Rand v. Commissioner, 141 T. C. No. 12 (2013)

In Rand v. Commissioner, the U. S. Tax Court ruled on how to calculate the underpayment for the accuracy-related penalty under IRC § 6662. The court held that refundable credits claimed on a tax return can reduce the amount of tax shown but cannot result in a negative tax amount. This decision clarifies that while erroneous claims for refundable credits like the Earned Income Credit can increase the underpayment subject to penalty, they do not create a negative tax liability for penalty calculation purposes, impacting how penalties are assessed for overstated credits.

Parties

Yitzchok D. Rand and Shulamis Klugman, the petitioners, filed a joint income tax return for 2008. The respondent was the Commissioner of Internal Revenue. The case proceeded through the U. S. Tax Court, where the petitioners were represented by Andrew R. Roberson, Roger J. Jones, and Patty C. Liu, and the respondent was represented by Michael T. Shelton and Lauren N. Hood.

Facts

Yitzchok D. Rand and Shulamis Klugman filed a joint federal income tax return for 2008, claiming a tax refund of $7,327 based on three refundable credits: the Earned Income Credit, the Additional Child Tax Credit, and the Recovery Rebate Credit. They reported $17,200 in wages, $1,020 in business income from tutoring, and a self-employment tax of $144. Their total tax liability before credits was $144, which was reduced to a negative amount by the claimed refundable credits. The IRS determined that the petitioners were not entitled to these credits and assessed an accuracy-related penalty under IRC § 6662, which the parties agreed applied but disputed the calculation of the underpayment.

Procedural History

The IRS sent a notice of deficiency to the petitioners on December 10, 2010, asserting adjustments for tax years 2006, 2007, and 2008. The petitioners filed a petition with the U. S. Tax Court contesting the 2008 penalty. The parties resolved all issues for 2006 and 2007 by stipulation, leaving only the penalty calculation for 2008 in dispute. The case was submitted without trial under Tax Court Rule 122, and the petitioners conceded liability for the penalty if an underpayment existed under IRC § 6662(a).

Issue(s)

Whether, for the purposes of calculating an underpayment under IRC § 6664(a)(1)(A), refundable credits claimed on a tax return can reduce the amount shown as tax below zero?

Rule(s) of Law

IRC § 6662 imposes a 20% accuracy-related penalty on the portion of an underpayment attributable to negligence or a substantial understatement of income tax. IRC § 6664(a) defines an "underpayment" as the excess of the tax imposed over the excess of the sum of the amount shown as tax by the taxpayer on their return, plus amounts not shown but previously assessed, over the amount of rebates made. The court considered whether the term "the amount shown as the tax" includes refundable credits and whether those credits can reduce that amount below zero.

Holding

The U. S. Tax Court held that refundable credits can reduce the amount shown as tax on the return but cannot reduce it below zero. Therefore, the court determined that the amount shown as tax on the petitioners' 2008 return was zero, resulting in an underpayment of $144 for penalty calculation purposes.

Reasoning

The court's reasoning focused on statutory construction and legislative history. It examined the definitions of "underpayment" and "deficiency" under IRC §§ 6664 and 6211, respectively, noting that while these terms were historically linked, Congress separated their definitions in 1989. The court applied the canon of statutory construction expressio unius est exclusio alterius to infer that refundable credits should be considered in calculating the tax shown but noted that IRC § 6211(b)(4) specifically allows refundable credits to be taken into account as negative amounts of tax only for deficiency calculations, not underpayments. The absence of a similar provision for underpayments under IRC § 6664 led the court to conclude that refundable credits cannot reduce the tax shown below zero for underpayment calculations. The court also invoked the rule of lenity, favoring the more lenient interpretation of the penalty statute, and rejected the IRS's position that the tax shown could be negative, which would have increased the penalty amount.

Disposition

The court affirmed the application of the accuracy-related penalty but limited the underpayment to $144, resulting in a penalty of $29 (20% of $144). The case was decided under Rule 155, allowing for further computation of the penalty.

Significance/Impact

This case significantly impacts the calculation of underpayments for accuracy-related penalties under IRC § 6662 by clarifying that refundable credits cannot reduce the tax shown below zero. This ruling ensures that taxpayers who claim erroneous refundable credits are subject to penalties based on the actual tax liability rather than the overstated refund amount. It also highlights the separation between the concepts of underpayment and deficiency, affecting how penalties are assessed and potentially influencing future legislative or regulatory actions concerning tax penalties and refundable credits. The decision has been subject to varied judicial opinions, reflecting the complexity of interpreting tax penalty statutes and their application to refundable credits.

