

# Practice

By *Charles P. Rettig*

## Criminal Tax Restitution Orders and the Civil Liability

Following the conviction of a defendant for a federal criminal tax violation or tax-related offense, the court may order the defendant to comply with certain tax-related conditions of probation or supervised release and/or order the payment of restitution to the IRS. Restitution is generally defined as “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.”<sup>1</sup>

In cases where a defendant committed a tax-related crime, the IRS may be deemed a victim entitled to payment of restitution to compensate it for its actual loss.<sup>2</sup> 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 if the defendant is convicted of a Title 18 criminal tax offense, as a condition of a supervised release or as a condition of probation.<sup>3</sup> When a criminal tax prosecution is settled between the defendant and the government, the parties enter into a plea agreement which typically waives an appeal of the restitution order.<sup>4</sup> 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 and agree to the amounts which are greater than the loss resulting from the count or counts of conviction.<sup>5</sup>

If the criminal tax prosecution 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 pre-sentence report that shows calculations of the amount of restitution. The pre-sentence report is based on, among other things, the information provided by the prosecutor and the defendant about



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the tax loss and an affidavit of the defendant about the ability to pay. After reviewing the pre-sentence report, the federal court may require additional documentation or hear testimony.<sup>6</sup> The defendant can object to the investigation report, offer evidence and call witnesses that can attest to the amount of the restitution. After the hearing, the judge decides on the amount of the restitution, which the defendant must pay as a condition of probation under 18 USC §3563(b)(2) or supervised release under 18 USC §3583(d).

Congress intended to give federal court orders—and criminal sentencing orders in particular—finality.<sup>7</sup> When a federal court issues its judgment and commitment order in a criminal case, the amount of restitution reflected in that order is considered final. Any subsequent modification of that restitution amount lies solely within the jurisdiction of the federal court that ordered the restitution.

The Firearms Excise Tax Improvement Act of 2010 (FETI Act)<sup>8</sup> amended Code Sec. 6201(a)(4)<sup>9</sup> to provide for the assessment and collection of the amount of restitution ordered in a federal criminal case for failure to pay any tax under Title 26.<sup>10</sup> Before the FETI Act was enacted, the IRS could not assess a restitution amount or administratively take action to collect an assessed or assessable restitution amount. The FETI Act provides that the assessed amount of restitution can be collected as if it were a tax. The federal court restitution order, however, remains, and the Justice Department retains its authority to collect under Title 18.<sup>11</sup> Thus, the FETI Act allows the Justice Department to enforce the restitution order and the IRS to collect the assessment based on the amount ordered as restitution.

No statute gives the IRS the power to modify or compromise any federal court's order unilaterally, not even an order of restitution where the IRS is identified as the victim. Even if the restitution ordered is based in whole or in part on unpaid income taxes for a tax period never examined by the IRS, the federal court's determination of that amount of restitution is uncontestable under Code Sec. 6201(a)(4). The FETI Act does not change this, despite the IRS's ability to assess and collect this 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 IRS cannot launch a collateral attack on a federal court's restitution order under any judicial or administrative proceeding under the Code.

Criminal restitution and civil tax liability are separate and distinct. The assessment of restitution under

Code Sec. 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." Although criminal restitution and civil tax liability are distinct, the IRS may not collect both for the same period because this would be an impermissible double collection. Once the restitution is assessed the 10-year statute of limitation applies.<sup>12</sup> Any payments made to satisfy the restitution-based assessment must also be applied by the IRS to satisfy the related civil tax liability for the same tax period. Such application of payments is made possible due to a mirror assessment of restitution order and ultimate civil liability for the same period.

## Collection Procedures

The IRS Small Business/Self-Employed Division recently issued interim guidance providing procedures for IRS collection employees involved in criminal tax cases in which a court orders tax-related conditions of probation which include restitution. Although criminal restitution and a civil tax liability are distinct, the IRS may not collect both for the same period because that would be impermissible double collection. Any payments made to satisfy the restitution-based assessment must also be applied by the IRS to satisfy the civil tax liability for the same tax period. The proper application of payments is achieved through the use of a mirrored assessment of restitution order and ultimate civil liability for the same period.

IRS Advisory Probation Liaisons (APLs) receive notification from IRS Criminal Investigation (CI) when the court orders IRS-related conditions of probation including restitution. The APL monitors the case for compliance with these conditions and determines what civil actions are to be taken on the case. Civil administrative collection actions on probation cases depend on what conditions were included in the court order, whether assessments have been made and the collection potential given the taxpayer's circumstances.

At some point, an IRS Revenue Officer (RO) will be assigned to collect the restitution and may pursue various actions including the filing a notice of federal tax lien (NFTL), levy, seizure, installment agreement (IA), offer in compromise (OIC) or classifying the case as currently not collectible (CNC). Which actions are appropriate will depend on the court order and other factors. Neither the existence of a court ordered payment plan nor the taxpayer's timely payments to the court preclude the IRS from

administrative collection of restitution-based assessments. However, when a court orders restitution paid to the government as well as nongovernment victims, the IRS will not pursue enforced collection actions until the nongovernment victims are paid in full.<sup>13</sup>

Because the Justice Department retains its ability to enforce the restitution order while the IRS has a parallel ability to collect administratively, communication with the Justice Department is important prior to taking enforcement action to collect restitution-based assessments. The APL will be familiar with the conditions set forth in the federal court order and will advise the RO regarding whether collection actions should be coordinated with the Justice Department. The APL will also facilitate coordination and communication with CI, the U.S. Probation Officer and the Justice Department when necessary. If the probationary term has concluded, the APL will assist the RO in determining whether the Justice Department is taking any actions to enforce its restitution judgment and whether any planned administrative collection actions would be appropriate under the circumstances.

## **Installment Agreements and Offers in Compromise**

The IRS may enter into IAs to collect a restitution-based assessment. The agreement must provide for the full payment of the restitution-based assessment. IAs for other civil assessments may be entered into when the agreement won't result in full payment of the restitution-based assessment. The agreement cannot compromise or reduce the amount of the restitution ordered by the court in any manner. Any changes to the terms of the court-ordered payment schedule must be made by the court. To be legally sufficient, the entire amount of the restitution ordered must be satisfied at the conclusion of the IA, and the periodic amount and frequency of payments of an IA should be no less than that set in the court's payment plan.<sup>14</sup> The IRS cannot accept an offer in compromise that includes a civil assessment based on a restitution order unless the taxpayer has paid or will pay the full amount of the restitution as part of the offer.<sup>15</sup>

## **Collection Due Process (CDP)**

Before the IRS can administratively collect on any assessment, it generally affords CDP hearing rights to a taxpayer pursuant to Code Sec. 6320 or 6330. Code Sec. 6320(a) provides that the IRS shall notify a taxpayer

when a Notice of Federal Tax Lien is filed against a taxpayer's property and allow that taxpayer to request a CDP hearing. Similarly, Code Sec. 6330(a) states that the IRS shall provide a taxpayer with a notice of intent to levy explaining that the taxpayer has a right to a CDP hearing. Code Secs. 6320(b)(2) and 6330(b)(2) allow only one hearing with respect to a tax and tax periods covered by the notice (CDP notice).

During the CDP hearing, a taxpayer can raise a number of issues that relate to the unpaid tax, such as: (1) spousal defenses; (2) a challenge to the appropriateness of collection actions; and (3) potential collection alternatives.<sup>16</sup> Typically, a taxpayer may also challenge the underlying tax liability pursuant to Code Sec. 6330(c)(2)(B). A taxpayer, however, may contest the underlying tax liability only if it did not have a prior opportunity to dispute such tax liability. Also, pursuant to Code Sec. 6330(c)(4) a taxpayer can raise only those issues at a CDP hearing that were not raised or considered at a previous CDP hearing or any other previous administrative or judicial proceeding, and a taxpayer meaningfully participated in such a hearing or proceeding.

The federal court restitution order is final and cannot be challenged or modified during a CDP hearing or a subsequent CDP case. Code Sec. 6201(a)(4)(C) explicitly prohibits collateral attacks on a restitution order, and Code Sec. 6330(c)(4) prohibits a challenge to the amount of restitution because a criminal case is considered a prior judicial hearing in which a taxpayer has meaningfully participated.

The only way the amount of a restitution order can be changed is if the restitution order is modified by the federal court which issued the order. Accordingly, IRS Appeals has no authority to change the amount of a restitution order or even entertain at a CDP hearing a challenge to the amount of restitution ordered. Code Secs. 6201(a)(4) and 6330(c)(4) support this prohibition against review by the Office of Appeals of a federal court's restitution order. The taxpayer is entitled to CDP rights but may not challenge the underlying liability upon which the restitution is based.

## **Deficiency and Litigation Issues**

IRS Counsel recently issued guidance regarding statutory Notices of Deficiency following a civil examination for tax periods covered by a restitution order in a criminal tax prosecution and of issues to be aware of when litigating Tax Court cases that include tax periods covered by a restitution order.<sup>17</sup> After a criminal case is closed the IRS often conducts a civil examination of the

defendant-taxpayer for any open year, including any of the tax periods covered by the criminal prosecution, even if the taxpayer is ordered to pay criminal restitution. Specifically, the IRS is not prohibited from determining the civil tax liability for the same tax years for which criminal restitution was ordered.

Criminal restitution and civil tax liability are separate and distinct. Code Sec. 6201(a)(4)(A) recognizes that the restitution order is not itself a determination of tax liability by requiring the amount of restitution to be collected in the same manner “as if such amount were such tax.” The distinction between criminal restitution and tax liability becomes clear with an example provided in the recently issued guidance of a return preparer convicted of aiding and assisting in the preparation of the false returns,<sup>18</sup> who is ordered to pay restitution calculated with reference to 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.<sup>19</sup>

It is not uncommon for the IRS to conduct a civil tax examination after the close of a criminal tax prosecution 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 Code Sec. 6663.<sup>20</sup> The criminal prosecution and resulting court order of restitution does not preclude the IRS from assessing tax liabilities and civil penalties that differ from the amount of the restitution ordered for the same tax period.<sup>21</sup> Regardless of whether the civil examination for the same tax period covered by the restitution order results in a deficiency determination greater or lesser than the amount of restitution, the IRS must assess and collect the full amount of restitution ordered.

The civil tax liability and penalties, if any, determined by the IRS are independent of the amount of restitution ordered by the federal district court in the earlier criminal case. The restitution amount is a floor and not a ceiling with respect to the tax period at issue. Although the amount of a restitution may not be the actual amount of the taxpayer’s full tax liability for that tax period under Title 26, the IRS will effectively treat the amount of restitution as the minimum tax liability for the relevant tax period by assessing it “as if such amount were such tax” for that period.<sup>22</sup>

Unlike the assessment of restitution under Code Sec. 6201(a)(4), the IRS’s determinations of the taxpayer’s civil tax liability and of certain penalties are subject to

deficiency procedures, just like any other civil tax determination where a criminal tax case was never anticipated or prosecuted. The IRS’s assessment of restitution, on the other hand, does not involve deficiency procedures, and the taxpayer may not challenge the restitution assessment in any proceeding under the Internal Revenue Code (“the Code”), including before the Tax Court. Code Sec. 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 Code Sec. 6213(b)(5) prohibits the petition of a restitution-based assessment to Tax Court.<sup>23</sup>

Because the assessment of restitution under Code Sec. 6201(a)(4) is not 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 IRS does not treat the amount of restitution as the amount of tax liability for the relevant tax period. A restitution-based assessment is independent of the IRS’s determination of the civil tax liability for the same period and, for example, NOL carrybacks, carryovers and other deductions may be applied to reduce the ultimate civil tax liability for that period, irrespective of the restitution amount.<sup>24</sup>

Taxpayers have a duty of consistency and cannot change their legal position to gain a benefit from the IRS that would be unavailable to them if they had been successful in their criminal defense. Although the IRS 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 IRS must collect the entire amount of restitution ordered and assessed under Code Sec. 6201(a)(4)(A).

The IRS may only abate a restitution-based assessment to bring it in line with an amended restitution order from the sentencing court. A federal court may only modify a restitution order in the limited circumstances listed in 18 USC §3664(o)(1). The IRS will not contact the Justice Department or the U.S. Attorney’s Office to request a modification of the restitution order based on the results of the civil exam. Defendants who wish to challenge the amount of restitution must do so as part of the criminal case and cannot wait until the civil examination to argue that the amount of criminal restitution is too high. Only if the federal court amends the restitution order<sup>25</sup> will the IRS assess and collect an amount of restitution different from that originally ordered in the initial criminal sentence.

Amounts of tax liability ordered pursuant to a restitution order are not subject to deficiency procedures

pursuant to Code Sec. 6213(b)(5)(A). Thus, a Notice of Deficiency for taxes and penalties that covers the same tax periods for which the federal court orders restitution will only be based on the amounts determined by the civil examination. Allegations set forth in the Tax Court petition address only the liabilities determined in the

statutory Notice of Deficiency and do not cover any amounts assessed solely based on a restitution order. If a petition includes challenges to the assessment of periods and amounts of underlying tax liability determined by the restitution order, IRS Counsel will likely file a motion to dismiss the Tax Court's petition for lack of jurisdiction.

## ENDNOTES

- <sup>1</sup> BLACK'S LAW DICTIONARY 1428 (19th ed. 2009).
- <sup>2</sup> Federal courts order restitution pursuant to 18 USC §3556.
- <sup>3</sup> 18 USC §§3563(b)(2), 3583(d), 3663(a)(3), 3663A.
- <sup>4</sup> 18 USC §3663(a)(3).
- <sup>5</sup> *Sloan*, CA-7, 505 F3d 685, 695; *Cooper*, CA-10, 498 F3d 1156, 1158.
- <sup>6</sup> 18 USC §3664(d)(4).
- <sup>7</sup> See *Dolan*, SCt, 130 US 2533, 2539–40 (recognizing the importance of the finality and certainty of a restitution determination in helping victims secure prompt restitution).
- <sup>8</sup> Firearms Excise Tax Improvement Act of 2010 (P.L. 111-237) (FETI Act).
- <sup>9</sup> All Code Sections refer to the Internal Revenue Code ("the Code").
- <sup>10</sup> United States Code, Title 26. The law applies to restitution orders entered after August 16, 2010.
- <sup>11</sup> United States Code, Title 18.
- <sup>12</sup> Code Sec. 6502.
- <sup>13</sup> The collection account may be closed as a currently not collectible (CNC) hardship with a mandatory follow-up date based on information contained in the court order. The government may take steps to protect its interest, such as filing a NFTL.
- <sup>14</sup> Procedures for issuing IAs in restitution cases are to be published in upcoming interim guidance and incorporated into IRM 5.14.7.
- <sup>15</sup> The IRS is without authority to compromise the federal court's order of restitution. *Cf., e.g., Savoie*, CA-1, 985 F2d 612, 619 (victim's civil settlement with defendant does not prevent court from ordering full restitution); *Sheinbaum*, CA-5, 136 F3d 443, 448 (same); *Hairston*, CA-11, 888 F2d 1349, 1355 (same); *F.D.I.C. v. Dover*, CA-6, 453 F3d 710, 717 (victim's post-sentencing settlement with defendant does not alter restitution order). Additional guidance on OIC in restitution cases has been published in IRM 5.8.4.
- <sup>16</sup> Code Sec. 6330(c)(2)(A).
- <sup>17</sup> Deficiency and Litigation Issues Concerning Tax Periods for Which Criminal Restitution Has Been Ordered, Notice CC-2013-012 (July 31,

2013), clarifying and revising Notice CC-2011-018 (Aug. 26, 2011).

- <sup>18</sup> In violation of 26 USC §7206(2).
- <sup>19</sup> Restitution determined under the Mandatory Victim Restitution Act of 1996, P.L. 104-132, §204(a), 111 Stat. 1227 (1996) (codified as amended at 18 USC §3663A), 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 USC §3663(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 USC §§3663(a)(3), 3663A(a)(3). *Supra* note 5.
- <sup>20</sup> Criminal restitution is generally limited to the victim's actual loss and does not include civil penalties. See *Chalupnik*, CA-8, 514 F3d 748,754. Exceptions to this general rule include cases in which a defendant agrees to pay penalties as part of a plea agreement, see 18 USC §3663(a)(3) and cases in which defendant evaded the payment of penalties in violation of 26 USC §7201.
- <sup>21</sup> See *Mitchell*, SCt, 38-1 usct ¶9152, 303 US 391 (1938) (holding that Congress may impose both a criminal and a civil sanction in respect to the same act or omission); *Morse*, CA-8, 419 F3d 829, 833-35 (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 IRS, the doctrine of *res judicata* did not apply to preclude a civil fraud penalty assessment on a tax deficiency because a criminal prosecution for filing false income tax returns did not involve the same cause of action as a civil tax deficiency case).
- <sup>22</sup> In e-mailed advice, the IRS advised that a closing agreement (Form 906) should make clear to the taxpayer that it has no bearing on the assessment of court-ordered restitution because the IRS is precluded from collecting in full both the restitution-based assessment and the civil tax liabilities under the closing

agreement for the same tax period. The IRS's determination of civil tax liabilities and penalties for a tax period is separate and distinct from a court's order of restitution. However, the use of a closing agreement for those tax periods will have no bearing or effect on the IRS's required assessment under Code Sec. 6201(a)(4)(A) of an amount ordered as restitution. CCA 2013043011575554 (Apr. 30, 2013).

- <sup>23</sup> The prohibition against challenges to the amount of restitution in Title 26 proceeding includes but is not limited to deficiency, collection due process and refund cases.
- <sup>24</sup> For example, a taxpayer is ordered to pay \$100,000 in restitution for the tax period ending Dec. 2010, and the IRS subsequently examines the taxpayer for the same tax period. Pursuant to the examination, the IRS determines a civil tax liability of \$150,000. The taxpayer timely requests that an NOL deduction from the tax period ending Dec. 2011 be carried back to the tax period ending Dec. 2010, which would reduce his tax liability by \$100,000. If the IRS allows the NOL carryback, the taxpayer's civil tax liability would be reduced to \$50,000, and any penalties would be based upon the amount of the remaining civil tax liability. The IRS 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 IRS is required to collect \$100,000 from the taxpayer for tax period ending Dec. 2010 to satisfy the restitution-based assessment because the IRS must "assess and collect the amount" ordered as restitution, regardless of whether the civil tax liability is determined to be less. Code Sec. 6201(a)(4)(A) (emphasis added). Because the IRS 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 tax liability of \$50,000. See *Tucker*, CA-8, 217 F3d 960; *Helmsley*, CA-2, 941 F2d 71, 102.
- <sup>25</sup> Pursuant to 18 USC § 3664(o)(1).

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