Waldman v. Commissioner, 88 T. C. 1384 (1987)

Restitution payments made pursuant to a criminal conviction or plea of guilty are not deductible as business expenses under Section 162(f) of the Internal Revenue Code.

Summary

Harvey Waldman, convicted of conspiracy to commit grand theft, was ordered to pay restitution to his victims as a condition of his sentence being stayed. He attempted to deduct these payments as business expenses under Section 162(a). The Tax Court, however, ruled that such restitution payments fall under Section 162(f), which disallows deductions for fines or similar penalties paid to a government for law violations. The court found that restitution in this context was a penalty aimed at rehabilitation and deterrence, not compensation, and was thus non-deductible.

Facts

Harvey Waldman was the president and sole shareholder of National Home Loan Co. (NHL), which engaged in loan brokering. In 1979, he was charged with 29 counts of conspiracy to commit grand theft due to NHL's misrepresentations to lenders about the security of loans. Waldman pleaded guilty to one count, with the remaining charges dismissed. He was sentenced to prison, but execution of the sentence was stayed on the condition that he pay restitution to victims. In 1981, he paid $28,500 in restitution and sought to deduct this as a business expense on his taxes.

Procedural History

Waldman filed a petition with the U. S. Tax Court after the Commissioner of Internal Revenue disallowed his deduction. The case was submitted fully stipulated, and the court held that the restitution was non-deductible under Section 162(f).

Issue(s)

1. Whether restitution paid pursuant to a criminal conviction is a "fine or similar penalty" under Section 162(f).
2. Whether such restitution is "paid to a government" for purposes of Section 162(f).

Holding

1. Yes, because restitution paid as a condition of a criminal conviction or plea of guilty is considered a "fine or similar penalty" under the regulations interpreting Section 162(f).
2. Yes, because the obligation to pay restitution was imposed by the government and the payments were under the government's control, satisfying the "paid to a government" requirement of Section 162(f).

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Court’s Reasoning

The court relied on the regulation under Section 162(f) which defines a “fine or similar penalty” to include amounts paid pursuant to a conviction or plea of guilty. Waldman’s restitution was directly tied to his guilty plea and thus fell under this definition. The court also considered the purpose of the restitution, citing California case law stating that restitution in criminal cases aims at rehabilitation and deterrence, not compensation, aligning it with the enforcement of law rather than civil remedy. The court rejected Waldman’s reliance on *Spitz v. United States*, finding it unpersuasive and not binding. Furthermore, the court determined that the payments were “paid to a government” because the state retained control over the disposition of the payments, even though they were directed to victims. The court cited *Bailey v. Commissioner* to support the notion that the government need not directly receive the funds for them to be considered paid to a government under Section 162(f).

Practical Implications

This decision clarifies that restitution payments mandated by a criminal conviction cannot be deducted as business expenses. It impacts how legal professionals advise clients on the tax treatment of such payments, emphasizing that any obligation arising from criminal activity and imposed by a court is likely non-deductible. This ruling affects defendants in criminal cases involving financial restitution, requiring them to consider the full financial impact of their sentences. The decision also informs future tax cases involving penalties, reinforcing the broad interpretation of Section 162(f) to include payments that serve governmental purposes of law enforcement and deterrence.

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