Lemishow v. Commissioner, 110 T. C. 346, 1998 U. S. Tax Ct. LEXIS 26, 110 T. C. No. 26 (1998)

The IRS's method of calculating accuracy-related penalties for negligent underpayments, as outlined in IRS regulations, is upheld as a reasonable interpretation of the tax code.

Summary

In Lemishow v. Commissioner, the Tax Court upheld the IRS's method of calculating accuracy-related penalties for negligent underpayments under section 6662 of the Internal Revenue Code. Albert Lemishow had withdrawn $480,414 from his retirement accounts but did not report all of it as income. The court found him negligent for not reporting $102,519 of this amount. The IRS calculated the penalty by first determining the total underpayment, then subtracting the underpayment that would exist if the negligent income were excluded, and applying the 20% penalty to the difference. This decision clarifies the IRS's method of applying penalties when multiple adjustments to income are involved, and it follows the regulation's prescribed order for adjustments.

Facts

Albert Lemishow withdrew $480,414 from his Individual Retirement Accounts and Keogh plans in 1993. He attempted to roll over $377,895 of this amount but failed, resulting in the full withdrawal being taxable income. However, he did not report $102,519 of the withdrawn amount on his tax return. The IRS assessed an accuracy-related penalty under section 6662 for the underpayment attributable to this unreported $102,519, which was deemed a negligent omission. The dispute arose over the method of calculating the penalty amount, with the IRS using a method that resulted in a higher penalty than Lemishow's proposed method.

Procedural History

Lemishow initially contested the taxability of the full withdrawal amount, which was resolved in an earlier opinion by the Tax Court, determining the entire $480,414 to be taxable income. Subsequently, the issue of the accuracy-related penalty calculation came before the court again, leading to the supplemental opinion upholding the IRS's method of computation.

Issue(s)

1. Whether the IRS's method of calculating the accuracy-related penalty under section 6662, by first calculating the total underpayment, then calculating the underpayment excluding the negligent income, and applying the penalty to the difference, is a reasonable interpretation of the statute.

Holding

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1. Yes, because the IRS's method as outlined in section 1. 6664-3 of the Income Tax Regulations is a reasonable interpretation of the statute's ambiguous language regarding how to compute the portion of the underpayment attributable to negligence.

Court's Reasoning

The court applied the two-step test from Chevron U. S. A. , Inc. v. Natural Resources Defense Council, Inc. , to evaluate the IRS regulation. First, the court found that the Internal Revenue Code did not clearly specify how to calculate the penalty for the portion of the underpayment attributable to negligence. Second, it determined that the IRS's method, as detailed in section 1. 6664-3 of the Income Tax Regulations, was a permissible construction of the statute. The court noted that the regulation provides a clear order for applying adjustments to the tax return, starting with those not subject to penalties, followed by those subject to penalties at different rates. This order was seen as a reasonable way to allocate penalties when multiple adjustments are involved. The court also referenced United States v. Craddock, where a similar approach to calculating penalties was upheld, reinforcing the reasonableness of the IRS's method.

Practical Implications

This decision provides clarity on how accuracy-related penalties should be calculated when multiple adjustments to income are involved. Tax practitioners and taxpayers should be aware that the IRS's method of calculating penalties, by first determining the total underpayment and then excluding non-negligent income, may result in higher penalties than alternative calculations. This approach is likely to be followed in future cases involving similar issues. Additionally, this case reinforces the deference given to IRS regulations under the Chevron doctrine, impacting how courts may view other regulatory interpretations of tax statutes. Taxpayers and their advisors should consider this method when assessing potential penalties for underpayments due to negligence.

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