McLaine v. Commissioner, 138 T. C. 228 (U. S. Tax Ct. 2012)

John J. McLaine argued that his 1999 tax liability was paid by his former employer's successor, entitling him to a credit under I. R. C. § 31. The U. S. Tax Court ruled against McLaine, finding no such payment was made and rejecting his claim for a credit. The decision upheld the IRS's right to collect McLaine's tax debt, including interest and penalties, and clarified that subsequent employer payments of unwithheld taxes do not automatically generate a withholding credit for employees.

Parties

John J. McLaine was the petitioner, challenging the Commissioner of Internal Revenue's determination. The respondent was the Commissioner of Internal Revenue. The case was heard by the United States Tax Court.

Facts

John J. McLaine exercised nonqualified stock options (NQOs) granted by his former employer, Excel Communications, Inc. , in 1999. Upon exercising the options, McLaine received proceeds but no taxes were withheld. He reported the income but did not pay the full tax amount due. The IRS issued a notice of intent to levy to collect the outstanding tax, interest, and penalties. McLaine contested this, claiming a credit under I. R. C. § 31 for payments allegedly made by Excel's successor, VarTec Telecom, Inc. , in later years. The IRS's Appeals Office upheld the collection action, leading to McLaine's appeal to the Tax Court.

Procedural History

The IRS issued a notice of intent to levy to collect McLaine's unpaid 1999 federal income tax. McLaine requested a collection due process (CDP) hearing, which resulted in the IRS Appeals Office sustaining the collection action. McLaine then petitioned the U. S. Tax Court for review of the Appeals Office's determination under I. R. C. § 6330(d)(1). The court reviewed the case de novo for factual determinations and for abuse of discretion concerning the Appeals officer's refusal to consider collection alternatives.

Issue(s)

Whether McLaine is entitled to a credit under I. R. C. § 31 for any payment made by Excel or its successor, VarTec, of the nonwithheld taxes related to his 1999 NQO exercise?

Rule(s) of Law

I. R. C. § 31(a) allows a credit against income tax for "the amount withheld as tax under chapter 24. " Treas. Reg. § 1. 31-1(a) specifies that the credit is available for "tax deducted and withheld at the source upon wages. " I. R. C. § 3403 imposes

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liability on employers for withheld taxes, independent of the employee's liability. I. R. C. § 6205 and its regulations allow employers to correct underwithholdings on an interest-free basis under certain conditions.

Holding

The Tax Court held that McLaine was not entitled to a credit under I. R. C. § 31 because no payment was made by Excel or its successor of the nonwithheld taxes related to McLaine's 1999 NQO exercise. The court further held that, even if such a payment had been made, it would not entitle McLaine to a § 31 credit as a matter of law.

Reasoning

The court found no evidence that VarTec paid the taxes associated with McLaine's 1999 NQO exercise. The IRS's reduced proof of claim in VarTec's bankruptcy was deemed more likely related to a settlement of an audit of Excel rather than payment of McLaine's taxes. Furthermore, the court reasoned that any payment by an employer or its successor of nonwithheld taxes in a subsequent year does not constitute "tax withheld at the source" under Treas. Reg. § 1. 31-1(a). The court also considered policy implications, noting that allowing such a credit would unfairly benefit employees who did not pay their taxes and could enable tax planning to avoid interest and penalties. The majority's opinion was supported by a concurring opinion emphasizing that subsequent employer payments do not automatically generate a withholding credit for employees under § 31.

Disposition

The Tax Court sustained the IRS's determination to proceed with collection of McLaine's 1999 tax liability, interest, and penalties. The court found no abuse of discretion in the Appeals officer's refusal to consider collection alternatives, as McLaine failed to provide required financial information.

Significance/Impact

The decision clarifies the application of I. R. C. § 31 credits in collection cases, emphasizing that subsequent employer payments of unwithheld taxes do not automatically generate withholding credits for employees. It reinforces the IRS's authority to collect tax liabilities, interest, and penalties from employees despite employer payments made under different legal obligations. The case also underscores the importance of timely payment of taxes and the limited circumstances under which employer corrections of underwithholdings may benefit employees. Subsequent cases have cited McLaine for its holdings on § 31 credits and the independent nature of employer withholding liabilities under § 3403.

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