Return Preparer Penalties: Imposition of a Penalty Under I.R.C. § 6701 Requires Clear and Convincing Evidence.

The Internal Revenue Code contains a number of return preparer penalties: return preparers can be penalized for preparing returns on the basis of an unreasonable position, I.R.C. § 6694(a); they can be penalized for preparing returns in a willful or reckless manner, I.R.C. § 6694(b); and they can also be penalized for knowingly preparing a return that understates the taxpayer's liability, I.R.C. § 6701(a). A recent case from the Eleventh Circuit explores the standard of proof necessary to sustain a return preparer penalty under Section 6701. *Carlson v. United States,* 2014 U.S. App. LEXIS 11001 (11th Cir. June 13, 2014).

Ms. Carlson, the plaintiff, spent five years working as a return preparer for Jackson Hewitt. *Id.*, slip op. at *3. She left the company after the owner was arrested on drug trafficking charges. An investigation into Jackson Hewitt's business ensued. Of the 1200-1500 returns Ms. Carlson prepared, the IRS concluded that 40 returns had deductions that could not be substantiated. *Id.*, slip op. at *4. Ms. Carlson sought a refund, and she brought a refund action in district court after her administrative claim was rejected.

At trial, the district court instructed the jury that the government had to establish Ms. Carlson's liability by a preponderance of the evidence; Ms. Carlson had argued that the government should be required to demonstrate clear and convincing evidence to prevail. *Id.*, slip op. at *5. A verdict of $119,173.12 was entered against Ms. Carlson, and her post-trial motions were denied.

On appeal, the Eleventh Circuit ruled that the higher standard of proof was required because Section 6701 dealt with fraudulent conduct. In the Court's view, since the penalty required a showing that the preparer *knew* that the return understated the tax. *Id.*, slip op. at *10.

The Court acknowledged that its decision conflicted with prior rulings from the Second and Eighth Circuits. *Id.*, slip op. at *11(citing *Barr v. United States,* 67 F.3d 469, 469 (2d Cir. 1995); *Mattingly v. United States,* 924 F.2d 785 (8th Cir. 1991)). It concluded that the structure of the various prepare penalties supported its decision that Section 6701 required proof of fraud, since the standards under Section 6694 were lower. *Id.*, slip op. at *13-*14.

The Court of Appeals then turned to the district court's ruling denying Ms. Carlson's motions for judgment as a matter of law. What is interesting here is just how thin the government's case really was: the Eleventh Circuit's opinion cites numerous where the government simply showed that deductions claimed on the return were not substantiated without any showing that Ms. Carlson knew that they were unsubstantiated.

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