Feller v. Commissioner, 135 T. C. 497 (2010) (U. S. Tax Court, 2010)

The U. S. Tax Court upheld the IRS's imposition of civil fraud penalties on Rick D. Feller for overstated withholding tax credits, affirming the validity of Treasury regulations defining 'underpayment' to include such overstatements. Feller, a CPA, had fraudulently claimed refunds by inflating his withholding credits over six years, a practice he admitted to in a criminal plea. The court's ruling clarifies that overstated withholding credits can be considered in calculating fraud penalties, impacting how tax fraud is assessed and penalized.

Parties

Rick D. Feller, the petitioner, challenged the IRS's determination of civil fraud penalties. The Commissioner of Internal Revenue, the respondent, defended the imposition of the penalties. Feller's case progressed from a criminal conviction to a civil tax dispute, with Feller as the appellant in the U. S. Tax Court.

Facts

Rick D. Feller, a certified public accountant, was a partner in an accounting firm and president of SFT Health Care Corp. , which owned two nursing homes. From 1992 to 1997, Feller filed false tax returns claiming fictitious wages and withholding tax credits, resulting in overstated refunds totaling $320,078. After an IRS audit and criminal investigation, Feller pleaded guilty to willfully submitting a false tax return for 1997. The IRS issued notices of deficiency for 1992-1997, asserting fraud penalties under IRC section 6663 due to Feller's overstated withholding credits.

Procedural History

The IRS issued notices of deficiency on November 22, 2006, determining fraud penalties for 1992-1997 based on Feller's overstated withholding credits. On November 27, 2006, the IRS assessed adjustments related to these overstatements using mathematical error assessment procedures. Feller sought redetermination in the U. S. Tax Court, arguing the statute of limitations barred the deficiency notices and that the regulations defining 'underpayment' were invalid. The Tax Court, applying the *Chevron* deference standard, upheld the regulations and affirmed the fraud penalties.

Issue(s)

Whether the issuance of the notices of deficiency for 1992-1997 was barred by the statute of limitations under IRC section 6501? Whether Feller's overstated withholding credits for 1992-1997 resulted in underpayments of income tax attributable to fraud pursuant to IRC sections 6663 and 6664? Whether Treasury Regulation section 1. 6664-2(c)(1) and section 1. 6664-2(g), Example (3), Income Tax Regs. , validly include overstated withholding credits in the calculation of underpayments for fraud penalties?

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Rule(s) of Law

IRC section 6663 imposes a 75% penalty on any portion of an underpayment attributable to fraud. IRC section 6664 defines an 'underpayment' as the amount by which the tax imposed exceeds the sum of the tax shown on the return and amounts previously assessed or collected, minus rebates made. Treasury Regulation section 1. 6664-2(c)(1) specifies that the tax shown on the return is reduced by excess withholding credits claimed over actual withholdings for the purpose of calculating an underpayment.

Holding

The Tax Court held that Feller filed false returns with intent to evade tax within the meaning of IRC section 6501(c), thus the issuance of the deficiency notices was not time-barred. Furthermore, the court upheld the validity of Treasury Regulation section 1. 6664-2(c)(1) and section 1. 6664-2(g), Example (3), confirming that overstated withholding credits are included in calculating underpayments for fraud penalties. Consequently, Feller was subject to the fraud penalty for each year at issue.

Reasoning

The court applied the two-step *Chevron* analysis to determine the validity of the regulation. Under *Chevron* step 1, the court found that IRC section 6664 is ambiguous regarding the definition of 'underpayment' as it does not explicitly address withholding credits. Under *Chevron* step 2, the court concluded that the regulation's inclusion of overstated withholding credits in the calculation of underpayment is a permissible construction of the statute. The court reasoned that the regulation aligns with the legislative intent to distinguish between 'deficiency' and 'underpayment,' and that Congress's subsequent amendments to section 6664 did not alter the regulation's interpretation. The court also emphasized Feller's clear intent to evade tax, supporting the imposition of the fraud penalties.

Disposition

The Tax Court affirmed the IRS's imposition of fraud penalties on Feller for the years 1992-1997, upholding the validity of the relevant Treasury regulations.

Significance/Impact

The decision in *Feller v. Commissioner* clarifies the scope of IRC section 6664 and the regulations under it, affirming that overstated withholding credits can be included in calculating fraud penalties. This ruling impacts how the IRS assesses fraud penalties, reinforcing the agency's ability to penalize taxpayers who manipulate withholding credits to evade taxes. The case also sets a precedent for applying *Chevron* deference in tax law, affirming the IRS's regulatory authority in defining ambiguous statutory terms.

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