May v. Commissioner, 136 T. C. 153 (2011)

In May v. Commissioner, the U. S. Tax Court upheld the imposition of fraud penalties under section 6663 against Mark May for underpaying taxes due to overstated withholding credits and disallowed state and local tax deductions. The court found that May, who controlled the finances of Maranatha Financial Group, Inc. , deliberately claimed credits for unremitted withholdings. This ruling clarifies the scope of the Tax Court's jurisdiction over fraud penalties and the application of the fraud penalty when tax withholdings are not remitted to the government.

Parties

Plaintiffs/Appellants: Mark May and Cynthia May (Petitioners). Defendant/Appellee: Commissioner of Internal Revenue (Respondent). The case was consolidated for trial in the U. S. Tax Court.

Facts

Mark May was the president, CEO, and a shareholder of Maranatha Financial Group, Inc. (Maranatha), a corporation with about 100 employees. During the years 1994, 1995, and 1996, Maranatha withheld taxes from employee paychecks, including May's, but failed to remit these withholdings to federal, state, or local tax authorities. May had sole check signature authority over Maranatha's corporate account and was aware of the failure to remit withholdings. He claimed withholding credits on his joint federal income tax returns with his wife, Cynthia May, for these unremitted amounts. Additionally, May claimed deductions for state and local income taxes allegedly paid through withholdings. May was later convicted of tax evasion and failure to pay over payroll taxes. The Commissioner of Internal Revenue determined deficiencies and assessed fraud penalties against May for these years.

Procedural History

The Commissioner issued a notice of deficiency for the tax years 1994, 1995, and 1996, determining deficiencies and fraud penalties against Mark and Cynthia May. The Mays timely filed a petition for redetermination with the U. S. Tax Court. The cases were consolidated for trial. The Commissioner conceded that Cynthia May was entitled to relief under section 6015 from joint and several liability for the years at issue, resolving all issues pertaining to her. The remaining issues for decision were the jurisdiction of the Tax Court over fraud penalties based on overstated withholding credits, May's liability for these penalties, and his liability for deficiencies resulting from disallowed state and local tax deductions.

Issue(s)

1. Whether the U. S. Tax Court has jurisdiction to redetermine the underpayments for purposes of calculating the section 6663 fraud penalties when a portion of the underpayment for each taxable year resulted from overstated credits for taxes

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withheld from wages?
2. Whether Mark May is liable for the section 6663 fraud penalties for the taxable years at issue with respect to the claimed withholding tax credits?
3. Whether Mark May is liable for the deficiencies resulting from disallowed deductions for state and local income taxes paid and for section 6663 fraud penalties with respect to such deficiencies?

Rule(s) of Law

1. The jurisdiction of the U. S. Tax Court attaches upon the issuance of a valid notice of deficiency and the timely filing of a petition. Section 6665 provides that "additions to the tax, additional amounts, and penalties * * * shall be paid upon notice and demand and shall be assessed, collected, and paid in the same manner as taxes".
2. Fraud penalties under section 6663 require the Commissioner to prove by clear and convincing evidence that an underpayment of tax exists and that the taxpayer intended to evade taxes known to be owing by conduct intended to conceal, mislead, or otherwise prevent the collection of taxes.
3. An "underpayment" under section 6664 is defined as the amount by which any tax imposed exceeds the excess of the sum of the amount shown as the tax by the taxpayer on his return plus amounts not so shown previously assessed over the amount of rebates made. The amount shown as the tax by the taxpayer on his return is reduced by the excess of the amounts shown by the taxpayer on his return as credits for tax withheld over the amounts actually withheld or paid.

Holding

1. The U. S. Tax Court has jurisdiction to redetermine the underpayments for purposes of calculating the section 6663 fraud penalties when a portion of the underpayment for each taxable year resulted from overstated credits for taxes withheld from wages.
2. Mark May is liable for the section 6663 fraud penalties for the taxable years at issue with respect to the claimed withholding tax credits.
3. Mark May is liable for the deficiencies resulting from disallowed deductions for state and local income taxes paid and for section 6663 fraud penalties with respect to such deficiencies, except for $772 of the 1996 local income taxes for which he provided evidence of payment.

Reasoning

The court's reasoning focused on the statutory framework and legal precedents. It relied on Rice v. Commissioner to establish jurisdiction over fraud penalties, emphasizing that the Tax Court's jurisdiction extends to penalties assessed in the same manner as deficiencies. The court analyzed the definition of "underpayment" under section 6664 and its regulations, concluding that overstated withholding credits increase underpayments. The court rejected May's arguments that no underpayment existed due to actual withholding, applying a functional test from

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United States v. Blanchard to determine that the funds never left May's control and were thus not actually withheld. The court found clear and convincing evidence of May's fraudulent intent based on his knowledge and control over the nonremittance of withholdings and his subsequent claiming of credits and deductions. The court also addressed the period of limitations, holding that May's fraudulent actions extended the period under section 6501(c)(1).

Disposition

The court upheld the fraud penalties against Mark May for the underpayments resulting from overstated withholding credits and disallowed state and local tax deductions, except for $772 of the 1996 local income taxes. The court directed the entry of a decision under Rule 155 in docket No. 14385-05 and for the petitioner in docket No. 4782-07.

Significance/Impact

May v. Commissioner clarifies the Tax Court's jurisdiction over fraud penalties based on overstated withholding credits and the application of the fraud penalty when tax withholdings are not remitted to the government. The case establishes a functional test for determining whether funds have been "actually withheld" and emphasizes the importance of the taxpayer's control over withheld funds. This decision impacts the assessment of fraud penalties in cases involving nonremittance of withholdings and reinforces the broad scope of the Tax Court's jurisdiction over such penalties. It also serves as a reminder of the severe consequences of fraudulent tax practices, particularly when involving corporate officers with control over corporate finances.

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