Stephens v. Commissioner, 93 T. C. 108 (1989)

Restitution payments made as a condition of criminal probation are not deductible as losses under Section 165(c)(2) of the Internal Revenue Code because they are considered fines or similar penalties under Section 162(f).

Summary

Jon T. Stephens was convicted of fraud and ordered to pay $1 million in restitution as a condition of probation. He sought to deduct this payment under Section 165(c)(2) as a loss from a transaction entered into for profit. The Tax Court held that the payment was not deductible, as it was considered a 'fine or similar penalty' under Section 162(f), despite being made to a private party rather than the government. The court's reasoning emphasized that the payment was a consequence of criminal conviction and part of the sentencing, thus falling within the public policy concerns addressed by Section 162(f).

Facts

Jon T. Stephens was convicted of wire fraud, transportation of fraud proceeds, and conspiracy. He was sentenced to prison and fined on multiple counts. For one count, his prison sentence was suspended, and he was placed on probation with the condition of paying $1 million in restitution to Raytheon Co. , the victim of his fraud. Stephens paid $530,000 of this amount from a Bermuda bank account and sought to deduct this payment on his 1984 tax return.

Procedural History

Stephens filed an amended return for 1984, claiming a refund based on the restitution payment. The Commissioner of Internal Revenue disallowed the deduction, leading to a deficiency notice. Stephens petitioned the United States Tax Court, which ultimately ruled against the deductibility of the restitution payment.

Issue(s)

1. Whether the restitution payment is governed by Section 165(c)(2) of the Internal Revenue Code, allowing a deduction for losses from transactions entered into for profit.
2. Whether the standards of Section 162(f) apply to determine the deductibility under Section 165(c)(2).
3. Whether the restitution payment constitutes a 'fine or similar penalty' under Section 162(f), thus precluding its deductibility.

Holding

1. No, because the payment, while arising from a transaction entered into for profit, was a consequence of a criminal conviction and thus subject to the non-deductibility

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rules under Section 162(f).
2. Yes, because the public policy considerations of Section 162(f) extend to determinations under Section 165(c)(2).
3. Yes, because the restitution payment was ordered as a condition of probation following a criminal conviction, making it a 'fine or similar penalty' under Section 162(f).

Court's Reasoning

The court determined that the restitution payment, though made to a private party, was a consequence of Stephens' criminal conviction and part of his sentencing. The court applied the standards of Section 162(f), which disallows deductions for fines or similar penalties paid for violating the law, to the analysis under Section 165(c)(2). The court cited case law, including *Waldman v. Commissioner*, to support its conclusion that the payment was a 'fine or similar penalty' despite not being paid directly to the government. The court noted that the payment's civil aspect (reimbursement to Raytheon) was incidental to its criminal nature. The court also distinguished *Spitz v. United States*, as that case involved restitution without a criminal context.

Practical Implications

This decision clarifies that restitution payments ordered as part of criminal sentencing cannot be deducted as losses under Section 165(c)(2). Tax practitioners must advise clients that such payments, even if made to private parties, fall under the non-deductibility provisions of Section 162(f). This ruling affects how legal and tax professionals handle cases involving criminal convictions with restitution orders, emphasizing the need to consider the broader public policy implications of tax deductions. Subsequent cases have followed this ruling, reinforcing the principle that criminal restitution is not deductible, regardless of the recipient.

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