Filing a Qualified Amended Return to Avoid Accuracy Penalties

By Megan L. Brackney, Esq.

Neither the Internal Revenue Code ("I.R.C.") nor Treasury Regulations requires taxpayers to file amended returns.[1] However, the ethical rules of Circular 230, the NAEA, and the AICPA call for tax practitioners to advise their clients about errors or omissions in their tax filings.[2] Once you have advised your client about an error, the client likely will ask you "should I correct the error, and, if so, how?" Under certain circumstances, a qualified amended return, or "QAR," may provide a method for correcting an error without penalties.

A QAR is an amended return that corrects an error in a previously filed return before the IRS contacts the taxpayer about that return.[3] Specifically, in order to be a QAR, the taxpayer must file the amended return before he or she is first contacted by the IRS about an examination (including a criminal investigation) of the return at issue and before the IRS contacts a pass-through entity in which the taxpayer is a partner or a member about an audit of its return. Other less common disqualifications for a QAR are, if, before the taxpayer files the amended return, the promoter of an abusive transaction in which the taxpayer participated is already under audit, the IRS has issued a third party summons to any person, group, or class to which the taxpayer belongs regarding any activity for which he or she reported a tax benefit, or the IRS has announced a settlement initiative or compromise for a listed transaction in which the taxpayer participated.[4]

The effect of a QAR is to reduce or eliminate the accuracy penalty under I.R.C. § 6662 on the amount shown as additional tax on the QAR.[5] The I.R.C. § 6662 penalties are for negligence or disregard of rules or regulation, substantial understatement of income tax, and substantial valuation misstatements or gross valuation misstatements.[6] A QAR will not prevent the IRS from assessing fraud penalties or penalties under other IRC sections, as the QAR Regulations only provide for reduction in I.R.C. § 6662 penalties.[7]

That a QAR cannot be used to avoid fraud penalties is consistent with the Supreme Court's analysis in *Badaracco v. Comm'r,*[8] in which it considered the impact of filing an amended return correcting a previously filed fraudulent return. The Supreme Court held that the filing of non-fraudulent amended income tax return following the filing of a fraudulent return did not trigger three-year period of limitations for assessment under I.R.C. § 6501. The Supreme Court held that "once a fraudulent return has been filed, the case remains one 'of a false or fraudulent return,' regardless of the taxpayer's later revised conduct, for purposes of criminal prosecution and civil fraud liability." If you are concerned that the client's original return was fraudulent, you should not attempt to file a QAR, but should consider other options, such as making a voluntary disclosure.[9]

A question that is commonly asked in this context is whether the filing of a QAR will extend the statute of limitations for assessment for that tax year. The answer is generally, "no," but there is one narrow exception. Section 6501(c)(7) states that if the taxpayer files an amended return showing that the taxpayer owes additional tax 60 days before the statute of limitations would otherwise expire, the statute of limitation is extended for 60 days after the IRS receives the amended return.[10]

Another question that may arise is whether an amended return must correct all errors. The answer to this question is, unequivocally, "yes." The amended return, like the original tax return, is the taxpayer's representation to the IRS that all information on the return is true, correct, and complete to the best of his or her knowledge. To file an amended return that does not correct all known errors is to file a false return. Accordingly, if you are planning to submit a QAR on behalf of a client, make sure that all incomplete and/or incorrect items are addressed.

Ms. Brackney is a partner at Kostelanetz & Fink, LLP and specializes in civil and criminal tax controversies. Ms. Brackney received her J.D. from the University of Kansas School of Law and her LL.M. in Taxation from New York University. Ms. Brackney is a member of the New York State Bar Association Tax Section's Executive Committee and a Fellow of the American College of Tax Counsel. Ms. Brackney may be reached at (212) 808-8100 or mbrackney@kflaw.com .

---

[1] *Evans Cooperage Co., Inc. v. United States*, 712 F.2d 199 (5th Cir. 1983). It should also be mentioned that correcting a mistake before the due date of the return is not an amended return but is a superseding return that is considered part of the original return. *See* Michael Sardar, *A Tax Return Do Over?*, The CPA Journal (July 2016).
[2] *See* Circular 203, 10 C.F.R. § 10.21, American Institute of Certified Public Accounts, Statement on Standards for Tax Services, No. 6; National Association of Enrolled Agents, Rules of Professional Conduct, No. 16.
[3] Treas. Reg. § 1.6664-2(c)(3).
[4] Treas. Reg. § 6664-2(c)(3)(i). *See e.g., Bergmann v. Comm'r*, 137 T.C. 136 (2011), *aff'd* 552 Fed. Appx. 673 (9th Cir. 2014) (taxpayer's amended returns were not "qualified" because they were filed after the audit of the promoter of the transaction at issue on the taxpayer's return).
[5] Treas. Reg. § 1.6664-2(c)(2).
[6] I.R.C. § 6662(a).
[7] Treas. Reg. § 1.6664-2(c)(2); *see also* Internal Revenue Manual ("IRM") 20.1.5.2.4 (Jan. 24, 2012).
[8] *Badaracco v. Comm'r*, 464 U.S. 386, 394 (1984).
[9] The IRS's voluntary disclosure practice is outside of the scope of this article, but IRM 9.5.11.9, "Voluntary Disclosure Practice," describes the IRS's voluntary disclosure policies and procedures and states that taxpayers can voluntarily disclose both domestic and offshore tax non-compliance to avoid criminal prosecution and potentially reduce civil penalties.
[10] *See also* IRM 25.6.1.9.4.2 (May 11, 2016).