119 T.C. 44 (2002)

Interest paid on underpayments of federal income tax, even when the underpayment stems from business income, is considered personal interest and is not deductible as a business expense.

Summary

Edward Robinson, a sole proprietor attorney, deducted interest paid in 1995 on a 1987 income tax underpayment, attributing it to his law practice. The Tax Court addressed whether this interest was deductible as a business expense under I.R.C. § 163(h)(2)(A). The court upheld Treasury Regulations §§ 1.163-8T and 1.163-9T, which classify such interest as non-deductible personal interest. Overruling its prior decision in *Redlark v. Commissioner*, the Tax Court sided with the IRS, holding that deficiency interest on business income is not "properly allocable to a trade or business" and is therefore not deductible as a business expense. The court reasoned that tax obligations are personal, regardless of income source, and the regulations provide a permissible interpretation of the ambiguous statute.

Facts

Edward Robinson operated a law practice as a sole proprietorship. An audit of the Robinsons' 1987 joint tax return resulted in adjustments, deficiencies, and additions to tax, to which the Robinsons agreed. In 1995, the IRS seized and sold Robinson's property, applying proceeds to the 1987 tax underpayment interest. On their 1995 Schedule C, the Robinsons deducted this interest payment as a business expense.

Procedural History

The IRS disallowed the interest deduction for 1995, leading to a deficiency determination. The Robinsons petitioned the Tax Court, arguing the interest was a deductible business expense and challenging the validity of Treasury Regulations §§ 1.163-8T and 1.163-9T. The Tax Court, in this reviewed opinion, sided with the Commissioner and overruled its prior stance in *Redlark*.

Issue(s)

1. Whether interest paid on a federal income tax underpayment, stemming from adjustments to business income, is considered "interest paid or accrued on indebtedness properly allocable to a trade or business" under I.R.C. § 163(h)(2)(A), and thus deductible as a business expense.
2. Whether Treasury Regulations §§ 1.163-8T and 1.163-9T, which classify such interest as non-deductible personal interest, are valid.

Holding

1. No, because interest paid on a federal income tax underpayment, even if

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related to business income, is not considered "properly allocable to a trade or business" within the meaning of I.R.C. § 163(h)(2)(A).
2. Yes, because, in light of the ambiguous statute and legislative history, these regulations constitute a permissible interpretation of I.R.C. § 163(h)(2)(A).

Court's Reasoning

The Tax Court reasoned that while I.R.C. § 163(a) generally allows interest deductions, I.R.C. § 163(h)(1) disallows deductions for "personal interest." Personal interest is defined in I.R.C. § 163(h)(2), with exceptions, including interest "properly allocable to a trade or business." The court found the term "properly allocable" ambiguous. Referencing legislative history, including the Joint Committee staff summary and the Blue Book, the court concluded these materials support the IRS's interpretation that interest on income tax underpayments is personal interest. The court acknowledged pre-1986 cases that allowed business expense deductions for such interest but distinguished them based on statutory language changes in the 1986 Tax Reform Act. Ultimately, the court deferred to the Treasury Regulations as a permissible and reasonable interpretation of the ambiguous statute, reversing its prior position in *Redlark* and aligning with the majority of Circuit Courts that have addressed the issue. The court emphasized that income tax obligations are inherently personal, irrespective of the income's source.

Practical Implications

Robinson v. Commissioner establishes that, in line with the majority of circuit courts, the Tax Court will now uphold the IRS's position that interest on income tax deficiencies is generally non-deductible personal interest, even if the underlying income is business-related. This decision clarifies that taxpayers operating businesses as sole proprietorships or pass-through entities cannot deduct interest on underpayments of their individual income taxes as business expenses. Legal professionals should advise clients that despite the connection between business income and tax liability, interest on underpayments is considered a personal expense for federal income tax purposes. This case emphasizes the importance of understanding Treasury Regulations §§ 1.163-8T and 1.163-9T in advising clients on the deductibility of interest expenses and highlights the Tax Court's adherence to the principle of deference to agency interpretations of ambiguous statutes, especially in the wake of evolving judicial precedent and the *Mead* decision's emphasis on agency authority.

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