Schachter v. Commissioner, T. C. Memo. 1998-260

Criminal fines cannot be credited against civil fraud additions to tax, as they serve distinct purposes under the law.

Summary

In Schachter v. Commissioner, the Tax Court ruled that Martin Schachter could not offset civil fraud additions to his tax liability with the $250,000 criminal fine he received for tax evasion. The court emphasized that civil fraud penalties aim to protect government revenue and cover investigation costs, while criminal fines are intended as punishment. This decision was grounded in the distinct purposes of criminal and civil sanctions, as established in prior cases like Helvering v. Mitchell, and reinforced by the legislative intent behind the Criminal Fine Enforcement Act of 1984. The ruling clarifies that taxpayers cannot reduce their civil tax penalties through criminal fines, impacting how such cases are handled in tax law practice.

Facts

Martin Schachter pleaded guilty to income tax evasion and conspiracy to defraud the United States regarding his 1986 income tax liability. He was sentenced to two years in prison, fined $250,000, and ordered to pay $161,845 in restitution. Following this, the IRS assessed civil fraud additions to tax for Schachter's tax years 1985-1988. Schachter argued that the criminal fine should be credited against these civil fraud additions, claiming it was remedial and akin to restitution.

Procedural History

The Tax Court initially upheld the IRS's determination of civil fraud additions to tax in Schachter v. Commissioner, T. C. Memo. 1998-260. In a subsequent Rule 155 hearing, Schachter sought to apply the criminal fine as a credit against the civil fraud additions. The Tax Court rejected this argument in its supplemental opinion.

Issue(s)

1. Whether a criminal fine imposed for tax evasion can be credited against civil fraud additions to tax.

Holding

1. No, because criminal fines and civil fraud additions to tax serve different purposes under the law, and allowing such a credit would frustrate Congress's intent in imposing civil fraud penalties.

Court's Reasoning

The court relied on the distinction between criminal and civil sanctions as articulated in Helvering v. Mitchell and subsequent cases. It noted that civil fraud penalties are designed to protect government revenue and cover investigation costs, as stated in Helvering v. Mitchell, 303 U. S. at 401: “for the protection of the revenue and to reimburse the Government for the heavy expense of investigation and the loss resulting from the taxpayer’s fraud. ” In contrast, the court found that the $250,000 criminal fine served as punishment, supported by the legislative history of the Criminal Fine Enforcement Act of 1984, which aimed to increase fines as a deterrent to criminal behavior. The court rejected Schachter’s argument that the fine was remedial, emphasizing that the factors judges consider under 18 U. S. C. § 3622 do not change the punitive nature of fines imposed under § 3623. The court also noted that allowing such a credit would undermine Congress’s intent in imposing civil fraud penalties, which are meant to ensure taxpayers bear part of the cost of detecting and prosecuting fraud.

Practical Implications

This decision clarifies that taxpayers cannot offset civil fraud penalties with criminal fines, reinforcing the separation between criminal and civil tax sanctions. Practitioners must advise clients that pleading guilty to tax evasion and paying a criminal fine does not reduce their liability for civil fraud additions to tax. This ruling may influence plea negotiations in tax evasion cases, as defendants cannot expect civil tax relief through criminal fines. It also underscores the importance of understanding the distinct purposes of criminal and civil penalties in tax law, impacting how attorneys approach tax fraud cases and the advice they give to clients facing both criminal and civil tax proceedings.