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THE TAX LAWYER

Ohtani Interpreter Gets Prison For $17 Million Theft — IRS Taxes Him

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Ippei Mizuhara, Shohei Ohtani's former interpreter, was convicted of stealing nearly $17 million from his boss and has been sentenced to 57 months in prison. His prison term starts March 24, and when his 57 months ends, he will have three years of supervised release. Plus, he was also ordered to pay Ohtani nearly $17 million in restitution. It could have been much worse. He might have gotten up to 33 years in prison after he pleaded guilty.

If he pays back his former boss the stolen money, does the IRS let him off the hook on taxes? Not hardly. As a general matter, taxes apply to all income, even illegal income. After all, that is what ultimately brought down Al Capone. He was not convicted of murder, graft or racketeering, but of income tax evasion. No matter how you make your living, the tax laws apply.

The U.S. has a long and rich tradition of taxing the criminal element. But for criminals, if you report your illegal income, it may be admitting to a crime. Claiming tax deductions can look even worse than reporting income in the first place. Besides, illegal payments like paying a hitman to get rid of a competitor are not deductible. So if Mizuhara pays back Ohtani, does the IRS let him off the tax hook?

No, every tax year stands on its own. So Mizuhara gets taxed in the year he pocketed the money. What happens later is a separate transaction in a later tax year. He *might* be able to eke out a tax deduction when he pays it back, but that is far from certain. People in this unenviable position may end up trying to claim an odd kind of tax refund under Section 1341 of the tax code.

It embodies the "claim of right" doctrine, and attempts to place the taxpayer back in the position he *would have been in* had he never received the income in the first place. To claim a deduction under Section 1341, the taxpayer must have included money in income in the prior year because he had an unrestricted right to it *then*. The taxpayer must learn in a *later* year that he did *not* have an unrestricted right to it after all (*i.e.*, he has to give it back).

Of course, Mizuhara did not have a right — unrestricted or otherwise — to the stolen $17 million in the first place, so it's not likely the IRS would give him his tax money back. The nuances of these rules are not simple, nor are the mechanics. And there are frequent problems in application and in the IRS reaction to it when it sees this on a tax return.

This unusual tax code provision surfaces most frequently when an employee has to return pay they received in a prior year. Returning pay for services you've performed can create *major* tax problems. The Dodd-Frank Wall Street Reform and Consumer Protection Act (PL 111-203) expanded SEC regulatory authority, particularly in the area of clawback liabilities that directors and officers face after a financial restatement. Paybacks can be required even when directors and officers had no knowledge of wrongdoing.

Clawbacks are not new. Section 304 of the Sarbanes-Oxley Act also has a clawback remedy. Yet it applies only to the CEO and CFO, and only for one year's compensation prior to a restatement. Sarbanes-Oxley's clawback provision also requires bad intent. If you have to give back pay, the tax code does not allow you to undo a prior transaction. Every tax year stands on its own and requires an annual tax return, but the giveback usually happens in a later tax year. Even these situations involve tricky taxes, and Mizuhara is probably out of luck.