

No. 13-244

In the Supreme Court of the United States

MARK MAY, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

*ON PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT*

BRIEF FOR THE RESPONDENT IN OPPOSITION

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QUESTION PRESENTED

Whether, for purposes of the fraud penalty imposed by 26 U.S.C. 6663, taxes deducted from wages but not paid over to the taxing authorities due to the willfully fraudulent acts of the taxpayer are not “actually withheld,” and thus constitute an “underpayment * * * attributable to fraud.”

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1-5) is not published but is available at 2013 WL 1352477. The opinion of the United States Tax Court (Pet. App. 6-25) is reported at 137 T.C. 147.

JURISDICTION

The judgment of the court of appeals was entered on February 19, 2013. A petition for rehearing was denied on June 4, 2013 (Pet. App. 29-30). The petition for a writ of certiorari was filed on August 19, 2013. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. During 1994, 1995, and 1996, petitioner was the president, chief executive officer, and a shareholder of Maranatha Financial Group, Inc. (Maranatha). Pet.

App. 1-2, 8-9. In those roles, petitioner controlled the company's finances. He was the only person authorized to sign Maranatha's payroll and corporate checks. *Id.* at 2, 9.

Petitioner received a biweekly paycheck and pay stub issued through a payroll service provider. The pay stubs reflected biweekly gross pay of \$10,000, with approximately \$3500 in withholdings for federal, state, and local taxes. In preparing paychecks for its employees (including petitioner), Maranatha deducted all of the applicable taxes from the employees' gross pay, but the company never remitted those taxes to federal, state, or local tax authorities. Pet. App. 2, 9. Maranatha used "at least a portion of the unremitted funds to continue operation of the business, which included paying [petitioner] an annual salary of \$260,000." *Id.* at 9. Petitioner was responsible for remitting the taxes to the proper authorities, and he was aware of the failure to remit them. *Ibid.*

Because he was the responsible officer, all unremitted withholdings were later assessed against petitioner under 26 U.S.C. 6672. Pet. App. 9-10. Furthermore, in April 2002, a federal grand jury in the Southern District of Ohio returned an indictment charging petitioner with two counts of tax evasion, in violation of 26 U.S.C. 7201; and four counts of failure to pay over payroll taxes, in violation of 26 U.S.C. 7202. Pet. App. 10. Petitioner was convicted on all counts, and the court of appeals affirmed. *United States v. May*, 174 Fed. Appx. 877, 879 (6th Cir. 2006). Evidence in the criminal trial established that petitioner had used funds in Maranatha's account for personal expenses. Pet. App. 11.

On their joint federal income tax returns for 1994, 1995, and 1996, petitioner and his wife claimed withholding credits for the federal-tax amounts that had been subtracted from petitioner's gross pay in preparing his paychecks. Pet. App. 10. They also claimed deductions for state income taxes allegedly paid through withholding during those years, as well as deductions for local taxes allegedly withheld during 1995 and 1996. *Ibid.*

The Commissioner issued a notice of deficiency for 1994, 1995, and 1996. The Commissioner disallowed deductions for the state and local income taxes that petitioner claimed to have paid through withholding. Pet. App. 7. The Commissioner further determined that there were underpayments of federal tax due to petitioner's fraud, and that petitioner was therefore liable for penalties under 26 U.S.C. 6663(a). Pet. App. 7. In determining the amounts of the underpayments of tax to which the fraud penalties applied, the Commissioner included the disallowed withholding credits for federal taxes claimed on petitioner's tax returns. *Ibid.* Petitioner and his wife filed a petition in the Tax Court contesting the deficiencies and penalties. *Id.* at 2-3.

2. The Tax Court upheld the deficiencies and fraud penalties against petitioner, except to the extent that the court allowed a contested \$772 deduction for local income taxes paid by check in 1996. Pet. App. 6-25.*

The Tax Court rejected petitioner's argument that there were no "underpayments" of tax to which the

* During the Tax Court proceeding, the Commissioner conceded that petitioner's wife was entitled to "innocent spouse" relief from joint liability for the deficiencies under 26 U.S.C. 6015(b). Pet. App. 3.

fraud penalty applied. Pet. App. 13-17. The court explained that 26 U.S.C. 6664(a) defines “underpayment” as the difference between the correct tax owed and the amount shown as the tax by the taxpayer on his return. The court further explained that, under the relevant Treasury regulation, “the amount shown as the tax by the taxpayer on his return” should be reduced by the excess of the amount shown by the taxpayer as credit for a tax withheld at the source over the amount “actually withheld.” 26 C.F.R. 1.6664-2(c)(1). The effect of this regulation, the court explained, is that “if a taxpayer overstates prepayment credits, such as the credit for wages withheld, the overstatement decreases tax due as shown on the return and increases the underpayment of tax.” Pet. App. 14. The court held that the Treasury regulation “validly interprets the definition of ‘underpayment’ in section 6664 and therefore extends the meaning of ‘underpayment’ to include a taxpayer’s overstated credits for withholding.” *Id.* at 15.

Petitioner argued that, because federal taxes were “actually withheld” from his paycheck, he did not overstate the withholding credit on his tax returns and no underpayment of tax existed. The court of appeals rejected those contentions. The court acknowledged that, under 26 C.F.R. 1.31-1(a), “[i]f the tax has actually been withheld at the source, credit or refund shall be made to the recipient of the income even though such tax has not been paid over to the Government by the employer.” Pet. App. 15. The court concluded, however, that the proper approach for determining whether taxes were “actually withheld” at the source “should consider whether the funds functionally left

the control of a taxpayer.” *Id.* at 16 (citing *United States v. Blanchard*, 618 F.3d 562 (6th Cir. 2010)).

The Tax Court noted that petitioner had full control over the corporation’s finances, was responsible for the corporation’s remittance of tax withholdings to the IRS, and knew that the taxes were not being remitted. Pet. App. 16. Moreover, petitioner “was entrusted with the withheld funds and misappropriated them back to the corporate account which he controlled, using them to continue operations of the corporation in which he had an equity share and which paid him an annual salary of \$260,000.” *Id.* at 17. The court accordingly concluded that, although petitioner “was technically subject to tax withholding” in that his W-2s showed withholding of taxes each pay period, the taxes had not “actually been withheld” within the meaning of 26 C.F.R. 1.31-1 because petitioner had continued to use the “withheld” funds for his benefit. Pet. App. 16-17. As a result, the overstated credits for withheld taxes decreased the amount shown as the tax by petitioner on his returns, thereby increasing the underpayments of tax to which the fraud penalties applied. *Ibid.*

For the same reason the Tax Court held that no federal taxes were “actually withheld” from petitioner’s paychecks, the court further held that no state taxes were withheld and that petitioner therefore was not entitled to deductions for state income tax withholdings. Pet. App. 20. The Tax Court determined deficiencies against taxpayer of \$7659 for 1994, \$10,389 for 1995, and \$8465 for 1996, as well as fraud penalties of \$84,957.75, \$89,748.75, and \$69,930.75 for those years, respectively. *Id.* at 17, 27-28.

3. The court of appeals affirmed. Pet. App. 1-5. Petitioner contended that, because Maranatha had deducted federal taxes from his paychecks, he was entitled to claim the withholding credits, resulting in no underpayment of tax. The court of appeals rejected that contention, explaining that it had rejected the same argument in affirming petitioner's criminal conviction. *Id.* at 4; see *United States v. May*, 174 Fed. Appx. 877 (6th Cir. 2006). The court explained that the same reasoning applied here because petitioner had "maintained sole authority over the use of Maranatha's funds and used the funds for the continued operation of the company, including paying employee wages, such as his own." Pet. App. 4. The court concluded that "the Tax Court did not err in finding that [petitioner] fraudulently claimed withholding credits." *Ibid.*

The court of appeals also rejected petitioner's argument that his state taxes were deemed "paid" (and therefore were deductible) "because they were withheld from his paycheck." Pet. App. 4. The court explained that this contention "fails for the same reasons set forth above with respect to [petitioner's] federal tax withholdings." *Ibid.*

ARGUMENT

Petitioner contends (Pet. 9-22) that, because federal taxes were deducted from his gross pay when Maranatha prepared his paychecks, and his W-2s stated that those taxes had been withheld, he was entitled to claim the amount purportedly withheld as a credit on his personal federal tax returns. The court of appeals correctly rejected that argument, and its decision does not conflict with any decision of this Court or another court of appeals. Further review is not warranted.

1. Section 6663 of Title 26 of the United States Code provides for a penalty “[i]f any part of any underpayment of tax required to be shown on a return is due to fraud.” The “underpayment” to which the fraud penalty applies is defined as the amount by which the correct tax due under the Internal Revenue Code exceeds “the amount shown as the tax by the taxpayer on his return.” 26 U.S.C. 6664(a)(1)(A).

The Treasury regulation interpreting Section 6664 provides, in relevant part, that “the amount shown as the tax by the taxpayer on his return” is the amount shown on the return “reduced by the excess of” (1) the amount shown as credit for tax withheld over (2) the amount actually withheld. 26 C.F.R. 1.6664-2(c)(1). Accordingly, if the taxpayer overstates the credit for withholding on his tax return, “the overstatement decreases the amount shown as the tax by the taxpayer on his return and increases the underpayment of tax.” *Sadler v. Commissioner*, 113 T.C. 99, 103 (1999); see *Feller v. Commissioner*, 135 T.C. 497, 510-511 (2010); *Langston v. Commissioner*, 97 T.C.M. (CCH) 1326 (2009).

2. Petitioner contends (Pet. 12-18) that he did not overstate the credit for withholding on his personal tax returns because, as shown on his W-2s, the amounts he claimed as withholdings were “actually withheld” from his paychecks. The court of appeals correctly rejected that argument, concluding that the relevant funds were not “actually withheld” within the meaning of 26 C.F.R. 1.6664-2(c) because those funds never left petitioner’s functional control. As a result, petitioner’s overstatement of credit for withheld federal taxes decreased “the amount shown as the tax by the taxpayer on his return,” see *ibid.*, which increased

the underpayment of tax subject to the fraud penalty under 26 U.S.C. 6663.

In arguing that he was entitled to claim a credit for the amounts deducted from his paychecks, petitioner relies on 26 C.F.R. 1.31-1, which provides that “[i]f the tax has actually been withheld at the source, credit or refund shall be made to the recipient of the income even though such tax has not been paid over to the Government by the employer.” That rule makes clear that an employer’s failure to remit taxes withheld from an employee’s wages will not ordinarily prevent the employee from receiving credit for the taxes that were withheld. Application of that rule produces sound results in the usual circumstances for which it was designed, since withholding of taxes from an employee’s wages ordinarily deprives the employee of functional control over the funds’ disposition, and the employer’s subsequent failure to remit the money to taxing authorities is not usually attributable to the taxpayer.

The courts below correctly held, however, that Section 1.31-1 was inapplicable here. Unlike the typical employee whose taxes are withheld from wages but not remitted by his employer, petitioner retained control over the “withheld” funds and used them for his personal benefit, in knowing violation of his duty to remit the funds to the government. See Pet. App. 4, 16-17. Petitioner’s retention and subsequent use of those funds amply justified the conclusion that those funds had not “actually been withheld” within the meaning of the regulation.

3. Petitioner contends (Pet. 9-12) that the court of appeals’ decision conflicts with this Court’s decisions in *Begier v. IRS*, 496 U.S. 53 (1990), and *Slodov v.*

United States, 436 U.S. 238 (1978). Petitioner’s reliance on those precedents is misplaced.

In *Begier* and *Slodov*, the Court explained the general rule that an employee receives credit for taxes withheld from his wages regardless of whether the taxes are paid over to the government by the employer. See *Begier*, 496 U.S. at 60-61 (“[w]ithholding [of federal taxes from wages] occurs at the time of payment to the employee of his net wages”); *Slodov*, 436 U.S. at 243 (“Once net wages are paid to the employee, the taxes withheld are credited to the employee regardless of whether they are paid by the employer.”). Those holdings are reflected in the general rule of 26 C.F.R. 1.31-1 discussed above.

Contrary to petitioner’s suggestions (*e.g.*, Pet. 11, 12-13, 18), however, neither of the courts below held that Maranatha’s failure to remit the relevant funds to the appropriate taxing authorities, in and of itself, prevented petitioner from claiming the withholding credits. Rather, the courts below found it decisive that petitioner himself retained control over the funds, even after they had purportedly been withheld, and used them for his own benefit. Thus, the Tax Court stated that “the proper test to determine whether actual withholding at the source occurred should consider whether the funds functionally left the control of a taxpayer.” Pet. App. 16. The court observed that petitioner “was entrusted with the withheld funds and misappropriated them back to the corporate account which he controlled, using them to continue operation of the corporation in which he had an equity stake and which paid him an annual salary of \$260,000.” *Id.* at 17. “Because [petitioner] was responsible for the nonremittance and fully controlled the corporate fi-

nances,” the Tax Court “conclude[d] that the funds never left [petitioner’s] functional control and were therefore not ‘actually withheld at the source’ from his wages for purposes of” the applicable Treasury regulation. *Ibid.* The court of appeals likewise held that petitioner could not claim the withholding credit “because the Tax Court determined that [petitioner] maintained sole authority over the use of Maranatha’s funds and used the funds for the continued operation of the company, including paying employee wages, such as his own.” *Id.* at 4.

The Court in *Begier* and *Slodov* had no occasion to address the situation here, where the taxpayer claims credit for amounts that he himself willfully and fraudulently failed to pay over to the government and devoted instead to his personal benefit. Petitioner cites no decision involving similar facts in which a taxpayer’s claim to a withholding credit has been sustained. When taxes that are shown as “withheld” on the taxpayer’s W-2 remain within the taxpayer’s control, and the taxpayer uses them for his own benefit, the taxes have not “actually been withheld” from his wages within the meaning of 26 C.F.R. 1.31-1.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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