Dixon v. Commissioner, 141 T. C. 173 (2013) (U. S. Tax Court, 2013)

In Dixon v. Commissioner, the U. S. Tax Court ruled that the IRS must honor an employer's designation of delinquent employment tax payments toward specific employees' income tax liabilities. James and Sharon Dixon, who had failed to file income tax returns, funded their employer Tryco to make payments designated for their 1992-1995 taxes. The court found that the IRS's refusal to apply these payments as designated was an abuse of discretion, preventing a second collection of the same tax. This decision underscores the importance of respecting taxpayers' designations to avoid double taxation.

Parties

James R. Dixon and Sharon C. Dixon, Petitioners, v. Commissioner of Internal Revenue, Respondent. The Dixons were both petitioners at the trial level and on appeal, challenging the IRS's decision to levy on their assets for unpaid income taxes from 1992-1995.

Facts

James and Sharon Dixon were owners, officers, and employees of Tryco Corp. during 1992-1995. They were criminally prosecuted for failing to file individual income tax returns for those years. As part of a plea agreement with the Department of Justice, they acknowledged a 'tax loss' of $61,021 and agreed to potential restitution. In December 1999, Tryco, funded by the Dixons, remitted $61,021 to the IRS, designating it as payment for the corporation's Form 941 taxes, specifically for the withheld income taxes of the Dixons for 1992-1995. In early 2000, after discovering an additional $30,202 owed, Tryco remitted this amount to the IRS, again designated for the Dixons' 1995 taxes. The IRS initially credited these payments to the Dixons' accounts but later reversed this action, applying the funds to Tryco's general employment tax liabilities instead.

Procedural History

The IRS issued notices of intent to levy on the Dixons' assets to satisfy their alleged unpaid 1992-1995 income tax liabilities. The Dixons requested a Collection Due Process (CDP) hearing, asserting that Tryco's payments had discharged their tax liabilities. The Appeals officer upheld the levy, concluding that Tryco's payments were not withheld at the source and could not be designated for specific employees. The Dixons timely petitioned the U. S. Tax Court for review under I. R. C. sec. 6330(d)(1). The court reviewed the Appeals officer's determination and the IRS's application of the payments.

Issue(s)

Whether the IRS was obligated to honor Tryco's designation of its delinquent employment tax payments toward the Dixons' 1992-1995 income tax liabilities?

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Rule(s) of Law

The IRS must honor a taxpayer's designation of voluntary tax payments according to Rev. Rul. 73-305, Rev. Rul. 79-284, and Rev. Proc. 2002-26. I. R. C. sec. 6330(d)(1) provides jurisdiction for judicial review of CDP determinations. I. R. C. sec. 31(a)(1) allows a credit for tax withheld from wages if the tax has actually been withheld at the source. I. R. C. sec. 3402(d) provides that if an employer fails to withhold tax, and the tax is later paid by the employee, the employer's liability is relieved.

Holding

The Tax Court held that the IRS was required to honor Tryco's designation of its delinquent employment tax payments toward the Dixons' 1992-1995 income tax liabilities. The court found that the IRS's failure to do so was an abuse of discretion, as these payments discharged the Dixons' tax liabilities, precluding the IRS from levying on their assets to collect the same tax again.

Reasoning

The court reasoned that the IRS's policy, as established in revenue rulings and procedures, allows taxpayers to designate how voluntary payments should be applied. The court rejected the IRS's argument that such designations could not extend to payments designated for specific employees' income tax liabilities. The court also considered the IRS's practice in employment tax refund litigation and the logic of I. R. C. sec. 6331, which supports the designation of payments toward specific employees' liabilities to ensure proper credit and avoid double taxation. The court noted the Dixons' plea agreements, which included restitution language, further supporting the designation of the payments toward their tax liabilities. The court also addressed the dissent's arguments, emphasizing that the IRS's obligation to honor designations stems from its own policies and the need to prevent double collection of taxes.

Disposition

The court reversed the Appeals officer's determination, holding that the IRS abused its discretion by not honoring Tryco's designation of its payments toward the Dixons' income tax liabilities. The court instructed that the Dixons' 1992-1995 income tax liabilities were fully discharged by Tryco's payments, prohibiting further collection action against them for those years.

Significance/Impact

This case reinforces the principle that the IRS must honor taxpayer designations of voluntary payments, extending this obligation to payments designated for specific employees' income tax liabilities. It clarifies that such designations can prevent double taxation, a significant issue in tax law. The decision may influence future IRS practices regarding the application of payments and underscores the importance of

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clear designation instructions from taxpayers. The case also highlights the complexities of tax law concerning employment and income tax liabilities, and the potential for abuse of discretion in IRS collection actions.

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