May v. Commissioner, 67 T. C. 1130 (1977)

Payments made under Internal Revenue Code section 6651(a)(2) as additions to tax are not deductible as interest or business expenses.

Summary

In May v. Commissioner, the Tax Court ruled that penalties paid under section 6651(a)(2) of the Internal Revenue Code for late payment of taxes are not deductible as interest or business expenses. Frances J. May claimed a deduction for $881. 34 paid as additions to tax for delinquent filings from 1966 to 1970. The court held that these payments were penalties, not interest, and thus not deductible under sections 162(f) and 163(a). The decision underscores the distinction between penalties and interest and reaffirms that penalties for late tax payments cannot be deducted, even if linked to business activities.

Facts

Frances J. May, an Oklahoma resident, filed her 1972 federal income tax return claiming an itemized deduction of $2,295. 36 for "I. R. S. Penalty & Interest. " This included $881. 34 paid as additions to tax under section 6651(a)(2) for delinquent returns from 1966 to 1970. The IRS disallowed $881. 34 of the deduction, deeming it a non-deductible penalty rather than interest. May argued that the payments should be considered interest or a sanction to encourage prompt compliance, citing legislative history.

Procedural History

The IRS determined a deficiency in May's 1972 federal income tax and disallowed the deduction for the $881. 34 paid under section 6651(a)(2). May petitioned the Tax Court to challenge the disallowance. The court heard the case and issued its opinion, upholding the IRS's determination.

Issue(s)

1. Whether payments made under section 6651(a)(2) of the Internal Revenue Code are deductible as interest under section 163(a)?
2. Whether such payments are deductible as ordinary and necessary business expenses under section 162(a)?

Holding

1. No, because the payments under section 6651(a)(2) are penalties, not interest, and thus not deductible under section 163(a).
2. No, because section 162(f) prohibits the deduction of fines and similar penalties, and these payments do not qualify as ordinary and necessary business expenses.

Court's Reasoning

The court distinguished between interest and penalties, noting that interest under section 6601(a) is the cost for the use of money, while section 6651(a)(2) imposes an addition to tax as a penalty for late payment. The court emphasized that penalties can be avoided if the failure to pay is due to reasonable cause, unlike interest. It cited section 162(f), which prohibits deductions for fines and penalties, and the regulations defining section 6651(a)(2) payments as penalties. The court also referenced John Reuter, Jr. , where a similar penalty for late filing was disallowed as a business expense, arguing that allowing such deductions would frustrate the policy of encouraging timely compliance. The court concluded that the payments were neither interest nor deductible business expenses.

Practical Implications

This decision clarifies that penalties under section 6651(a)(2) are not deductible, impacting how taxpayers and their advisors should treat such payments. Practitioners must advise clients to distinguish between interest and penalties on tax returns, as only interest may be deductible. The ruling reinforces the IRS's enforcement of timely tax payments and filings by denying deductions for penalties, potentially affecting business practices related to tax compliance. Subsequent cases have followed this precedent, solidifying the non-deductibility of such penalties. Taxpayers should be aware of this ruling when planning their tax strategies to avoid similar disallowances.