BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
ELLEN E. MURPHY, Executrix of the)
Estate of JOHN P. MURPHY, Deceased)
and ELLEN E. MURPHY, Individually)

Appearances:

For Appellant: A. E. Levinson, Attorney at Law

For Respondent: J. J. Arditto, Franchise Tax Counsel; William L. Toomey, Jr., Assistant Franchise Tax Counsel.

O P I N I O N

This appeal is made pursuant to Section 19 of the Personal Income Tax Act (Chapter 329, Statutes of 1935, as amended) from the action of the Franchise Tax Commissioner upon the protest of Ellen E. Murphy as executrix of the estate of John P. Murphy, deceased, and Ellen E. Murphy, individually, to his proposed assessment of additional taxes in the amount of $172.01 and $309.08 for the income years ended December 31, 1935, and December 31, 1936, respectively.

In 1935 and 1936 Mr. John C. Murphy was head of a well-known fraternal organization. He was paid $6,000 in 1935, and $7,200 in 1936 for his services. He and Mrs. Murphy filed joint returns for both years. In their 1935 income tax return taxpayers showed the following:

F. R. Hand, Toronto, Canada, $6,000, less expenses $2,564.58--Net $3,435.42.

In their 1936 income year return they showed the following:

Independent Order of Foresters, Toronto, Canada, $7,200, less expense $2,552.00--Net $4,648.00.

An adjustment of the 1935 return resulted in an additional assessment of $10.35 which was paid. An audit by the Commissioner disclosed additional tax liability for the income year 1936 in the sum of $181.29. This additional tax was based on the sale of a piece of real property in San Francisco by the taxpayers which they reported as a loss, but which after adjusting items of depreciation resulted in a profit. This additional tax was paid.

For the year 1935 Mrs. Murphy received from the Order of Foresters, the sum of $9,316.00 and for the year 1936 she received the sum of $8,533.86, neither of which amounts were reported nor

disclosed, nor was there anything set forth in either return from which the Commissioner could have been put on notice or inquiry that additional income in a very substantial amount had been received but not reported.

It appears from the testimony of A. E. Levinson that while he was acting as attorney for Mrs. Murphy during 1940 he learned of this omission and after discussing it with Mrs. Murphy reported the fact to the Federal Revenue Agent who made an audit which resulted in a deficiency assessment which was paid in October of 1940, and that at about the time the federal audit was completed he called the facts to the attention of the Franchise Tax Commissioner.

Mrs. Murphy did not testify or appear at the hearing of this appeal and there was no direct evidence as to why she failed to report this income in the joint return. The reason advanced by her counsel, A. E. Levinson, was that at the time the returns were filed she was advised by an attorney, also named Murphy, that the omitted items of income were not United States income and should not be reported.

Although a finding of constructive fraud might be justified by the facts, we deem it unnecessary to decide whether there was fraud. The question presented is: Where taxpayers in reporting their income from all sources omit entirely a substantial part of that income and their returns do not contain any information whatsoever concerning the unreported income, nor the slightest suggestion that unreported income in a very substantial amount has been received, does the four-year period specified in Section 19 commence to run from the filing of the return, insofar as the unreported income is concerned?

For the income years in question the Personal Income Tax Act of 1935 (Statutes of 1935, page 1090) provided, in part, as follows:

> "Section 3. (a) Every person taxable under this act shall make a return to the commissioner, stating specifically the items of his gross income and the deductions and credit allowed by this act..."
>
> "Section 5. (a) There shall be levied, collected and paid for each taxable year upon the entire net income of every resident of this state, and upon the net income of every nonresident which is derived from sources within this state, taxes..."
>
> Section 7 defined gross income.
>
> Section 19 as amended by the Statutes of 1941, p. 3074 provides in part,
>
> "Except in the case of a fraudulent return, every notice of a proposed deficiency tax shall be mailed to the taxpayer within four years after the return was filed, and no deficiency shall be

assessed or collected with respect to the year for which such return was filed, unless such notice is mailed within such period...."

The returns upon which Appellant relies were filed more than four years before such notice was mailed.

Various federal acts have contained provisions similar to the quoted provisions of the California act. Some of them are referred to in the cases hereinafter cited.

In John D. Alkire Inv. Co. v. Nicholas, 114 Fed. (2d) 607, 610, the court held that the first returns filed by taxpayer did not comply in a substantial degree with the requirements of the statute in respect to disclosing the requisite information essential to the making of assessments and that they did not suffice to start the period of limitation. The court said:

"The taxpayer no longer contends that the rentals did not represent gains for which it was subject to be taxed. Its sole contention now is that the deficiency assessments were barred by the statutes of limitation-the three-year period from the filing of the return provided in the Revenue Act of 1926, and the two-year period-provided in the subsequent acts. That contention turns upon whether the returns currently made for the years in question were returns within the meaning of the statutes of limitation. Section 239 and 52, supra, respectively, required every corporation to make a return 'stating specifically the items of its gross income and the deductions and credits allowed***.' The burden was thus cast upon the taxpayer to furnish by return the information on which assessments were to be made. And by providing that the period of limitation should begin to run from the filing of the return, the statute manifested a clear legislative intent that the period should begin only when the taxpayer had furnished such information in the manner prescribed. Florsheim Bros. Co. v. United States, 280 U. S. 453, 50 S. Cts. 215, 74 L. Ed. 542.

"Meticulous accuracy, perfect completeness, or absence of any omission is not exacted. But a return which fails to comply in a substantial degree with the requirements of the statute in respect to disclosing the requisite information essential to the making of assessments does not suffice to start the period of limitation.

"These returns represented that the taxpayer had made disposition of its income bearing property, had no gross income, was entitled to no deductions or credits, and had no net income. Disposition had been made of the income bearing property, but it had

been conveyed in trust with power of revocation reserved to the taxpayer. And that provision in the transaction of conveyance made the taxpayer liable for the tax on the income. That was a significant and decisive feature of the conveyance in respect to the taxpayer's liability for the tax. Yet the returns were silent concerning it. They did not indicate or suggest even vaguely or remotely that the disposition was in trust with the right of revocation reserved. They were utterly barren of any information which could put the commissioner on notice that the disposition was not made in the ordinary manner but was in trust with reservation of the power of revocation, in consequence of which the taxpayer was liable for the tax, therefore, and assessments were in order. More than that, the notation that disposition had been made of all the income bearing property and the representation that there was no gross income, net income, or taxable gain, considered together, strongly suggested that the conveyance had been made in the usual manner, not in trust with the power of revocation reserved. While there was no intentional fraud, wilful negligence or purposed attempt at evasion of tax on the part of the taxpayer, the returns not only failed to disclose requisite information but were misleading and calculated to prevent discovery of material facts. Returns of that kind are not effective to start the period of limitation running."

In National Contracting Co. v. Commissioner of Internal Revenue, 105 Fed. (2d) 488, 491, 492, it was also held that the returns filed by taxpayer did not set the statute of limitations in operation, the court saying:

"... the Board found: 'On its face only the formal parts at the top of the form were filled in, and a typed sheet was pasted to the form, which states in substance that the return is submitted subject to the final disposition of the petitioner's tax liability for the years 1920-1924 "Now pending before the Commissioner of Internal Revenue" and that the right is reserved to amend the return upon such final disposition since there are items pending which affect the year 1925. This rider states further that, the taxpayer having elected to report on a completed contract basis, there is no taxable profit since no contracts were completed during the taxable year, and all expenses during the year were assigned to contracts under way and not completed. The remainder of the form contains only comparative balance sheets as of the beginning and the end of the year, and the verification affidavit subscribed to by the president and treasurer of the petitioner.'

"The document is in the record and conforms to its

description by the Board. We think the Board correctly held that as the document filed by the taxpayer did not state, or attempt or purport to state, the items of its gross income or deductions or credits as required by section 239 of the Revenue Act 1926, they were not the returns required by that section, and that their filing did not set the statute of limitations in operation. Lucas v. Pilliod Lumber Co. 281 U. S. 245, 50 S. Ct. 297, 74 L. Ed. 829, 67 A. L. R. 1350; Florsheim Bros. v. United States, 280 U. S. 453, 50 S. Ct. 215, 74 L. Ed. 542,. They did not evince 'an honest and genuine endeavor to satisfy the law' requiring items of gross income deductions and credits to be returned. Zellerbach Paper Co. v. Helvering, 293 U. S. 172-180, 55 S. Ct. 127, 131, 79 L. Ed. 264

****

". . . This taxpayer did not supply to the Commissioner any substantial basis for tax determination in any document signed by its officers, nos did it make any good-faith attempt to do so."

These two cases support the contentions of the Commissioner that taxpayer's returns did not start the limitation period.

Appellant has cited Zellerbach Paper Co. v. Helvering, 293 U. S. 172, Clifton Mfg. Co. v. United States, 293 U. S. 186 and National Paper Products Company v. Helvering, 293 U. S. 183, in which the law was amended after the original returns were filed. It appears that the original returns did comply with the statute at the time they were filed and it was held that they started the period of limitations,

In Zellerbach Paper Co. v. Helvering, supra, the court said:

"Perfect accuracy or completeness is not necessary to rescue a return from nullity, if it purports to be a return, is sworn to as such (Lucas v. Pilliod Lumber co., 281 U. S. 245), and evinces an honest and genuine endeavor to satisfy the law."

The returns involved in this appeal, when considered in the light of the admitted facts, do not appear on their face to evince "an honest and genuine endeavor to satisfy the law" and there has not been introduced any direct evidence to show that an honest and genuine endeavor was made to satisfy the law.

Appellant has also cited Mitchell v. Commissioner of Internal Revenue (November 1941), 45 B. T. A. 822, where gross negligence was held not to be fraud. In that case it was not contended by the Commissioner that the return did not comply in a substantial degree with the requirements of the statute.

Appeal of Ellen E. Murphy, Executrix of the Estate of John P. Murphy, Deceased and Ellen E. Murphy, Individually

O R D E R

Pursuant to the views expressed in the opinion of the Board in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED that the action of Chas. J. McColgan, Franchise Tax Commissioner, in overruling the protest of Ellen E. Murphy as executrix of the estate of John P. Murphy, deceased, and Ellen E. Murphy, individually, to the proposed assessment of additional taxes in the amounts of $172.01 and $309.08 for the income years ended December 31, 1935, and December 31, 1936, respectively, be and it is hereby affirmed.

Done at Sacramento, California, this 15th day of July 1943, by the State Board of Equalization.

R. E. Collins, Chairman
J. H. Quinn, Member
Geo. R. Reilly, Member

ATTEST: Dixwell L. Pierce, Secretary