

# The Case Against Do-It-Yourself Tax Returns: You Don't Know What You Don't Know



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In an effort to comply with the increasing complexity of the Internal Revenue Code (the "Code") and the regulations promulgated thereunder, many taxpayers are looking to tax preparation software for assistance in preparing their own tax returns. According to the IRS's filing season statistics for the week ending September 1, 2017, more than 52,765,000 taxpayers have self-prepared and e-filed their own federal tax returns for the 2016 tax year.<sup>[1]</sup> Undoubtedly, many of these individuals utilize tax preparation software in doing so. The process is fairly simple. First, the software asks the user a series of questions designed to solicit the user's tax-related information. The user answers the relevant questions, and then the software generates the user's tax return based upon the user's answers. Problems arise when the user misunderstands the questions and inputs the wrong information. This is particularly true in situations where the user itemizes deductions. Unfortunately, this can potentially subject the user to costly penalties.

Pursuant to § 6662 of the Code, if the Internal Revenue Service (IRS) determines that a taxpayer has underpaid his or her federal income tax and the underpayment is attributable to the taxpayer's negligence, disregard of the rules or regulations, or substantial understatement of income tax, the IRS will assess an accuracy-related penalty equal to twenty percent (20%) of the taxpayer's underpayment.<sup>[2]</sup> A taxpayer can generally avoid this accuracy-related penalty, however, if the taxpayer can show there was a reasonable cause for his or her underpayment and that the taxpayer acted in good faith.<sup>[3]</sup> In that regard, many taxpayers seeking abatement of an accuracy-related penalty assert reasonable cause based upon their good faith reliance on the advice of a competent tax professional. On the other hand, the Tax Court has repeatedly rejected taxpayers' arguments asserting reliance on tax preparation software.

In a recent case, *Bulakites v. Commissioner*, T.C. Memo. 2017-79 (2017), the Tax Court reiterated its position that "[t]ax preparation software is only as good as the information one inputs into it,"<sup>[4]</sup> finding that the taxpayer's alleged reliance on TurboTax fell short of the reasonable cause and good faith necessary to avoid the imposition of accuracy-related penalties. In *Bulakites*, the court sided with the IRS in disallowing a number of the taxpayer's deductions taken on his 2011 and 2012 tax returns and upheld the IRS's assessment of an accuracy-related penalty for both tax years as a result of the disallowed deductions.

Barry Bulakites had used TurboTax to prepare the returns at issue, and although he admitted to making mistakes, Bulakites claimed that the tax preparation software had lured him into claiming some of the disallowed deductions, which ultimately resulted in a substantial understatement of his federal income tax. For example, § 215(a) of the Code allows as a deduction an amount equal to alimony paid during an

individual's tax year. Section 71(b) of the Code, however, defines alimony as an amount paid pursuant to a divorce decree or written separation agreement. Bulakites was required to pay his ex-wife \$24,000 per year pursuant to their written separation agreement. Nevertheless, Bulakites orally agreed to and actually paid his ex-wife amounts well in excess of this required amount in an effort to "do the right thing." As a result, Bulakites claimed deductions of approximately \$70,000 in 2011 and \$66,000 in 2012. Despite its finding that the taxpayer's motivation in making the excess payments was sincere, the Tax Court limited the taxpayer's alimony deduction to the amounts required under the separation agreement.

Additionally, the Tax Court disallowed a deduction in the amount of \$185,673 for "other expenses" claimed by Bulakites on his 2011 return. Bulakites claimed that this deduction resulted from "a carryforward of a net operating loss from a previous year that he mistakenly put on the wrong line of his return."<sup>[5]</sup> Because Bulakites did not file with his 2011 tax return the required statement setting forth the amount of the net operating loss deduction and all material and pertinent facts relative thereto (including information related to the computation of the net operating loss deduction), as required by § 1.172-1(c) of the Treasury Regulations, the Tax Court disallowed this deduction.<sup>[6]</sup>

This case highlights the importance of filing an accurate tax return and heeds the following warning: [t]he misuse of tax preparation software, even if unintentional or accidental, is no defense to accuracy-related penalties under section 6662."<sup>[7]</sup> Although tax preparation software is a beneficial tool that may assist some taxpayers in complying with and avoiding the pitfalls of applicable tax laws, it is important for taxpayers to remember that, absent some evidence that the tax preparation software has a programming flaw or a specific instructional error, the legal responsibility for failing to comply falls squarely upon the users of the software.

<sup>[1]</sup> See 2017 Filing Season Statistics available at <https://www.irs.gov/newsroom/filing-season-statistics-for-week-ending-september-1-2017>.

<sup>[2]</sup> A "substantial understatement of income tax" occurs "if the amount of the understatement for the taxable year exceeds the greater of (i) 10 percent of the tax required to be shown on the return for the taxable year, or (ii) \$5,000." I.R.C. § 6662(d)(1)(A).

<sup>[3]</sup> I.R.C. § 6664(c)(1).

<sup>[4]</sup> Bulakites v. Commissioner, T.C. Memo. 2017-79 (2017), at \*3 (quoting *Bunney v. Commissioner*, 114 T.C. 259, 267 (2000)).

<sup>[5]</sup> Bulakites, T.C. Memo. 2017-79, at \*3.

<sup>[6]</sup> The Tax Court also disallowed certain interest deductions claimed by the taxpayer that purportedly related to a business loan Bulakites was required to obtain in order to pay approximately \$500,000 under a lawsuit settlement. Although the evidence showed that Bulakites made payments to the lender, Bulakites was unable to substantiate the amount of the interest because he did not provide any business records, loan statements or any loan-repayment schedules.

<sup>[7]</sup> Langley v. Commissioner, T.C. Memo. 2013-22, at \*3.