Klein v. Commissioner, 149 T. C. No. 15 (2017)

In Klein v. Commissioner, the U. S. Tax Court ruled that the IRS cannot assess or collect interest and additions to tax on criminal restitution amounts under I. R. C. § 6201(a)(4). Zipora and Samuel Klein had paid full restitution as ordered by a district court, but the IRS sought to collect additional interest and penalties. The Tax Court held that restitution, assessed as if it were a tax, does not generate interest or penalties under the tax code, emphasizing the distinction between restitution and actual tax liability.

Parties

Zipora Klein and Samuel Klein, Petitioners, v. Commissioner of Internal Revenue, Respondent.

Facts

Zipora and Samuel Klein, a married couple, pleaded guilty to violating I. R. C. § 7206(1) by filing a false return for 2006. They agreed to make full restitution for the losses caused by their underreported income from 2003-2006. The U. S. District Court for the Central District of California, based on the Government's tax-loss calculation of $562,179, ordered the Kleins to pay this amount as restitution to the IRS. The Kleins eventually paid the full amount, including applicable statutory additions under title 18, and the Government released the title 18 lien.

Subsequently, the IRS assessed against the Kleins not only the restitution amount but also underpayment interest under I. R. C. § 6601(a) and additions to tax under I. R. C. § 6651(a)(3). When the Kleins did not pay these additional amounts, the IRS filed notices of Federal tax lien (NFTL) to initiate collection actions.

Procedural History

Following the IRS's actions, the Kleins requested a Collection Due Process (CDP) hearing, challenging the NFTL filings. The IRS Appeals Office conducted the hearing and sustained the NFTL filings, stating that the balance due consisted entirely of assessed interest and additions to tax calculated on the restitution amount. The Kleins timely petitioned the U. S. Tax Court for review of the IRS's determination. The Commissioner moved for summary judgment, and the Tax Court treated the Kleins' opposition as a cross-motion for summary judgment.

Issue(s)

Whether the IRS may assess and collect interest and additions to tax on amounts of restitution assessed under I. R. C. § 6201(a)(4)?

Rule(s) of Law

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I. R. C. § 6201(a)(4) authorizes the Secretary to "assess and collect the amount of restitution under an order pursuant to section 3556 of title 18 * * * for failure to pay any tax imposed by this title in the same manner as if such amount were such tax. " I. R. C. § 6601(a) provides that interest shall be paid if any amount of tax imposed by title 26 is not paid on or before the last date prescribed for payment. I. R. C. § 6651(a)(3) imposes an addition to tax in case of failure to pay timely "any amount in respect of any tax required to be shown on a return * * * which is not so shown. "

Holding

The U. S. Tax Court held that I. R. C. § 6201(a)(4) does not authorize the IRS to add underpayment interest or failure-to-pay additions to tax to a title 18 restitution award. Therefore, the IRS may not assess or collect from the Kleins underpayment interest or additions to tax without first determining their civil tax liabilities.

Reasoning

The Tax Court's reasoning focused on the statutory text and legislative history of I. R. C. § 6201(a)(4). The court interpreted the phrase "in the same manner as if such amount were such tax" to mean that restitution is treated as if it were a tax solely for the purpose of creating an account receivable against which payments can be credited. The court emphasized that restitution is not literally a tax, and thus, does not generate interest under I. R. C. § 6601(a) or additions to tax under I. R. C. § 6651(a)(3).

The court rejected the Commissioner's argument that the IRS Manual's provisions support the imposition of interest and additions to tax, noting that these provisions lack the force of law and do not reflect thorough analysis. The court also distinguished the language of I. R. C. § 6201(a)(4) from that of I. R. C. § 6665(a)(1), which explicitly states that additions to tax and penalties shall be assessed and collected "in the same manner as taxes. "

The legislative history of I. R. C. § 6201(a)(4) supported the court's conclusion, indicating that the provision was intended to facilitate IRS bookkeeping rather than expand its authority to assess interest and additions to tax on restitution amounts. The court also noted that the restitution amount, based on a tax-loss calculation used for sentencing, differs from the taxpayer's actual civil tax liability, which the IRS may determine through a civil examination.

The court concluded that if the IRS wishes to collect interest and additions to tax, it must commence a civil examination to determine the Kleins' actual tax liabilities for the years in question.

Disposition

The Tax Court denied the Commissioner's motions for summary judgment and granted summary judgment in favor of the Kleins, ruling that the IRS could not

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assess or collect interest and additions to tax on the restitution amount assessed under I. R. C. § 6201(a)(4).

Significance/Impact

The Klein decision clarifies that I. R. C. § 6201(a)(4) does not authorize the IRS to assess interest and additions to tax on restitution amounts, emphasizing the distinction between restitution and actual tax liabilities. This ruling limits the IRS's ability to collect additional sums on criminal restitution orders without conducting a civil examination to determine the taxpayer's actual tax liabilities. The decision impacts how the IRS can enforce criminal restitution orders and underscores the need for clear statutory language regarding the assessment and collection of tax-related penalties and interest.

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