



Poor Records Not Equated to Fraud

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Fraud and the Dentist

A recent Court of Claims case proves to be instructive both for the general application of the civil fraud penalty and how an examination can spin out of control—as well as the dangers of accepting the ability to sign agreements on behalf of the client and then actually signing such an agreement.

The case this week takes place in the United States Court of Claims, and is the case of *Gagliardi v. United States*, 2008 TNT 98-20. Dr. Gagliardi was a dentist who didn't practice the most thorough of internal controls over his business receipts, and this lack of control resulted, when he switched over to using a bookkeeper to keep track of his books, to a significant amount of income not being reported on his return. The IRS agent proposed to assess the civil fraud penalty, and the taxpayer's representative, acting under his Power of Attorney, signed off on the assessment.

The Gagliardis were not happy with this result, and sued in the Court of Claims to obtain a refund of the civil fraud penalty. Their story is this week's podcast.

Civil Fraud Penalty

The IRC provides a number of penalties that can be applied to taxpayers for an underpayment of tax, and one of the most onerous is the civil fraud penalty under §6663. That section provides:

(a) Imposition of penalty

If any part of any underpayment of tax required to be shown on a return is due to fraud, there shall be added to the tax an amount equal to 75 percent of the portion of the underpayment which is attributable to fraud.

(b) Determination of portion attributable to fraud

If the Secretary establishes that any portion of an underpayment is attributable to fraud, the entire underpayment shall be treated as attributable to fraud, except with respect to any portion of the underpayment which the taxpayer establishes (by a preponderance of the evidence) is not attributable to fraud.

(c) Special rule for joint returns

In the case of a joint return, this section shall not apply with respect to a spouse unless some part of the underpayment is due to the fraud of such spouse.

The penalty itself is 75%—and note that §6663(b) provides that one the IRS establishes that *any* portion of the underpayment is due to fraud, the presumption is that all of the underpayment is subject to the penalty except to the extent that the taxpayer can now establish that portion was not due to fraud.

While this not a criminal penalty, it obviously often would arise in the civil portion of such tax matters—and a case where the IRS is discussing the fraud penalty is a case where a taxpayer would seem to need to worry about whether the IRS might decide the overall conduct might rise to the criminal level.

The Case of the Missing Dental Deposits

Dr. Gagliardi is a dentist who practiced in two locations in New Jersey during the 2000 and 2001 tax years in question. The year 2000 was the year when Dr. Gagliardi decided to stop having his CPA, Mr. Goodman, do the bookkeeping for his practices, and rather engaged the service of Carol Downey, a bookkeeper who had worked under contract with Mr. Goodman and who was recommended

to Dr. Gagliardi by Mr. Goodman.

Prior to that date, Mr. Goodman had handled the books as described by the court:

After Dr. Gagliardi opened his first dental practice, Mr. Goodman performed bookkeeping services for Dr. Gagliardi's dental practices. Mr. Goodman was given business records from Dr. Gagliardi's dental practices, including the payroll book, check stubs, business bank account statements, and deposit tickets. Tr. at 129 (testimony of Dr. Gagliardi), 202 (testimony of Mrs. Gagliardi).

After Dr. Gagliardi stopped using the services of Ms. Downey, Mr. Goodman again began handling the books for Dr. Gagliardi. For the two years in question, the court described Ms. Downey's work as follows:

Ms. Downey has operated her own bookkeeping business since 1996 and was a subcontractor in Mr. Goodman's office before she began work for plaintiffs. She was responsible for what she termed "bookkeeping" for the three dental practices for the tax years in question, but she had no involvement in plaintiffs' personal finances, nor was she attempting to audit, review, or otherwise confirm that the receipts and other documents she received captured all business income. See Tr. at 143 (testifying that she had no knowledge of revenue received by dental practices because responsibilities did not include accounting of revenue from patients). Her role centered primarily on entering into the QuickBooks bookkeeping database the deposits made to business accounts, managing accounts payable for the practices by preparing checks drawn on the business accounts in order to ensure that all the bills were paid, reconciling business bank accounts, and preparing reports from the QuickBooks database to pass through to Mr. Goodman -- the balance sheet, profit and loss statements, and supporting documentation, including bank statements and credit card statements. (QuickBooks is a bookkeeping software suite that, among other things, can catalogue bank deposit entries.) Tr. at 145-46.

The fact that Ms. Downey was not involved with the personal accounts and, per her engagement, did not do any independent verification of the items given to her would prove to create an issue—because it turns out that Dr. and Mrs. Gagliardi didn't necessarily always deposit the cash from the dental practices in the business bank account.

Rather, it appears our dentist and his wife thought that it was all their money and since they needed spending money they would put money into their personal accounts if they needed some put there.

While the opinion doesn't explicitly say so, it appears they had done this in the

past, but it appears that, interpreting events in a favorable light for the doctors, that Ms. Downey and Mr. Goodman may have thought that the other one was going to take care of accounting for those extra deposits.

Mr. Goodman explained what he did as follows:

Mr. Goodman did not perform bookkeeping for plaintiffs during the 2000 and 2001 tax years. He relied on Ms. Downey to provide him with QuickBooks data to prepare the income reported on individual Schedule Cs and the expenses for each of the dental practices. He used both QuickBooks format, e.g., for scheduling depreciation, and Creative Solutions Systems software (another bookkeeping software package) to generate the information required for Schedule Cs. He did not verify that the QuickBooks data were recorded properly.

Mr. Goodman took care of the tax filings, but appeared to presume that the Quickbooks reports generated from the data in that file was the complete record of the activity in the businesses in question.

Mrs. Gagliardi's interaction with Mr. Goodman at the meeting to go over their tax information became a key issue in the case—and there was a difference in how the meeting was remembered by Mrs. Gagliardi and Mr. Goodman. Mrs. Gagliardi's recollection was described as follows:

Plaintiffs testified that, during their annual meetings for the tax years in question, they provided Mr. Goodman with information about the deposits of business income that they made to all of their personal accounts in the same manner that they had done in previous years. Mrs. Gagliardi stated that plaintiffs commingled their business and personal accounts during 2000-2001 and "filed one return, so everything was one for us." Tr. at 193. Mrs. Gagliardi admitted that she had no written evidence that she had provided Mr. Goodman with information pertaining to deposits to the two Fleet bank accounts; however, she was convincing that she compiled a list of deposits that she read off to Mr. Goodman and importuned that "[w]e weren't taking a paycheck, so where else would I get that money to put into that account, or the other account?" Tr. at 194. During these two tax years plaintiffs obtained a loan from her father and reported rental income, because the audit did not uncover any discrepancy (that Mr. Goodman could not explain satisfactorily) for these items. See Tr. at 194-97.

Mr. Goodman gave a somewhat different account of what he was told.

He disclaimed knowledge of any deposits to the Kearny account until Ms. Wieme brought the account to his attention. Tr. at 406-07. Mr. Goodman denied that Mrs. Gagliardi orally gave him the totals of business income deposited into personal accounts and denied that plaintiffs followed a practice of reporting

additional business income in this fashion. Tr. at 448-51.

Faced with this difference of views, the Court had to decide whose testimony it believed—and Mr. Goodman came out on the short end of this evaluation.

These key denials were not credible. The court found Mr. Goodman to be off-hand. He had no records relating to information received in connection with his annual meeting with plaintiffs. The memories of the principals -- plaintiffs and Mr. Goodman -- were captive to the brevity and informality of these encounters, as well as to their respective self interest. Mrs. Gagliardi is not a fabricator. Dr. Gagliardi and Mr. Goodman are not records people.

The Court noticed that Mr. Goodman had a potential problem since he had not questioned whether the income numbers were complete, and had eventually agreed to a fraud penalty on behalf of his clients. As well, given that Mr. Goodman was the accountant, the Court's comment that he was not a records person (which may have been influenced by his lack of documentation) was hardly a ringing endorsement.

What the IRS Found

Now we turn to the IRS agent and the examination. The agent uncovered the following facts:

Plaintiffs established three bank accounts, each corresponding to one of the three dental practices (the "business bank accounts"). The bulk of the income from each of the dental practices was deposited into the corresponding business bank account. In the course of the audit, Ms. Wieme identified deposits of income from the dental practices made to three other bank accounts: a bank account with Fleet National Bank in the name of Dr. Gagliardi and his mother (the "shared Fleet account"); a bank account with Fleet National Bank in Mrs. Gagliardi's name ("Mrs. Gagliardi's Fleet account"); and a bank account with Kearny Federal Savings Bank in Dr. Gagliardi's name (the "Kearny account"). The income from the dental practices that was not reported in plaintiffs' 2000 and 2001 tax returns correlated with the deposits of income from the dental practices into these three non-business accounts in 2000 and into the Kearny account in 2001.

The shortfalls found were as follows:

After an audit of plaintiffs' returns for the 2000 and 2001 tax years that commenced on January 28, 2003, the IRS adjusted the amount of tax due by \$17,917.00 for the 2000 tax year and by \$5,740.00 for the 2001 tax year and

imposed penalties for fraud in the amount of \$13,437.75 for the 2000 tax year and \$4,305.00 for the 2001 tax year.

The Fraud Penalty

On July 14, 2004 Mr. Goodman signed a Form 870 consenting to the assessment of the tax, including the fraud penalty under §6663(a). The reason why Mr. Goodman consented to that penalty on behalf of his client, as he explained it, was noted by the Court:

This was Mr. Goodman's first experience representing client taxpayers who faced a civil fraud penalty. Mr. Goodman testified that he "felt [that he] had to acquiesce" on plaintiffs' behalf in the fraud penalty because he could only refute the finding of fraud "with great difficulty." Tr. at 446. Ms. Wieme had mentioned to Mr. Goodman a possible criminal penalty in connection with the understatement of income. Tr. at 470-73. Mr. Goodman opined that he could have refuted the fraud penalty with a different IRS agent than Ms. Wieme. See Tr. at 480 ("Q [by counsel for defendant] [D]id you believe that you could refute the fraud penalty? A. . . . Practically I think I could have with a different agent."). Ms. Wieme admitted on cross-examination that the IRS Group Coordinator who reviewed her audit results determined that the appropriate penalty would be civil and did not indicate that a criminal penalty would be considered. Tr. at 567.

It appears that Mr. Goodman didn't have an answer when the IRS agent proposed a civil fraud penalty. While the Court notes he felt he could only refute the penalty "with great difficulty" it also noted that he seemed to believe somehow that this particular agent was his key point of difficulty. The court also noted that the agent had mentioned a potential criminal penalty, while the Agent admitted that, in fact, her superiors had indicated that no criminal penalty would be appropriate in this case.

The Court's Analysis

The IRS argued in court that six factors showed that the taxpayers had engaged in conduct that justified the imposition of the fraud penalty. The Court outlined the IRS's six badges of fraud as follows:

Defendant argued that six such "badges" showed clearly and convincingly that plaintiffs had the requisite fraudulent intent: (1) concealment though understatement of income in multiple years; (2) concealment of information from accountant and bookkeeper; (3) concealment of assets; (4) inadequate

records; (5) failure to cooperate with the IRS; and (6) implausible or inconsistent explanations of behavior. See Def.'s Br. filed Feb. 12, 2008, at 12-21. Defendant characterizes the badges of fraud in this case as "manifest." Id. at 13. Defendant's case-in-chief intended to adduce evidence that these six badges were present as the predicate for an inference of fraudulent intent.

The Court dealt with its view on why the IRS had failed to carry its burden by analyzing each of the six badges.

Concealment Through Understatement in Multiple Years

The Court notes that if a taxpayer continuously understates his/her income over a number of years, that goes to indicate a fraudulent intent. One understatement could be an accidental oversight or have an innocent explanation, but for this "accident" to keep happening for a number of years suggests it isn't an accident.

In the instant case, the underreporting of income covered two years, tax years 2000 and 2001. It warrants mention that these are the same two years that plaintiffs hired Ms. Downey and transferred bookkeeping responsibilities for the three dental practices from Mr. Goodman's firm to Ms. Downey. According to the final Form 4549 dated July 7, 2004, that Mr. Goodman signed on July 14, 2004, as plaintiffs' representative during the IRS audit, the understatement of gross receipts or sales was \$68,071.00 in 2000 and \$40,621.00 in 2001. DX 10 at 1, ln. 1b, cols. 2-3. The total gross receipts reported by plaintiffs were \$398,789.00 in 2000 and \$817,551.00 in 2001. See DX 1 at 0055, 0059; DX 2 at 0152, 0154, 0156. The percentage of gross receipts not reported was approximately 14.6% in 2000, and 4.7% in 2001.

The key question becomes whether this conduct is significant enough to suggest that this wasn't an accident, and the two years show a pattern of conduct that indicates an intentional fraud.

The IRS attempted to cast the transaction as significant because of the higher percentage of understatement when you looked at certain individual Schedule Cs rather than the self-employment income as a whole. However, the court was less impressed with this argument, and found as follows:

Taxpayers have an option to report all such gross receipts and other business information on one Schedule C; multiple Schedule Cs are not required. Tr. at 456 (testimony of Mr. Goodman). That plaintiffs filed individual Schedule Cs for each dental practice is of no moment. Defendant argues that plaintiffs should have been impressed with the magnitude of underreporting evidenced on the Schedule C for the Union City practice. In 2000 plaintiffs reported gross receipts

of \$54,072.00 for the Union City practice on a Schedule C to their Form 1040. DX 1 at 0055. The IRS adjusted the total gross income by \$68,071.00 to \$122,143.00. See DX 10 at 1, ln. 1b, col. 2. In 2001 plaintiffs reported gross receipts of \$58,561.00 for the Union City practice on a Schedule C to their Form 1040. DX 2 at 0152. The IRS adjusted the total gross income by \$40,621.00 to \$99,182.00. See DX 10 at 1, ln. 1b, col. 3. This assumes that plaintiffs reviewed not only their aggregate business income stated on the Form 1040 itself, but each optional Schedule C. For 2000 and 2001, plaintiffs' adjusted gross income was \$46,947.00 and \$15,920.00, respectively, against itemized deductions of \$32,383.00 and \$34,720.00, respectively. See DX 1, at 0051; DX 2, at 0149. The discrepancy would not call out to the taxpayers' attention any underreporting.

The Court found that neither the number of years involved, which related only to the two years when the bookkeeper was involved, nor the amount, which the Court found in aggregate wasn't high enough for it to be obvious to the taxpayers. So the Court was not impressed with this badge of fraud that the IRS suggested justified the penalty

Concealment of Information from the Accountant and Bookkeeper

A taxpayer intent on committing fraud very well might hide his actions from third parties. That is, there's no reason why the accountant or bookkeeper would be told about the existence of the funds the taxpayer didn't intend to report as income, since to do so means the taxpayer would have to assume that those other parties would go along with the fraud.

The IRS argued that, in fact, the taxpayers had concealed the existence of the deposits in the personal accounts from both the bookkeeper and the accountant.

As noted earlier, the taxpayers contended they continued to provide information about all accounts to Mr. Goodman as they had in the past. All parties admitted that Ms. Downey was not provided with any of the personal accounts. However, the court noted:

The court finds, based on Ms. Downey's cogent testimony, that Ms. Downey had no role in plaintiffs' tax preparation, nor was she charged with any responsibility to record plaintiffs' personal income or expenses. Ms. Downey's role is best characterized as a bookkeeper and manager of accounts payable for the three dental practices.

It simply wasn't her job to deal with those accounts, and so the Court found no "bad faith" in the fact that she wasn't provided with those accounts.

But, obviously, if the Gagliardis never told anyone about these deposits, that

would suggest an intent to keep this income off the return. So the key question is whether they informed Mr. Goodman. The Court noted:

Mrs. Gagliardi was insistent that Mr. Goodman had to know that she and her husband took no draws from business bank accounts that would provide them income on which they could live. See Tr. at 204 (Mrs. Gagliardi testifying that Mr. Goodman was aware that plaintiffs deposited business income directly into personal accounts because otherwise "I wouldn't have been able to pay my mortgage if I didn't put that money into my account.").³ According to plaintiffs, Mr. Goodman was not interested in retaining the checkbook registers. Mr. Goodman sidestepped any allusion of impropriety by stating that plaintiffs met with him in person only to give him information concerning expenses and several other deductions relevant to the preparation of their joint returns. He denied any knowledge of the Kearny account. The court has found that plaintiffs, especially Mrs. Gagliardi, testified more credibly as to what transpired during these meetings with Mr. Goodman.

The Court was also influenced by its understanding that Mr. Goodman was in a precarious legal position with his clients in this situation, both in terms of whether he should have been aware that the returns were prepared incorrectly, and his later agreement to the assessment of the fraud penalty when he signed off on behalf of his clients. Similarly, the taxpayers had an interest in avoiding the fraud penalty. In both cases, these biases might influence memories of the crucial meetings with Mr. Goodman.

The Court noted:

The court was at all times aware that Mr. Goodman had legal exposure as plaintiffs' tax preparer and that plaintiffs had a vested interest in defeating fraud penalties. Plaintiffs, on the one hand, and Mr. Goodman, on the other, carefully avoided calling each other liars, and the key witnesses offered scenarios that were plausible. The court credits Mr. Goodman's testimony insofar as he stated that his purpose in the annual face-to-face meeting was obtaining information about plaintiffs' personal expenses and deductions. The court credits plaintiffs insofar as they disclosed deposits orally and stood ready to give Mr. Goodman records of deposits to the personal accounts. Mr. Goodman was careful to minimize any oral disclosure by plaintiffs, and he portrayed their reportorial efforts as stumbling. See Tr. at 422-25 (Mr. Goodman testifying that he was repeatedly either unable to recall whether plaintiffs "orally provide[d] the sum total of [their] total deposits" to the personal accounts or that he was unaware of any such deposits). While he disclaimed any intent by plaintiffs to defraud, see Tr. at 174 ("I don't think he intended to defraud anybody."), he provided no safe

harbor that either Dr. or Mrs. Gagliardi had disclosed the deposits of revenues from the dental practices into personal accounts, and he denied any knowledge of the Kearny account's existence until Ms. Wieme informed him that she had uncovered it.

Faced with this conflict, the Court concentrated on the taxpayer's claims that they deposited the funds into personal accounts because that is what they lived off of, rather than paying for such expenses out of the business accounts.

The Court noted that no evidence was found by any of the parties of any personal expenses being paid out of the business accounts, supporting the taxpayers' theory that they only deposited the funds they needed—essentially, bypassing the business account likely because that made more sense to them than depositing the funds in a business checking account only to later write a check in the same amount from the business account to their personal accounts.

While the second path would have provided a greater level of control, it's also understandable how someone without formal accounting training might not see how this could cause the income to be missed—and that's even more true if, as the evidence seemed to suggest, they had done the same in earlier years and Mr. Goodman had captured and reported that income.

Concealment of Assets

The Court notes that this badge falls for the same reasons as the one before it—the Court believes the taxpayers did attempt to disclose the existence of these accounts and the fact that business funds went into them to their accountant. And they certainly didn't take active steps to keep the accountant from finding out about these accounts.

In fact, there were amounts transferred from one of the “concealed” accounts into the business account that was picked up as income on the accounts of the business, labeled as funds accidentally deposited into the wrong account. Mr. Goodman noted that “If there was fraud why would they deposit the money back into the account and record it as income?” and the Court found the IRS had no good response to that query.

Inadequate Records

The IRS's next badge was the claim of maintenance of inadequate records as an attempt to conceal the fraud.

Defendant maintains that plaintiffs failed to produce adequate records reflecting all their business income because they never advised Ms. Downey and Mr. Goodman that they were depositing dental income into their personal accounts.

However, the Court had already found that the taxpayers had apprised Mr. Goodman of the existence of the personal accounts and the deposits of business income in those accounts and, as regards Ms. Downey “the degree to which Ms. Downey was or was not informed of plaintiffs' personal finances is irrelevant, unless she saw evidence that plaintiffs were debiting the business bank accounts for any draws or personal expenses.”

Failure to Cooperate with the IRS

A failure to cooperate with the IRS on examination is certainly to be expected of a taxpayer attempting to fraudulently avoid paying taxes due. This factor didn't break clearly for the taxpayers and, in fact, the court rejected many of the taxpayer's claims and explanations in this area. However, the Court was heavily influenced by the fact that the taxpayers consented to an extension of the statute of limitations.

Plaintiffs' cooperation was evidenced by Mr. Goodman's signing the Form 872 "Consent to Extend Time To Assess Tax" for tax year 2000, which authorized the IRS to continue assessing tax for the year 2000. See DX 26. Had plaintiffs not agreed to this extension, Ms. Wieme opined that the statute of limitations likely would have run on the 2000 tax year during the course of investigation. She was of the view that the IRS would not have pursued investigation of tax year 2000 at all without first securing an extension. Tr. at 568-70.

Whether that's good news for Mr. Goodman or not is open to question, since the IRS appears to conceded that the extension of the statute allowed them to assess 2000, something that would not have happened without the extension. And, since the taxpayers would allege that Mr. Goodman exceeded his authority by consenting to the fraud penalty, it seems they might argue they didn't really agree to extend the statute. But it did serve to suggest that those that did consent to extending the statute did not seem to know there was a big problem in 2000 that would have argued for forcing the IRS's hand on the statute by refusing to extend it.

But other actions argued against the theory they were cooperative. The Court was troubled by the fact that the taxpayers appeared highly uncooperative in producing records for the personal accounts, actions that eventually forced the IRS agent to subpoena the records directly from the bank from the Fleet account, and her accidental discovery of the Kearney account.

However, ultimately the Court decided the overall actions didn't give this badge credence. It held:

The standard is not whether plaintiffs gave inadequate cooperation, but whether

they were uncooperative. Plaintiffs did cooperate by authorizing extension of the time to assess tax, thereby allowing the IRS to continue its investigation without making inordinate demands of Ms. Wieme. Given the totality of the circumstances, the court cannot say that defendant proved that plaintiffs were uncooperative with the IRS.

Implausible or Inconsistent Explanations of Behavior

The Court found that the taxpayers had clearly not kept the best set of records, but noted that the IRS had not assessed a negligence penalty, even as an alternative theory (one which seems likely they would have carried even with losing the fraud penalty). The opinion notes that “The court is convinced that, at worst, plaintiffs exhibited benign ineptitude in arranging their financial and tax affairs.”

The Court went on to note that the taxpayers did not have adequate controls in place, that Mr. Goodman had not advised them to do so but, in one of the few times the Court seems to give a sympathetic phrase to Mr. Goodman, noted that he was never asked to provide such advice either.

Ultimately the Court found the following plausible:

Based on the record, the court finds it plausible and consistent that, during the transition between having Mr. Goodman's firm handle bookkeeping for the dental practices and Ms. Downey's transfer to Dr. Gagliardi's dental office in the same building, some miscommunication and misunderstanding occurred as to who had responsibility for capturing all of plaintiffs' business income.⁷ Both Mr. Goodman and Ms. Downey believably were skeptical that plaintiffs could summon the required mindset to intend to evade taxes. See Tr. at 446 (Mr. Goodman testifying that "I don't think he intended to defraud anybody. I think they just handled some things wrong. I don't think there [w]as intent."); Tr. at 174 (Ms. Downey testifying that "I think he's an honest, nice guy. He's a good dentist, and he doesn't know anything about accounting. Or computers."). One uncontroverted piece of evidence dispelling intent to defraud was Dr. Gagliardi's redeposit of business income from the Kearny account to a business account.

In essence, everyone seemed to presume that “someone else” was taking care of assuring that all revenues were being captured to be reported on the tax return—and so those deposits simply never made their way into the totals reported on Schedule C not due to intent to evade tax, but through the simple fact that the procedures in place did not capture that income.

The Accountants Representation

Mr. Goodman's representation was a matter of dispute even in this case—the taxpayers attempted to argue that he had exceeded his authority in agreeing to the penalty and that the taxpayers shouldn't be held accountable for his actions in agreeing to that penalty.

However, at this point the Court did not remain as sympathetic towards the taxpayers as it had been before. The Court noted items that suggested the taxpayers had been extremely nonchalant about keeping up with the examination, and it seems very possible that Mr. Goodman's actions may have been forced just because something had to happen.

For instance, there's the issue of getting the personal bank account records. The court notes that situation as follows:

One strong indication that plaintiffs were uncooperative was their unexplained and unjustified delay in producing the records for the Kearny and two personal Fleet Bank accounts in response to Ms. Wieme's serial Information Document Requests. They did not deflect that fact by ignoring certified mailing of each notice that Ms. Wieme sent to each plaintiff, copy to Mr. Goodman. Nor did plaintiffs absolve themselves from knowledge that Ms. Wieme had to make repeated requests for information just because they turned over these letters unopened to Mr. Goodman. Ultimately, Ms. Wieme was required to subpoena bank records for the known bank accounts, the two Fleet National accounts. The Kearny account was brought to her attention only due to Dr. Gagliardi's redeposit in a business account of a check drawn from the Kearny account.

While we don't know for sure why those records could not be produced, it seems very possible that Mr. Goodman may have been unable to get the taxpayers to pay much more attention to his requests to the taxpayers as the IRS was getting to the letters it was sending, letters that were going unopened to Mr. Goodman. We can note that the records that the bookkeeper and accountant clearly had direct access to do not appear to have been a problem.

The Court also lectured the taxpayers that they had given Mr. Goodman a power of attorney to act on their behalf, and his actions did not go outside that authorization despite their “buyer's remorse” later at his actions. The court noted:

Plaintiffs presented the argument, both at trial and in their pretrial brief, that Mr. Goodman exceeded the scope of his authority by agreeing to the fraud penalty,

and particularly by doing so when he was instructed to delay any such final resolution of the audit during plaintiffs' trip to Italy. Plaintiffs spent a not-insignificant amount of their cross-examination attempting to render this point significant. Their argument is unavailing because Mr. Goodman held a valid power of attorney through two Forms 2848 executed by plaintiffs for tax years 2000 and 2001. See DX 11; DX 12. Forms 2848 authorized Mr. Goodman to serve as plaintiffs' representative for all matters before the IRS pertaining both to the filing of each tax return and to the audit period. See *id.* Mr. Goodman accepted the fraud penalty on behalf of plaintiffs by executing on July 14, 2004, a Form 870 Waiver of Restrictions on Assessment and Collection of Deficiency in Tax and Acceptance of Overassessment. See DX 9. The Form 870 by its own terms expressly reserved plaintiffs' rights to pursue this refund action. See *id.* at 000112 ("Your consent will not prevent you from filing a claim for refund. . . .").

However, Mr. Goodman's choice of how to inform his clients that he had consented to a fraud penalty seemed to be a somewhat strange method to do so.

The opinion notes:

Mr. Goodman was less than forthcoming about the assessment of the fraud penalty and his acceptance of that assessment. Plaintiffs maintain that they were totally ignorant of the course of the audit, including the assessment of a fraud penalty. Plaintiffs cannot escape their responsibility for apprising themselves of the nature of the audit because Ms. Wieme sent each of them by certified mail copies of all her Information Document Requests and other written correspondence pertaining to the audit. Mr. Goodman first informed plaintiffs that he was executing the Form 870, agreeing to the fraud penalty, some time after July 7, 2004, when Ms. Wieme gave Mr. Goodman the Form 870, and before July 14, 2004, when the Form 870 was actually executed. See Tr. at 441-42. Mr. Goodman's own discomfort with explaining the fraud penalty to plaintiffs was evident from the setting in which he did so: the conversation took place in the parking lot outside his office building, which he shares with one of Dr. Gagliardi's practices, and Mrs. Gagliardi credibly testified as to both her shock and dismay with Mr. Goodman's abruptness on that occasion. Tr. 214-16. However questionable Mr. Goodman's choice of venue might have been, plaintiff's arguments that Mr. Goodman exceeded the scope of his authority are immaterial in light of the Forms 2848 they executed authorizing Mr. Goodman to serve as plaintiff's representative for all matters pertaining to the audit period.

It certainly appears the client was totally disengaged from the audit right up until the bill arrived. At that point they finally seemed to be concerned about what Mr. Goodman had done.

Of course, many of us might question why Mr. Goodman had apparently agreed so quickly at the exam level to accept the fraud penalty. His explanation, noted earlier, is one that certainly seems to suggest he conceded this issue rather easily. To reiterate that matter, the court summarized the justification:

This was Mr. Goodman's first experience representing client taxpayers who faced a civil fraud penalty. Mr. Goodman testified that he "felt [that he] had to acquiesce" on plaintiffs' behalf in the fraud penalty because he could only refute the finding of fraud "with great difficulty." Tr. at 446. Ms. Wieme had mentioned to Mr. Goodman a possible criminal penalty in connection with the understatement of income. Tr. at 470-73. Mr. Goodman opined that he could have refuted the fraud penalty with a different IRS agent than Ms. Wieme. See Tr. at 480 ("Q [by counsel for defendant] [D]id you believe that you could refute the fraud penalty? A. . . . Practically I think I could have with a different agent."). Ms. Wieme admitted on cross-examination that the IRS Group Coordinator who reviewed her audit results determined that the appropriate penalty would be civil and did not indicate that a criminal penalty would be considered. Tr. at 567.

This explanation suggest a number of possible reasons why Mr. Goodman conceded this point, all of which are speculation, but which are ones that all representatives need to be aware of:

The accountant had taken on an engagement for which he did not have the adequate experience or expertise. He may not have realized how weak the IRS position on this penalty assessment was, and been far too quick to concede the issue at the lowest level of the IRS.

The accountant allowed himself to be intimidated by an IRS suggestion of a criminal prosecution of the taxpayer or his own concern that he might be subjected to disciplinary proceedings if he gave any credence to the idea that the taxpayers may have believed they had disclosed all of this information.

As the above suggests, eventually it appears that a potential conflict of interest existed between representing the interests of the taxpayer fully in the exam and defending the accountants' prior professional work in preparing the return. That is, a representative who had not been involved in preparation would likely have been more willing to argue that the taxpayers had relied on the professionals. Of course, such representation would almost always be more expensive, since the new representative would, at the least, spend significant time getting up to speed on the return.

There's certainly a strong suggestion that the client may have been difficult to interest in the exam. One reason why the accountant may have felt he couldn't argue against the fraud penalty is because the client was totally ignoring the exam and not responding to requests for information. As well, the client took a trip to Italy and then told to "stall" an exam where the agent was likely already unhappy about the problems getting the personal bank account information (which you will recall had to be subpoenaed).

However, in the end the Court of Claims found that the penalty was not justified. But that was only after the taxpayers had to incur the expense of bringing the case before the Court of Claims—which may very well have been nearly as expensive in legal fees as the penalty they finally got out of.