Patton v. Commissioner, 71 T. C. 389 (1978)

Payments of penalties under section 6672 of the Internal Revenue Code are not deductible as business expenses under section 162(a).

Summary

In Patton v. Commissioner, the Tax Court held that a penalty assessed under section 6672 of the Internal Revenue Code, paid by James W. Patton for failing to remit withheld taxes as a responsible officer of a corporation, was not deductible as an employee business expense under section 162(a). The court relied on section 162(f), which disallows deductions for fines or similar penalties, and upheld the IRS's disallowance of the deduction, emphasizing the regulatory definition of a penalty and the policy rationale against allowing deductions that would undermine the deterrent effect of such penalties.

Facts

James W. Patton was assessed a penalty of $76,632. 44 under section 6672 of the Internal Revenue Code for his role as a responsible officer of Olivia Extended Care Facility, which failed to pay over withheld taxes and FICA taxes. In 1974, Patton paid $1,958 towards this penalty and claimed it as a deduction on his joint federal income tax return as an employee business expense. The Commissioner of Internal Revenue disallowed this deduction, asserting that the payment was a penalty under section 6672 and thus nondeductible under section 162(f).

Procedural History

The Commissioner assessed the penalty against Patton in 1972. After Patton paid part of the assessment and claimed a deduction in 1974, the Commissioner disallowed the deduction. Patton and his wife filed a petition with the United States Tax Court challenging the disallowance. The Tax Court heard the case and issued its opinion on December 20, 1978, affirming the Commissioner's decision.

Issue(s)

1. Whether the payment made by James W. Patton under section 6672 is deductible as an employee business expense under section 162(a).

Holding

1. No, because the payment is a penalty under section 6672 and thus nondeductible under section 162(f), which disallows deductions for fines or similar penalties paid to a government for the violation of any law.

Court's Reasoning

The Tax Court applied section 162(f), which explicitly prohibits deductions for fines or similar penalties. The court relied on Treasury regulations that define a penalty under section 6672 as a “fine or similar penalty” for the purposes of section 162(f). The court rejected Patton’s argument that he was merely paying the tax liability of his corporate employer, emphasizing that the payment was a penalty assessed against him personally for willfully failing to remit withheld taxes. The court also considered policy arguments, noting that allowing such deductions would undermine the effectiveness of section 6672 as a deterrent against non-compliance with tax withholding requirements. The court cited previous cases like Uhlenbrock v. Commissioner, May v. Commissioner, and Smith v. Commissioner to support its interpretation and application of section 162(f).

Practical Implications

This decision clarifies that penalties assessed under section 6672 are not deductible as business expenses, reinforcing the IRS’s position on the matter. Attorneys and tax professionals must advise clients that payments made to satisfy such penalties cannot be claimed as deductions, even if the individual believes they are merely paying a corporate tax liability. This ruling has implications for corporate officers and others who might be held personally liable for corporate tax obligations, as it emphasizes the personal nature of the penalty and the policy against deductions that would lessen its impact. Subsequent cases have consistently followed this precedent, ensuring that the deterrent effect of section 6672 remains intact.

