Dixon v. Commissioner, 141 T. C. No. 3 (2013)

In Dixon v. Commissioner, the U. S. Tax Court ruled that the IRS must honor an employer's specific designation of tax payments towards an employee's income tax liabilities, even if those payments are made years after the tax was due. The case involved James and Sharon Dixon, who were criminally prosecuted for failing to file tax returns. They transferred funds to their company, Tryco Corp. , which then paid the IRS with instructions to apply the payments to the Dixons' income tax liabilities. The court held that these designated payments discharged the Dixons' tax liabilities, preventing the IRS from levying their assets to collect the same tax again. This ruling clarifies the IRS's obligation to respect taxpayer designations and impacts how tax liabilities are assessed and collected.

Parties

James R. Dixon and Sharon C. Dixon were the petitioners in this case, challenging the IRS's determination to levy on their assets. The respondent was the Commissioner of Internal Revenue. The Dixons were the plaintiffs at the trial level and appellants before the Tax Court.

Facts

James and Sharon Dixon were owners, officers, and employees of Tryco Corp. They were criminally prosecuted for failure to file individual income tax returns for the years 1992 through 1995. As part of a plea agreement with the Department of Justice, the Dixons acknowledged a "tax loss" of $61,021 and agreed to potential restitution. On the advice of their attorney, they transferred funds to Tryco Corp. , which then remitted $61,021 to the IRS in December 1999, with instructions to apply the payment to the withheld income taxes of the Dixons for the specified quarters of 1992-1995. In June 2000, Tryco remitted an additional $30,202 to the IRS for the fourth quarter of 1995. Despite these payments, the IRS later proposed to levy on the Dixons' assets to collect their 1992-1995 income tax liabilities, asserting that the payments did not discharge these liabilities.

Procedural History

The Dixons were granted a collection due process (CDP) hearing after the IRS issued a notice of intent to levy on their assets. The Appeals officer upheld the levy, concluding that Tryco's payments could not be designated to the withholding of specific employees. The Dixons timely petitioned the U. S. Tax Court for review under I. R. C. sec. 6330(d)(1). The Tax Court had jurisdiction over the matter as it involved the Dixons' income tax liabilities, not employment taxes, which are generally outside its jurisdiction.

Issue(s)

Whether the IRS was obligated to honor Tryco Corp. 's designation of its delinquent

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employment tax payments toward the Dixons' income tax liabilities for 1992-1995?

Whether the Dixons were entitled to a withholding credit under I. R. C. sec. 31(a) for the payments Tryco made to the IRS?

Rule(s) of Law

I. R. C. sec. 31(a)(1) provides that the amount withheld by an employer as tax from an employee's wages shall be allowed to the recipient of the income as a credit against their income tax liability for that year, but only if the tax has been "actually withheld at the source. "

I. R. C. sec. 6330(d)(1) grants the Tax Court jurisdiction to review IRS determinations in CDP hearings, including the propriety of collection actions.

IRS policy, as stated in Rev. Rul. 73-305 and subsequent guidance, allows taxpayers to designate how voluntary tax payments should be applied to their liabilities.

Holding

The Tax Court held that the Dixons were not entitled to a withholding credit under I. R. C. sec. 31(a) because the funds remitted by Tryco were not "actually withheld at the source" from the Dixons' wages during 1992-1995. However, the court also held that the IRS was required to honor Tryco's designation of its delinquent employment tax payments towards the Dixons' income tax liabilities for 1992-1995. As these payments discharged the Dixons' liabilities in full, the IRS's proposal to levy on their assets to collect the same tax again was an abuse of discretion.

Reasoning

The court reasoned that the IRS's policy of honoring taxpayer designations of voluntary payments is well-established and extends to specific written instructions for the application of such payments. The court rejected the IRS's argument that this policy is limited to designations between different types of tax liabilities of the same taxpayer, finding no such limitation in IRS guidance or judicial precedent. The court noted that allowing employers to designate payments toward specific employees' tax liabilities is consistent with the practice in employment tax refund litigation and necessary to prevent double collection of the same tax. The court also emphasized that the Dixons' payments were intended as restitution for their tax offenses, and it would be inequitable for the IRS to collect the same tax again.

The court distinguished between the Dixons' primary liability for income tax under I. R. C. sec. 1 and Tryco's derivative liability for withholding tax under I. R. C. sec. 3403. It found that Tryco's designated payments simultaneously discharged both liabilities, preventing double collection. The court also addressed the standard of review, noting that it did not need to decide whether a de novo standard applied because the IRS's refusal to honor the designation was an abuse of discretion under

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any standard.

Disposition

The Tax Court reversed the Appeals officer's determination and held that the IRS could not levy on the Dixons' assets to collect their 1992-1995 income tax liabilities, as these had been fully discharged by Tryco's designated payments.

Significance/Impact

This case clarifies the IRS's obligation to honor taxpayer designations of voluntary payments, extending the principle to include designations toward the tax liabilities of specific employees. It establishes that the IRS cannot ignore such designations and attempt to collect the same tax again, reinforcing protections against double taxation. The decision impacts how employers and employees can structure payments to resolve tax liabilities and may influence future IRS policy and practice regarding the application of tax payments. The ruling also highlights the importance of clear written instructions when making voluntary tax payments to ensure proper application by the IRS.

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