***Medeiros v. Commissioner, 77 T. C. 1255 (1981)***

The 100-percent penalty tax under IRC Section 6672 for failure to pay over employment taxes is not deductible under IRC Sections 162(a) or 165(c)(1).

**Summary**

Alvin E. Medeiros Jr. sought to deduct a $11,290. 65 payment made to the IRS in 1972, which included a $9,673. 69 penalty assessed under IRC Section 6672 and related interest. The IRS denied the deduction, arguing it was a non-deductible penalty. The Tax Court held that it lacked jurisdiction to determine Medeiros' liability for the penalty but affirmed that the payment was not deductible under IRC Sections 162(a) or 165(c)(1). The court reasoned that IRC Section 162(f) specifically disallows deductions for fines or penalties paid to the government, and allowing such a deduction would contravene public policy.

**Facts**

Alvin Medeiros entered into an oral agreement to purchase Red Line Transfer Co. in 1968. He provided $10,000 to Red Line's account to pay its debts, but the purchase fell through. Red Line failed to pay employment taxes, leading to a $9,673. 69 penalty assessment against Medeiros under IRC Section 6672 in 1969. Medeiros did not contest the assessment and paid it in 1972 after the IRS threatened to seize his residence. He then claimed the payment as a business expense deduction on his 1972 tax return.

**Procedural History**

The IRS disallowed Medeiros' deduction for the penalty payment, allowing only the interest portion. Medeiros petitioned the Tax Court, which held that it lacked jurisdiction to determine his liability for the penalty but could address the deductibility issue. The court ultimately ruled against Medeiros, finding the penalty payment non-deductible under both IRC Sections 162(a) and 165(c)(1).

**Issue(s)**

1. Whether the Tax Court has jurisdiction to determine Medeiros' liability for the penalty assessed under IRC Section 6672.
2. Whether the penalty payment made under IRC Section 6672 is deductible under IRC Section 162(a) as a business expense.
3. Whether the penalty payment is deductible under IRC Section 165(c)(1) as a loss incurred in a trade or business.

**Holding**

1. No, because the Tax Court's jurisdiction is limited to deficiencies in taxes covered by IRC Sections 6212(a) and 6213(a), which do not include penalties under IRC

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Section 6672.
2. No, because IRC Section 162(f) specifically disallows deductions for fines or penalties paid to the government, and the penalty under IRC Section 6672 falls within this category.
3. No, because the penalty payment does not constitute a loss incurred in Medeiros' trade or business, and allowing the deduction would frustrate public policy.

**Court's Reasoning**

The Tax Court's jurisdiction is statutorily limited and does not extend to determining liability for penalties under IRC Section 6672. Regarding deductibility, IRC Section 162(f) clearly prohibits deductions for penalties paid to the government, such as the one assessed under IRC Section 6672. The court also found that the payment did not qualify as a business loss under IRC Section 165(c)(1), as it was not related to Medeiros' own business activities. Moreover, the court cited public policy concerns, stating that allowing a deduction for such penalties would undermine the purpose of the penalty, which is to ensure compliance with tax obligations. The court referenced prior cases like *Smith v. Commissioner* to support its stance on public policy.

**Practical Implications**

This decision clarifies that penalties assessed under IRC Section 6672 for failure to pay over employment taxes are not deductible, emphasizing the importance of IRC Section 162(f) in disallowing deductions for penalties paid to the government. Taxpayers and practitioners must carefully consider the nature of payments made to the government, as penalties are generally non-deductible regardless of whether they arise from business activities. The case also highlights the limited jurisdiction of the Tax Court, which cannot determine liability for certain penalties, necessitating other avenues for contesting such assessments. Practitioners should advise clients to seek legal counsel promptly when facing potential penalties to explore all available options for contesting or mitigating their impact.

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