Accardo v. Commissioner, 94 T. C. 96 (1990)

Legal expenses incurred in defending against criminal charges are not deductible under IRC section 212(2) even if a potential forfeiture of income-producing assets is at stake.

Summary

In Accardo v. Commissioner, the Tax Court ruled that legal fees incurred by Anthony Accardo in successfully defending against RICO charges were not deductible. Accardo argued that the fees were deductible under IRC section 212(2) as they were incurred to protect his certificates of deposit from forfeiture. The court, however, held that the legal fees were not deductible because the criminal charges arose from Accardo's alleged racketeering activities, not from the management or conservation of the certificates of deposit. The decision reinforced the principle that deductibility of legal fees depends on the origin of the claim, not its potential consequences on income-producing property.

Facts

Anthony Accardo and 15 others were indicted for violating RICO by conspiring to control the Laborers Union's insurance business through a kickback scheme. The indictment included a forfeiture provision for any proceeds from the alleged racketeering activities. Accardo was acquitted but sought to deduct the legal fees incurred in his defense, claiming they were necessary to protect his certificates of deposit from forfeiture. These certificates were his only assets potentially subject to forfeiture, though the indictment did not specifically identify them. The funds used to purchase these assets were not obtained from the alleged racketeering activities.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in Accardo's federal income taxes for 1981 and 1982, including additions for negligence and substantial understatements. Accardo petitioned the Tax Court for a redetermination, arguing that his legal fees were deductible under IRC section 212(2). The case was submitted fully stipulated under Rule 122 of the Tax Court Rules of Practice and Procedure.

Issue(s)

1. Whether legal expenses incurred in the successful defense of RICO charges are deductible under IRC section 212(2) as expenses paid for the management, conservation, or maintenance of property held for the production of income.

2. Whether the taxpayers are liable for additions to tax under IRC sections 6653(a)(1) and (2) for negligence.

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3. Whether the taxpayers are liable for an addition to tax under IRC section 6661 for substantial understatement of income tax.

Holding

1. No, because the legal fees were incurred to defend against criminal charges arising from Accardo's alleged racketeering activities, not from the management or conservation of his certificates of deposit.

2. Yes, because the taxpayers failed to carry their burden of proof to show they were not negligent in claiming the deductions.

3. Yes, because the taxpayers' understatement of income tax was substantial and they did not establish any exception to the addition to tax under IRC section 6661.

Court's Reasoning

The court applied the principle established in United States v. Gilmore that the deductibility of legal expenses depends on whether the claim arises in connection with the taxpayer's profit-seeking activities, not on the consequences that might result to the taxpayer's income-producing property. The court distinguished Accardo's case from situations where legal fees might be deductible, noting that the RICO charges arose from his alleged criminal activities, not from the management or conservation of his certificates of deposit. The court also relied on Lykes v. United States, which rejected the argument that legal expenses incurred to protect income-producing assets from a tax deficiency were deductible. The court emphasized that allowing such a deduction would lead to capricious results, as the deductibility would depend on the character of the taxpayer's assets rather than the nature of the claim. The court found no evidence that Accardo made any effort to determine the propriety of his claimed deductions or to establish any plausible arguments in support of them, leading to the conclusion that he was negligent under IRC section 6653(a). The court also found that Accardo's understatement of income tax was substantial and that he did not establish any exception to the addition to tax under IRC section 6661.

Practical Implications

This decision clarifies that legal fees incurred in defending against criminal charges are not deductible under IRC section 212(2), even if the defense is necessary to protect income-producing assets from forfeiture. Taxpayers and their attorneys should carefully consider the origin of the claim when determining the deductibility of legal expenses. The decision also underscores the importance of taxpayers making a good faith effort to determine the propriety of their claimed deductions and adequately disclosing relevant facts on their tax returns to avoid additions to tax for negligence and substantial understatement. This case may be cited in future cases involving the deductibility of legal fees and the application of additions to tax

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for negligence and substantial understatement.

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