

## ACTION ON DECISION

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

**Issue:** Whether the Service is obligated to honor an employer's designation of delinquent employment tax payments toward a specific employee's income tax liability.

**Discussion:** The petitioners James R. Dixon and Sharon C. Dixon were owners, officers, and employees of Tryco Corporation. From 1992 through 1995, Tryco failed to file employment tax returns and pay its employment taxes, including income tax withholding on employee wages. During the same period, the Dixons failed to file their individual income tax returns and pay their individual income taxes. The Dixons were criminally prosecuted for failure to file their income tax returns, and during the plea negotiations, they attempted to pay their delinquent individual income taxes in full. Instead of paying these taxes directly, they transferred funds to Tryco and, pursuant to their directions, on December 22, 1999, Tryco used these funds to pay some of its delinquent employment taxes. Tryco additionally designated the payments to be applied to the "withheld income taxes" of the Dixons. The plea agreements and sentencing in the criminal proceeding reflected that, as a result of the payments by Tryco, the Dixons' income taxes were mostly satisfied. However, the Service applied the payments only to Tryco's unpaid employment tax liabilities and did not give the Dixons credit toward their income tax liabilities. The Service sent a notice of intent to levy and right to a hearing to the Dixons with regard to their unpaid income tax liabilities, who requested a collection due process (CDP) hearing. In its notice of determination, the Office of Appeals sustained the levy as to the payments that it determined represented tax not withheld at the source, concluding that on that basis, the Dixons were not entitled to a credit under I.R.C. § 31(a). Appeals also concluded that Tryco could not designate any of the payments that were not withheld at the source to the income taxes owed by the Dixons. The Dixons petitioned to the United States Tax Court.

The Tax Court disagreed with Appeals. The court made factual findings, based in part on credibility determinations, that most of Tryco's payments represented tax actually withheld at the source within the meaning of sections 3402 and 3403, and therefore, as to these payments, the Dixons were entitled to a credit under section 31(a) toward their income taxes. For the payments determined by the court to represent tax not withheld at the source, the court held that the Dixons were not entitled to a credit under section 31(a). However, the court held that the Service was required to honor Tryco's designations of these payments and credit the payments to the Dixons' income tax liabilities. The Tax Court reasoned that designation of its payments to the income tax liabilities of specific employees is consistent with Service policy and federal case law that permits a taxpayer's designation of voluntary payments of tax. The court also concluded that disregarding the designations would be inconsistent with the premises of

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the plea agreements and sentencing.

Under section 6330(a), with some exceptions not relevant to this case, no levy may be made on the property of the taxpayer without first giving the taxpayer an opportunity for a hearing before Appeals. At the hearing, the taxpayer may raise any relevant issue relating to the unpaid tax or proposed levy. Section 6330(c)(2)(A). In their CDP hearing, the Dixons argued that their tax liability was paid by Tryco during the criminal proceedings, and thus raised a proper issue regarding the amount of the unpaid tax.

An employer is required to deduct and withhold income tax from its employees' wages and periodically remit the withheld income tax to the Service. Section 3402. Every employer required to deduct and withhold income tax from the wages of an employee is liable for the payment of such tax whether or not it is collected from the employee by the employer. Section 3403; Treas. Reg. § 31.3403-1. Any mistake by the employer when calculating the income tax withholding can be adjusted prior to the end of the calendar year. Section 6205(a)(1); section 31.6205-1(c)(2). The tax will be considered withheld at the source if the employer collects any underwithheld tax from the employee prior to the end of the calendar year. Section 1.31-1(b); section 31.6205-1(d)(2). A credit is available to the employee if the employer withholds income tax at the source, even if the tax has not been paid by the employer. Section 31(a); section 1.31-1(a).

The Service disagrees with the Tax Court that employment tax payments that were not withheld at the source may be designated by an employer to a specific employee's income tax liability. Pursuant to sections 3402 and 31(a), an employee may only get a credit for income taxes withheld at the source. If the income tax is not withheld at the source, a later payment by the employer of its liability for the tax it should have withheld will not result in a credit to the employee. In the absence of a statutory credit, the Dixons cannot rely on the rule allowing designation of partial voluntary payments. See Rev. Proc. 2002-26. Such rule only permits a taxpayer to designate a payment toward its own tax liabilities, such as where an employer designates a payment of employment taxes toward the trust fund portion of its employment tax liability. See *Wood v. United States*, 808 F.2d 411, 416 (5th Cir. 1987). Here, Tryco could not designate that its employment tax payments be applied to the income taxes of the Dixons because such income taxes were owed by the Dixons, and not Tryco.

Accordingly, the Service will not follow the holding in *Dixon* that an employer can designate payments of its employment taxes to income taxes of specific employees, and effectively override the statutory limitations in the availability of a credit under section 31(a). We have, however, declined to pursue appeal of this case because due to its unique facts, *Dixon* has limited precedential effect.

**Recommendation:** Nonacquiescence

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