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Must You Amend Your Tax Return?

By Robert W. Wood

Are you required to file an amended tax return to correct errors you later discover? Does it depend on the years involved, the size or number of the errors or if you are under audit? Does it depend on how the error came to light, when you discovered it, or even what you knew or should have known at the time you filed your original return?

These sound like fundamental tax questions on which everyone would agree. But if you ask tax practitioners, you might get a mix of responses. It may seem surprising that there is no explicit requirement in the Internal Revenue Code, Treasury Regulations, or case law stating that a taxpayer *must* file amended tax returns upon discovering a reporting error. The IRS tends to use the word "should" when describing circumstances in which an amended return is indicated.

Amended returns are mentioned in the Treasury regulations and Internal Revenue Code. Treas. Reg. §§ 301.6211–1(a), 301.6402–3(a), 1.461–1(a)(3)(i). IRC § 6213(g)(1). But the ability and even the wisdom of filing amended tax returns is not the same thing as a mandatory duty. The Supreme Court has held that "[n]one of these provisions, however, requires the filing of [an amended return]." *Badaracco v. Comm'r*, 464 U.S. 386 (1984). Tax returns, whether original or amended, are required to be filed under penalties of perjury. IRC § 6065. All tax returns must contain or be verified by a written declaration that is made under penalties of perjury. Id. If a taxpayer submits a return *without* the executed penalties of perjury statement, that return is a nullity. *Beard v. Comm'r* 82 T.C. 766, 777 (1984); *Hettig v. United States* 845 F.2d 794 (8th Cir. 1988); *United States v. Moore*, 627 F.2d 830 (7th Cir. 1980); *Williams v. Comm'r* 114 T.C. 136 (2000).

In fact, even altering that perjury wording, which many taxpayers have tried, can spoil the return completely. The IRS takes the perjury legend seriously, as does the tax law. If a taxpayer does not believe that their tax return to be true and correct as to every material matter, they can be found guilty of a felony and may be fined up to $100,000 and imprisoned for up to 3 years. IRC § 7206(1).

The Supreme Court has held that there is no legal *requirement* to file an amended tax return. Id. at 397. *See also LP Ciminelli Interests, Inc. v. U.S.* 2012 WL 5499444 (W.D. NY 2012) at 8. Similarly, the Tax Court has held that taxpayers are not required to file an amended return, even when an originally filed tax return is discovered to be incorrect. Indeed, the failure to file an amended return in this context does not, by itself, establish an intent to evade tax. *Broadhead v. Comm'r*, T.C. Memo. 1955-328. On the other hand, when it comes to serious errors that might look criminal, one useful guide is to ask how the error happened and what the taxpayer knew when he or she filed the original return.

Was the error discovered later, by the taxpayer, an accountant, or someone else? Did the taxpayer believe the tax return was true, correct and complete when he or she filed it? If the taxpayer believed the tax return was correct when filed, the need to file an amended return is clearly less. Mistakes happen, and the fact that the taxpayer *believed* that the tax return was correct when he signed and filed should obviate bad intent. But what about the reverse? There is clearly exposure, even potential criminal exposure, if the taxpayer *knew* of the inaccuracy of the return at the time he signed and filed it.

In that event, you might assume that all signs would point to the wisdom of amending the return to correct the errors. That is often true, although it is not always so clear. For example, does filing an amended return that differs materially from the original return serve to admit that the original return was false? These are the kinds of issues that need specialty tax counsel to consider the specific facts and circumstances facing the client.

An original return that reported $100,000 of income might look odd next to an amended return reporting $3.1 million of income. Even such a wild disparity might be explained if the taxpayer believed the $3 million was a loan, the advance on a prepaid variable forward contract, or some other nontaxable item. The details matter, and so do the timing and context.

A taxpayer who realizes after filing his tax return that he should have reported additional income should in most cases amend and report it. But what if the taxpayer is already under audit or even under criminal investigation? Amending is still worth discussing, but the amendment may turn out to be used against the taxpayer, in effect as an admission. Thoughtful professional tax advice about the nature of the error, the nature of the taxpayer and the surrounding circumstances is clearly a good idea.

No Cherry Picking

What about the scope of the amendment, can you just fix one error, maybe one in your favor? You don't *have* to file an amended return, but if you do, you must correct everything. This is the IRS version of "in for a penny, in for a pound." You can't cherry-pick and make only those corrections that get you money back, but not those that increase your tax liability.

Example: You file your original return and believe it to be accurate. Six months later, after you've already received the $3,600 refund you claimed, you discover you forgot to report a stock loss that would have netted you an additional $1,000 refund. You also discovered that you under-reported your earnings from a partnership, because you just received an amended Form K-1 saying that instead of the $50,000 of income you reported (from the first K1), your share of the income was actually $150,000. If you amend, you must correct both errors, not just the one in your favor. It is possible that the IRS may send you a bill based on the revised Form K-1 the partnership sent you.

Math and Other Errors

Some errors do not merit an amended return. Math errors are not a reason to file an amended return, since the IRS will correct math errors on your return. Likewise, you usually shouldn't file an amended return if you discover you omitted a Form W-2, forgot to attach schedules, or other glitches of that sort. The IRS may process your return without them or will request them if needed.

There are certain parts of your original return that you cannot change with an amended return. You *can* change your filing status on an amended return from married filing separate to joint, or from qualifying widow(er) to head of household status. However, you *cannot* change from married filing joint to married filing separate after the due date for the original return has passed.

IRS Statute of Limitations

Although filing an amended tax return may not be required, it can be a wise strategic decision, and timing is always relevant. You can generally amend tax returns within three years of your original filing. If you are asking for money back, with an amended return that reports a smaller tax due than the original return, that three years is unforgiving.

Yet if you are reporting more income than you did on your original return and are therefore paying *additional* taxes, the IRS *may* accept the amended return and your additional payment. Sometimes, though, even though you are trying to amend beyond the first three years and if you are sending the IRS money, the IRS will reject it. I am not aware if there is a way to predict when the IRS will accept or reject the payment.

In general, the IRS has a three-year statute of limitations within which to audit, and that period begins upon the filing of the original return. IRC § 6501(a). But there are numerous types of income, types of errors, or factual circumstances that give the IRS six years to audit. For example, the statute is six years if your return includes a substantial understatement of income. Generally, this means you have omitted more than 25 percent of your gross income.

Suppose that you earned $200,000 but reported only $140,000. You omitted more than 25 percent, so you can be audited for six years. How about a big overstatement of your tax basis in an asset that you sold? Is that the same as an omission of income? The IRS long argued that it was the same thing, since you effectively omitted income.

However, in *United States v. Home Concrete*, the Supreme Court held against the IRS, ruling that overstating your basis is *not* the same thing as omitting income. *United States v. Home Concrete & Supply LLC*, 132 S. Ct. 1836 (2012). Shortly thereafter, Congress overruled the Supreme Court and gave the IRS six years to audit in such a case, so that is the current law. There are other situations that also give the IRS six years to audit.

With offshore accounts, the usual three years is doubled if you omitted more than $5,000 of foreign income (say, interest on an overseas account). Other forms concerning foreign assets and foreign gifts or inheritances are even more important long past six years. For example, if you receive a gift or inheritance of more than $100,000 from a non-U.S. person, you must file IRS Form 3520. If you fail to file it, your IRS statute of limitations *never starts to run*.

Speaking of foreign income and assets, IRS Form 8938 was added to the tax law by FATCA, the Foreign Account Tax Compliance Act. Form 8938 requires U.S. filers to disclose the details of foreign financial accounts and assets over specific thresholds. This form is separate from FBARs and is normally filed with your tax return. The threshold for disclosure can be as low as $50,000, so it pays to check out the filing requirements for your situation.

If you are required to file Form 8938 and omit it, the IRS statute of limitations never even starts to run. If you own part of a foreign corporation, it can trigger extra reporting, including filing a Form 5471. If you fail to file a required Form 5471, your entire tax return remains open for audit, indefinitely. The IRS can make adjustments to your entire tax return, with no expiration until the required Form 5471 is filed. You can think of a Form 5471 a bit like the signature on your tax return.

Fraudulent Returns

If a tax return is fraudulent, then the statute of limitations is extended indefinitely. IRC § 6501(c)(1). And while an amended return can make sense, filing an amended return does not cure the fraudulent original tax return for purposes of assessments and penalties. *Badaracco v. Comm'r* 464 U.S. at 394. Once fraud is committed by the filing of an original return, the offense is completed. *United States v. Habig* 390 U.S. 222 (1968). Some courts have considered the conduct of the accountant who prepared the tax return rather than the taxpayer for determining whether the statute of limitations is extended indefinitely for fraud. *Allen v. Comm'r* 128 T.C. at 42. Notably, § 6501(c)(1) focuses on the fraudulent nature of the return and not the identity of the perpetrator of the fraud. Id. at 40.

If the error(s) that are discovered look major, filing an amended return is something that most advisers would likely recommend. It demonstrates good faith, trying to correct something that you know is wrong. But as mentioned above, some thought should be given to whether the amendment could be viewed as an admission about the original return. That brings us to our next quirky rule for what is known as a qualified amended return.

Qualified Amended Return

A qualified amended return is an amended return that can be used in some cases to reduce or avoid penalties. Its purpose is to encourage taxpayers to voluntarily file amended returns to report underpaid taxes or to disclose information that was or became required by the tax law. One of the key requirements is that you are amending before you are contacted about an audit. An audit commencing, or even an initial contact about an audit, would close this door. The rules are complex, and you would need professional advice to determine if you can—or should—file such a return.

Conclusions

In general, there is no requirement or obligation to amend a prior tax return when a taxpayer discovers a post-filing error, but as the IRS says, taxpayers often *should* file amended returns. Most are filed the usual way, to correct an error, report additional income, delete an inappropriate deduction, or even to ask for a refund.

It is usually said that amended tax returns are more likely to be examined than initial returns. In the case of an amended return that asks for a big refund that is particularly true.

For example, suppose that your original tax return reports a large item as ordinary income. Then, your amended return claims that it was long term capital gain and requests a refund. That amendment is more likely to attract attention than if the original return had reported capital gain in the first place. As you think about amended returns, it is a useful paradigm to keep in mind.

Robert W. Wood *is a tax lawyer with www.WoodLLP.com, and the author of "Taxation of Damage Awards & Settlement Payments" (www.TaxInstitute.com). This is not legal advice.*