Ianniello v. Commissioner, T. C. Memo. 1991-415

Illegally skimmed income is taxable in the year it is acquired, and criminal forfeitures do not entitle a taxpayer to a deduction in the year of the illegal activity.

Summary

Matthew Ianniello and Benjamin Cohen were convicted of RICO violations and tax evasion for skimming receipts from P&G Funding Corp. The Tax Court ruled that the skimmed amounts constituted gross income under IRC section 61 in the year they were acquired, despite later forfeitures under RICO. The court rejected the taxpayers' arguments for a deduction under section 165(a) for the forfeited amounts in the year of the skimming, as the forfeitures occurred years later. Additionally, the court held that imposing both tax deficiencies and criminal forfeitures did not violate the Double Jeopardy or Eighth Amendment, as the tax liabilities were remedial, aimed at recovering lost revenue and costs, not punitive.

Facts

Matthew Ianniello and Benjamin Cohen were indicted and convicted for RICO violations, mail fraud, and tax evasion for skimming receipts from P&G Funding Corp. during 1979-1982. They were ordered to forfeit $666,667 each, representing their share of the skimmed funds, which they paid in 1989 and 1990. The IRS determined deficiencies in their 1981 and 1982 federal income taxes due to unreported skimmed income and assessed additions to tax for fraud.

Procedural History

The taxpayers were convicted in the U. S. District Court for the Southern District of New York in December 1985, with the convictions affirmed by the Second Circuit in December 1986. The IRS amended its answer in the Tax Court to assert additional deficiencies and fraud penalties. The Tax Court held that the skimmed income was taxable in the year it was acquired and that subsequent forfeitures did not entitle the taxpayers to a deduction in the year of the illegal activity.

Issue(s)

1. Whether the amounts skimmed from P&G Funding Corp. constituted gross income under IRC section 61 in the year they were acquired, despite later criminal forfeitures.
2. Whether the taxpayers were entitled to a loss deduction under IRC section 165(a) for the criminal forfeitures in the taxable years the skimming occurred.
3. Whether imposing both tax deficiencies and criminal forfeitures violated the Double Jeopardy Clause of the Fifth Amendment.
4. Whether imposing both tax deficiencies and criminal forfeitures violated the Excessive Fines or Cruel and Unusual Punishments Clauses of the Eighth Amendment.

Holding

1. Yes, because the taxpayers had dominion and control over the skimmed amounts in the year they were acquired, making them taxable income under section 61.
2. No, because the forfeitures occurred years after the taxable years in question, and the relation-back provision of RICO does not accelerate the deduction to the year of the illegal activity.
3. No, because the tax deficiencies and fraud penalties are remedial, aimed at recovering lost revenue and costs, not punitive, and thus do not constitute a second prosecution or multiple punishment.
4. No, because the tax deficiencies and fraud penalties are not punitive but remedial, and the Eighth Amendment protections do not extend to these civil tax liabilities.

Court's Reasoning

The court applied the principle that gross income includes all accessions to wealth over which a taxpayer has complete dominion, as per James v. United States. The skimmed funds were taxable in the year they were acquired, despite later forfeitures. The court rejected the taxpayers' claim for a section 165(a) deduction in the year of the skimming, noting that deductions for losses are allowed only in the year the loss is sustained, not when a relation-back provision deems the loss to have occurred. The court relied on Helvering v. Mitchell to distinguish between punitive and remedial actions, finding that the tax liabilities were remedial, aimed at recovering lost revenue and costs. The court also cited United States v. Halper to argue that the tax liabilities were not overwhelmingly disproportionate to the government's losses and thus did not constitute double jeopardy or an excessive fine. The court emphasized that the Eighth Amendment protections do not extend to civil tax liabilities, as established in Acker v. Commissioner.

Practical Implications

This decision clarifies that illegally obtained income is taxable in the year it is acquired, regardless of later forfeitures. Tax practitioners should advise clients involved in illegal activities that they cannot offset tax liabilities with future forfeitures. The ruling also reinforces the IRS's ability to impose tax deficiencies and fraud penalties without violating constitutional protections against double jeopardy or excessive fines. Legal professionals should be aware that these civil tax liabilities are considered remedial rather than punitive, which has significant implications for clients facing both criminal and civil proceedings. Subsequent cases like Schad v. Commissioner and Vasta v. Commissioner have followed this reasoning, indicating that any relief from the harsh tax treatment of illegal income must come from legislative action, not judicial interpretation.

