a "limited analysis" of Code Sec. 6501(c)(1) and failing to consider the broader implications of its reasoning. It also distinguished *City Wide* on the grounds that the taxpayer in that case had conceded the statute of limitations would be tolled if the return preparer acted with intent to evade tax. Finally, the court expressly declined to decide whether the intent of an authorized agent could be imputed to the taxpayer under Code Sec. 6501(c)(1).

Takeaway for Taxpayers

The divergence among federal courts on whose fraud can keep the statute of limitations open under Code Sec. 6501(c)(1) has significant implications for taxpayers. For those facing a belated assessment where the IRS contends that another person's fraud, such as that of a return preparer or tax advisor, renders the return "false or fraudulent," the most receptive judicial forum is likely to be the Federal Circuit (and by implication, the Court of Federal Claims), as it has adopted a taxpayer-friendly reading of the statute, holding that only the taxpayer's own fraudulent intent can justify eliminating a limitations period. Yet, access to the Federal Circuit and Court of Federal Claims is procedurally limited. Unlike the Tax Court, which has jurisdiction over proposed tax deficiencies and that taxpayers can access without first paying the disputed tax liability, taxpayers may only contest their tax liabilities in the Court of Federal Claims and the Federal Circuit through refund litigation. This requires full payment of the disputed tax liability,¹⁵ filing an administrative refund claim with the IRS,¹⁶ and only then, if the administrative refund claim is denied or unanswered, filing a complaint in the Court of Federal

Claims.¹⁷ This route is neither quick nor inexpensive; however, refund litigation in the Court of Federal Claims remains the most promising path for those seeking to challenge an untimely tax assessment that stems from another person's fraudulent conduct.

For taxpayers litigating in jurisdictions that have accepted the IRS' position on the scope of the fraud exception, an additional question remains unresolved: how far can the causal connection between the fraud and the position on the tax return stretch before the fraud no longer justifies keeping open the statute of limitations? Most of the cases adopting the IRS' view involve return preparers or advisors who directly touched some aspect of the taxpayer's return. But Code Sec. 6501(c)(1) does not expressly cabin its reach in terms of proximity. For example, could the statute of limitations remain open merely because a taxpayer's transactional counterparty engaged in fraud that is indirectly reflected in a taxpayer's return position? Imagine a situation in which a taxpayer invests in what they are told is a tax-deferred vehicle, and they report the transaction in good faith based on that representation, only to discover years later that the counterparty's description of the investment was false or fraudulent. Does that counterparty's misrepresentation render the taxpayer's return "false or fraudulent" within

the meaning of Code Sec. 6501(c)(1)? The text of the statute does not offer a clear answer, and courts have not yet decided how far from the tax return the relevant fraud may extend. This remains an open doctrinal question, with potentially sweeping implications if courts were to extend the logic employed in cases like *Allen*, *City Wide Transit*, or *Murrin*.

Finally, the above-discussed cases underscore that taxpayers should exercise care in selecting and supervising those who prepare or advise on their tax returns. Courts emphasizing the "fraudulent nature of the return" rather than the "fraudulent intent of the taxpayer" place the burden on individuals to ensure their filings are accurate, even when they rely on professionals. While few taxpayers possess the expertise to second-guess every technical determination, a healthy degree of diligence and skepticism—confirming credentials, reviewing filings for anomalies or positions that seem too good to be true, and seeking independent opinions for complex transactions—can serve as a first line of defense against an indefinite statute of limitations. In an environment where the transgressions of others can reopen otherwise closed tax years, diligence in advisor selection is not merely prudent, it may be the taxpayer's best shield against an indefinite tax assessment period.

ENDNOTES

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¹ No. 24-2037, CA-3, 2025-2 USTC ¶50,221, 2025 WL 2945747 (*Murrin*).

² Stephen Josey & Quentin Manuel, *Civil Tax Fraud: Should 75 Percent Appear Too Small, Be Thankful the IRS Doesn't Take It All*, TAXES, Aug. 2025, at 25; 11 USC §523.

³ SCT, 84-1 USTC ¶9150, 464 US 386, 104 SCT 756.

⁴ *S.G. Colestock*, 102 TC 380, 385, Dec. 49,703 (1994).

⁵ See, e.g., FSA 200104006 (Sep. 15, 2000) (fraudulent intent of the return preparer insufficient to extend statute of limitations).

⁶ FSA 200126019 (Mar. 30, 2001).

⁷ *V. Allen*, 128 TC 37, Dec. 56,851 (2007).

⁸ *City Wide Transit, Inc.*, CA-2, 2013-1 USTC ¶50,211, 709 F3d 102.

⁹ *S. Murrin*, CA-3, 2025-2 USTC ¶50,221.

¹⁰ *BASR Partnership*, CA-FC, 2015-2 USTC ¶50,412, 795 F3d 1338.

¹¹ 128 TC 37, Dec. 56,851 (2007).

¹² See, e.g., *L.R. Ames-Mechelke*, 106 TCM 77, Dec. 59,595(M), TC Memo. 2013-176.

¹³ CA-2, 2013-1 USTC ¶50,211, 709 F3d 102.

¹⁴ CA-FC, 2015-2 USTC ¶50,412, 795 F3d 1338.

¹⁵ *W.W. Flora*, SCT, 58-2 USTC ¶9606, 357 US 63, 78 SCT 1079.

¹⁶ Code Sec. 7422(a).

¹⁷ 28 USC §1346(a)(1).

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