Office of Chief Counsel  
Internal Revenue Service  
memorandum

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subject: Allowing Net Operating Loss Carrybacks or Other Deductions to Reduce a Civil Tax Liability for a Tax Period for which Restitution was Ordered and Assessed

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

ISSUE

Whether a net operating loss (NOL) carryback or carryover to, or other deduction in, a tax period for which an amount of restitution was ordered and assessed pursuant to I.R.C. § 6201(a)(4)(A) reduces the taxpayer’s civil tax liability for that tax period.

CONCLUSION

NOL carrybacks or carryovers to, or other deductions in, a tax period for which an amount of restitution was ordered and assessed pursuant to section 6201(a)(4)(A) reduce a taxpayer’s civil tax liability for that tax period. Such deductions, however, do not in any way affect the Service’s assessment or collection of the amount of restitution itself. Regardless of the amount of civil tax liability for that period, the Service must collect the entire amount ordered as restitution under section 6201(a)(4)(A).
BACKGROUND

A. Restitution, generally.

"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). In cases where a defendant committed a tax-related crime, the Internal Revenue Service is typically a victim. Federal district courts may order a defendant to pay restitution to the Service to compensate it for its actual loss caused by that defendant. Federal district courts order restitution pursuant to 18 U.S.C. § 3556. Restitution can be ordered in a criminal tax case as an independent part of a sentence if it is an aspect of a plea agreement or the defendant is convicted of a Title 18 criminal tax offense, 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 enter into a plea agreement that typically waives an appeal of the restitution order. 18 U.S.C. § 3663(a)(3). Although the plea agreement is generally prepared by the government, it is negotiated with the defendant, and the defendant can object to certain provisions of the agreement including those that relate to the existence and amount of the tax loss. The defendant can also agree to pay amounts that are greater than the loss resulting from the count or counts of conviction. United States v. Sloan, 505 F.3d 685, 695 (7th Cir. 2007); United States v. Cooper, 498 F.3d 1156, 1158 (10th Cir. 2007). If the criminal tax case is not amicably resolved and goes to trial, the amount of restitution is then determined by the judge in a sentencing hearing. Before the sentencing hearing, a probation officer prepares a presentence report that shows calculations for the proposed amount of restitution. The presentence report is based on, among other things, the information provided by the prosecutor about the tax loss and an affidavit of the defendant about his or her ability to pay. After reviewing the presentence report, the court may require additional documentation or hear testimony. 18 U.S.C. § 3664(d)(4). The defendant can object to the presentence report, offer evidence, and call witnesses that can attest to the amount of the restitution. After the sentencing hearing, the judge decides on the amount of the restitution that the defendant must pay. Failure to comply with a restitution order may result in the court holding the defendant in contempt of court, revoking probation, or resentencing the defendant. See 18 U.S.C. § 3613A.

B. The assessment of restitution under Section 6201(a)(4)(A).

Prior to August 16, 2010, the Service was not able to collect a restitution order administratively, because restitution was not assessable as a tax. 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.C.S. § 3556], for failure to pay any tax imposed under [the I.R.C.] in the same manner as if such amount were such tax.”
C. Deductions, generally.

In the context of a civil tax liability, deductions ultimately serve to reduce a taxpayer's liability for a given tax period. Due to the possibility of fluctuations in income and expenses, a taxpayer can have substantial profits in one year, but losses in another. With this in mind, the relief provisions of Section 172 were enacted for business income and loss. Section 172 provides that net operating loss deductions may be carried back a certain number of prior years or carried forward a certain number of future years as deductions to income, thereby preserving the economic impact of the loss. The NOL deductions are taken into account in determining the taxpayer's taxable income, thus reducing the tax liability for that tax year. Other deductions, such as business or interest expenses, work similarly in that they are used to reduce the taxpayer's taxable income for the tax year for which the expense was paid or accrued. See generally, Section 161 – 199.

LAW AND ANALYSIS

A. NOL carrybacks, carryovers and other deductions should be taken into account in determining a taxpayer's civil tax liability even if the deductions reduce the civil tax liability below the restitution-based assessment because the tax and the restitution are separate and distinct liabilities.

Criminal restitution and civil tax liability are separate and distinct. Section 6201(a)(4)(A) recognizes the distinction in requiring the Secretary to collect the amount of restitution ordered pursuant to 18 U.S.C. § 3556 in the same manner "as if such amount were such tax." The distinction between criminal restitution and tax liability is perhaps most starkly presented when a return preparer convicted of aiding and assisting in the preparation of the false returns, in violation of 26 U.S.C. § 7206(2), is ordered to pay restitution calculated with reference of the tax owed by his clients, a tax for which the return preparer is not civilly liable. The distinction is further illustrated by the fact that the amount of restitution ordered may differ depending on how the criminal case is resolved. Restitution determined under the Mandatory Victim Restitution Act of 1996, Pub. L. No. 104-132, § 204(a), 111 Stat. 1227 (1996) (codified as amended at 18 U.S.C. § 3663(A)), applies to certain tax cases and directs that the amount of restitution is generally the amount of property taken from the victim (an actual loss to the government in a tax case) under 18 U.S.C. § 3663A(b)(1)(A) and (B), whereas restitution ordered pursuant to a plea agreement may be "to the extent agreed to by the parties in a plea agreement" for any amount greater or less than the loss attributable to the criminal offense. 18 U.S.C. § 3663(a)(3). See, e.g., Sloan, 505 F.3d at 695; Cooper, 498 F.3d at 1158. Restitution ordered in a criminal case may vary depending on how the case was ultimately resolved, independent – at least in part – of the defendant's actual tax liability for the tax period at issue.

It is not uncommon for the Service to conduct a civil tax examination after the close of a criminal case for which restitution was ordered and determine that the taxpayer's civil
tax liability differs from the amount ordered as restitution. The examination may also reveal that civil penalties apply to the same tax period, including the fraud penalty under section 6663. The earlier criminal action and resulting court order of restitution for the applicable tax period does not preclude the Service from assessing tax liabilities and civil penalties that differ from the amount of the restitution ordered for the same tax period. See Helvering v. Mitchell, 303 U.S. 391 (1938) (holding that Congress may impose both a criminal and a civil sanction in respect to the same act or omission); Morse v. Commissioner, 419 F.3d 829, 833-35 (8th Cir. 2005) (holding that despite a federal criminal case against the same taxpayer resulting in a sentence that the taxpayer pay a fine and make restitution to the Service, the doctrine of res judicata did not apply to preclude a civil fraud penalty assessment on a tax deficiency because criminal prosecution for filing false income tax returns did not involve same cause of action as civil tax deficiency case). The civil tax determined by the Service is independent of the amount of restitution ordered by the federal district court in the earlier criminal case. Unlike the assessment of restitution under section 6201(a)(4), the Service's determination of the taxpayer's civil tax liability is subject to deficiency procedures, just like any other civil tax determination where a criminal tax case was never anticipated or prosecuted. The Service's assessment of restitution, on the other hand, does not involve deficiency procedures and the taxpayer may not challenge the assessment in any proceeding under the Code, including before Tax Court. Section 6201(a)(4)(C) prohibits a challenge to "the amount of restitution . . . on the basis of the existence or amount of the underlying tax liability in any proceeding authorized under [Title 26]", and section 6213(b)(5) prohibits the petition of a restitution-based assessment to Tax Court.

Because the assessment of restitution under section 6201(a)(4) is not itself a determination of the actual civil tax liability for the tax period for which restitution was ordered, and is assessed only "as if such amount were such tax," the Service does not treat the amount of restitution as the minimum tax liability for the relevant tax period. A restitution-based assessment is independent of the Service's determination of the civil tax liability for the same period, and NOL carrybacks, carryovers and other deductions may be applied to reduce the ultimate civil tax liability for that period, irrespective of the restitution amount. A taxpayer, of course, may, if permitted, elect not to carryback the

1 For example, a taxpayer is ordered to pay $100,000 in restitution for the tax period ending December 2010 and the Service subsequently examines the taxpayer for the same tax period. Pursuant to the examination, the Service determines that the taxpayer has a civil tax liability of $150,000. The taxpayer timely requests that a NOL deduction from the tax period ending December 2011 be carried back to the tax period ending December 2010, which would reduce his tax liability by $100,000. If the Service allows the NOL carryback, the taxpayer's civil tax liability would be reduced to $50,000. The Service may allow the NOL carryback, even though it would reduce the tax liability below the restitution-based assessment of $100,000 because the civil tax liability is separate and independent from the restitution-based assessment. The Service is required to collect $100,000 from the taxpayer for tax period ending December 2010 to satisfy the restitution-based assessment because the Service must assess and collect the amount ordered as restitution, regardless of whether the civil tax liability is determined to be less. See section 6201(a)(4)(A). Because the Service cannot collect twice for the same tax period, the first $50,000 collected to satisfy the restitution-based assessment of $100,000 must also be applied to the civil
NOL due to a lack of financial benefit resulting from the restitution ordered, and to carry the NOL forward only.\(^2\)

**B. The Service must collect the entire amount ordered as restitution under section 6201(a)(4)(A), regardless of whether the civil tax liability for the same period is less than the amount ordered as restitution.**

Congress intended to give federal district court orders – and criminal sentencing orders in particular – finality. See Dolan v. United States, 130 S. Ct. 2533, 2539-40 (2010) (recognizing the importance of the finality and certainty of a restitution determination in helping victims secure prompt restitution). When a federal district court issues its judgment and commitment order in a criminal case, the amount of restitution reflected in that order is considered final. 18 U.S.C. § 3664(o) ("A sentence that imposes an order of restitution is a final judgment[].") No statute gives the Service the power to modify or compromise any district court’s order unilaterally, not even an order of restitution with the Service identified as the victim. The FETI Act does not change this rule, despite the Service’s new ability to assess and collect the amount of restitution as if such amount were a tax. Likewise, a defendant convicted of a tax crime and ordered to pay restitution to the Service cannot launch a collateral attack on a federal court’s restitution order under any judicial or administrative proceeding under the Internal Revenue Code. See section 6201(a)(4)(C). Any challenge to the amount of restitution assessed under section 6201(a)(4) is an attempt to impermissibly modify the district court’s final restitution order and is, therefore, a prohibited collateral attack on that order.

Although the Service may apply NOL carrybacks and other deductions in such a manner that may ultimately result in a civil tax liability less than the amount ordered as restitution for the same period, the Service must collect the entire amount of restitution ordered and assessed under section 6201(a)(4)(A). The Service is without authority to compromise the federal district court’s order of restitution. Cf., e.g., United States v. Savoie, 985 F.2d 612, 619 (1st Cir. 1993) (victim’s civil settlement with defendant does not prevent court from ordering full restitution); United States v. Sheinbaum, 136 F.3d 443, 448 (5th Cir. 1998) (same); United States v. Hairston, 888 F.2d 1349, 1355 (11th Cir. 1989) (same); F.D.I.C. v. Dover, 453 F.3d 710, 717 (6th Cir. 2006) (victim’s post-sentencing settlement with defendant does not alter restitution order).

Section 6201(a)(4) is consistent with the Service’s lack of authority to compromise or otherwise adjust a district court’s restitution order. Under section 6201(a)(4)(A), the tax liability of $50,000. See United States v. Helmsley, 941 F.2d 71, 102 (2d Cir. 1991).

\(^2\) Deductions should not be granted for a position that is inconsistent with the taxpayer’s sworn testimony or stated position in the criminal case. Taxpayers have a duty of consistency and cannot change their legal position to gain a benefit from the Service that would be unavailable to them if they had been successful in their criminal defense. For example, if the defendant claims in the criminal case that he did not own a company but was instead the employee, he cannot later claim Schedule C deductions (Profit or Loss from a Business) for that same company in a civil examination.
Service "shall assess and collect the amount of restitution" ordered by the district court. (Emphasis added.) "Shall" in the statute is a mandatory term denoting a lack of discretion on the part of the Service. See Nat'l Ass'n of Home Builders v. Defenders of Wildlife, 551 U.S. 644, 661 (2007) ("the statutory language [shall] is mandatory and the . . . [agency] does not have the discretion"); Lopez v. Davis, 531 U.S. 230, 231 (2001) (noting "Congress' use of a mandatory 'shall' ... to impose discretionless obligations"); Jefferson v. United States, 546 F.3d 477, 484 (7th Cir. 2008) ("The language of [I.R.C. §] 904(b)(2) is written using the mandatory term 'shall' . . . which means that the promulgation of these materials was not optional."). Accordingly, the Service must assess and collect the amount of ordered restitution under section 6201(a)(4)(A) regardless of whether the civil tax liability is determined to be less than the restitution amount.

The Service may not, however, collect both restitution for a certain tax period and the taxpayer's full civil tax liability for the same period, as this would be impermissible double collection. See Helmsley, 941 F.2d at 102 ("[W]e believe it is self-evident that any amount paid as restitution for taxes owed must be deducted from any judgment entered for unpaid taxes in such a civil proceeding."). Any payments made to satisfy the restitution-based assessment must be applied to satisfy the civil tax liability for the same tax period.

Please contact Thomas Curteman, Senior Technical Reviewer of Procedure and Administration at (202) 622-3630, if you have any further questions.