

**Office of Chief Counsel
Internal Revenue Service
memorandum**

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to: Mary P. Hamilton
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(Small Business/Self-Employed)

from: Thomas W. Curteman, Jr.
Senior Technician Reviewer, Branch 4
(Procedure & Administration)

subject: Application of Restitution Payments

This Chief Counsel Advice responds to your request for assistance. This advice may not be used or cited as precedent.

ISSUES

Whether the Service must apply restitution payments that were ordered in connection to corporate income taxes to the corporate income tax liability, or whether they may be applied to other unpaid tax liabilities of the defendants/taxpayers making those restitution payments.

CONCLUSIONS

The Service may apply restitution payments, as involuntary payments, in the Service's best interest.

FACTS

The following facts are what we understand from the Office of Appeals. The Service opened an audit for the corporation, [REDACTED] regarding income taxes for the following periods: [REDACTED]. The audit resulted in a criminal investigation and charges under criminal tax statutes of the corporate principles, and his son [REDACTED]. As part of the judgment, the taxpayers pleaded

guilty to two different counts in the indictment, Count One and Count Seven, and were jointly ordered to pay criminal restitution totaling [REDACTED]. The restitution was fully paid on [REDACTED]. The corporation was not charged with tax crimes.

The Service completed a civil examination for the father's and son's personal income taxes as well as and the corporation's income taxes. Each taxpayer, [REDACTED] and [REDACTED] each had a hearing with Appeals regarding the proposal additional assessments. After the hearings, they agreed to additional assessments regarding both personal income taxes for [REDACTED] and business income taxes for tax periods [REDACTED] and [REDACTED] also agreed to fraud penalties. These additional assessments for individual liabilities were assessed for all periods on [REDACTED] and for the corporate liabilities on [REDACTED].

The Service retained the restitution pending the outcome of the examination and credited the restitution payments only once the Service assessed the personal and corporate taxes. The restitution funds were credited as follows:

<u>Tax Liability</u>	<u>Deficiency¹</u>	<u>Restitution Credited from</u>	<u>Restitution Credited from</u>
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]

The Service only credited the restitution payments received to the tax liabilities for the periods set out above, not to any penalties or interest for those periods. The restitution payments were first credited to pay the [REDACTED] personal additional income tax liabilities (again, not including penalties or interest) with the remainder credited to the corporation's income tax liabilities. The taxpayers' attorney filed a motion with the sentencing Federal district court for clarification of the restitution order. The judge

¹ This amount does not include any assessed penalties relating to the respective tax periods.

would not amend the judgment and determined that the dispute was between the taxpayers and the IRS.

LAW AND ANALYSIS

“Restitution is a compensation for loss; full or partial compensation paid by a criminal to a victim, not awarded in a civil trial for tort, but ordered as part of a criminal sentence or as a condition of probation.” Black’s Law Dictionary 1428 (19th Ed. 2009). When there is a tax-related crime, the government and particularly the Internal Revenue Service is usually the victim. Federal district courts may order a defendant to pay restitution pursuant to 18 U.S.C. § 3556 to the Service to compensate it for its actual loss caused by a convicted defendant. Restitution can also be ordered as part of a plea agreement, if the defendant is convicted of a Title 18 criminal offence, or as a condition of a supervised release or probation. 18 U.S.C. §§ 3663(a)(3), 3663A, 3583(d), 3563(b)(2). When a criminal tax case is settled between the defendant and the government, the parties may enter into a plea agreement that, among other things, waives an appeal of the restitution order. 18 U.S.C. § 3663(a)(3). The defendant can object to certain provisions of the plea agreement, including provisions that related to the existence and amount of tax loss. Failure to comply with the restitution order may result in the court holding the defendant in contempt, and the result of a contempt determination may include the court revoking probation or resentencing the defendant. See 18 U.S.C. § 3613A.

The Service treats a restitution payment as an involuntary payment because it is either a payment agreed to as a result of a plea agreement or a court order. Involuntary payments are defined as “any payment received by agents of the United States as a result of distraint or levy or from a legal proceeding in which the Government is seeking to collect its delinquent taxes or file a claim therefor.” *U.S. v. Pepperman*, 976 F.2d 123, 127 (3d Cir. 1992) (quoting *Amos v. Commissioner*, 47 T.C. 65, 69 (1966)).

The Service will apply involuntary payments to satisfy the outstanding balances in the order that best serves the interests of the government, considering the CSED for all outstanding liabilities. *Pepperman*, 97 F.2d at 127; *Amos*, 47 T.C. at 69. This will generally require application to the oldest tax, oldest penalty, and oldest interest, in that order until fully used. This order of payment application is based on Rev. Proc. 2002-26, which provides the Service’s position regarding payment application by the Service of a partial payment of tax, penalty, and interest for one or more taxable periods. In this case the Service did not err in applying the taxpayer’s restitution payments as involuntary payments in the best interest of the government.²

² On August 16, 2010, the Federal Excise Tax Improvement Act of 2010 (FETI Act), Pub. L. No. 111-237, § 3(a), amended section 6201(a)(4) to require the assessment and administrative collection of the “amount of restitution under an order pursuant to [18 U.S.C. § 3556], for failure to pay any tax imposed under [the I.R.C.] in the same manner as if such amount were such tax.” In this case, restitution was ordered before August 16, 2010, so the restitution amount cannot be assessed. Because the restitution-based assessment provisions of section 6201(a)(4) are not applicable to the facts in this case, we reserve

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS



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for another time whether the analysis or legal hazards are different for the application of restitution payments made when the amount of restitution is assessed by the Service.