BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
GEORGE W. FAIRCHILD)

Appearances:

For Appellant: Herbert E. Selwyn
Attorney at Law

For Respondent: Richard C. Creeggan
Counsel

O P I N I O N

This appeal is made pursuant to section 18594 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of George W. Fairchild against proposed assessments of fraud penalties in the amounts of $357.03, $359.01, $365.88, and $509.25 for the years 1963, 1964, 1965, and 1966, respectively. The deficiencies on which the penalties were based have been paid by appellant and are not in issue.

The issue presented is whether appellant is liable for penalties for fraud with intent to evade tax because of his failure to file timely personal income tax returns for the four years in question.

During those years appellant was unmarried and had no dependents. He is a mathematician, and since 1956 he has been employed as a scientific programmer by several different corporations in the Los Angeles area. In each appeal year his salary totaled between $18,000 and $20,000 and constituted his primary source of income. He also received dividends from stock amounting to from $100 to $200 per year, and interest from savings accounts of between $500 and $800 a year. During the years 1964 and 1966, appellant also sold various securities.

Appellant filed timely California personal income tax returns for the years 1960 and 1961. He did not file timely state returns for the years 1962 through 1967, inclusive, nor did he file timely federal income tax returns for the years 1962 through 1966, inclusive. After discovering that appellant had not filed a state return for 1962, respondent issued an assessment for that year on March 26, 1965. Appellant paid this assessment on April 8, 1965. On June 3, 1965, respondent mailed a letter to appellant concerning his failure to file a return for 1963. The letter demanded that a 1963 return be filed and also advised that, if a 1964 return had not been filed,,.this should be done immediately. Blank forms for 1963 and 1964 were enclosed, along with instructions, and a response within twenty days was requested. When respondent failed, to receive a response to this letter, it sent another letter to appellant on July 20, 1965. This letter was captioned "IMPORTANT 5-DAY COLLECTION NOTICE" and requested that appellant file a 1963 return within five days. This letter likewise went unanswered. Neither of the two letters was returned undelivered because of incorrect address.

Early in 1968, respondent began to investigate the circumstances surrounding appellant's failure to file returns for preceding years. Thereafter, on December 15, 1968, appellant filed delinquent returns for the years 1963 to 1967, inclusive. These returns included a penalty of 25 percent for delinquent filing, as provided in Revenue and Taxation Code section 18681, for the years 1963 to. 1966. Respondent assessed this same penalty for-1967 and appellant paid it.

A further result of respondent's investigation into these matters was the criminal prosecution of appellant for violations of the penal provisions of the Personal Income Tax Law. For each of the years 1964, 1965, and 1966, appellant was charged with violating Revenue and Taxation Code section 19406. That section makes it a felony for any person to wilfully fail to file a return with intent to evade the personal income tax. On December 19, 1968, appellant was acquitted of these felony charges but was convicted of the misdemeanor prescribed by Revenue and Taxation Code section 19401, viz., failure' to file a return with or without intent to evade any requirement of the Personal Income Tax Law.

Finally, on June 30, 1969, respondent issued Notices of Proposed Assessment for the years 1963 through 1966, adding to the tax 'and penalties already paid for each year the 50 percent civil penalty prescribed in Revenue and Taxation Code; section 18685 for fraud with

intent to evade tax. Appellant protested these assessments and appeals from respondent's denial of his protest.

The Franchise Tax Board has the burden of proving fraud by clear and convincing evidence (Appeal of George R. Wickham and Estate of Vesta B. Wickham, Cal. St. Bd. of Equal., Aug. 3,1965; Appeal of Richard A. and Virginia R. Ewert, Cal. St. Bd. of Equal., April 7, 1964), and this burden may be satisfied by circumstantial evidence. (Powell v. Granquist, 252 F.2d 56,61.) Fraud implies bad faith, intentional wrongdoing and a sinister motive. (Jones v. Commissioner, 259 F.2d 300, 303; Powell v. Granquist, supra, 252 F.2d at 60.) The taxpayer must have the specific intent to evade a tax believed to be owing. (Appeal of Richard A. and Virginia R. Ewert, supra; Powell v. Granquist, supra, 252 F.2d at 60.) Fraud is never imputed or presumed, and findings of fraud should not be sustained upon circumstances which at most create only suspicion. (Jones v. Commissioner, supra, 259 F.2d at 303.)

We have not heretofore been called upon to consider an appeal involving fraud penalties which are based on a taxpayer's failure to file any returns over a period of years. However, it is well established under the comparable federal civil fraud statute (section 6653(b) of the Internal Revenue Code of 1954) that the fraud penalty may properly be imposed when a taxpayer willfully fails to file returns, as well as when he files intentionally false returns. (Powell v. Granquist, supra; Cirillo v. Commissioner, 314 F.2d 478; Stoltzfus v. United States, 398 F.2d 1002; Kahr v. Commissioner, 414 F.2d 621.) Although the federal courts agree that willful failure to file a timely return does not, in itself and without more, establish liability for fraud (Jones v. Commissioner, supra; Powell v. Granquist, supra; Cirillo v. Commissioner, supra; Stoltzfus v. United States, supra), the Courts of Appeal do not agree on what "more" must be shown. The Fifth and Eighth Circuits require an independent, affirmative act of misrepresentation or concealment (Jones v. Commissioner, supra; First Trust & Savings Bank v. United States, 206 F.2d 97), while the Third Circuit requires only some "affirmative indication" of fraudulent intent. (Cirillo v. Commissioner, supra; Stoltzfus v. United States, supra.) The Ninth Circuit does not follow either of those two tests but simply considers the taxpayer's failure to file along with other relevant facts indetermining whether there was an intent to evade tax. (Powell v. Granquist, supra.)

Under the circumstances present in this appeal, it is unnecessary for us to decide on the proper test of

fraudulent intent for purposes of Revenue and Taxation Code section 18685. In this case there is nothing other than appellant's failure to file timely returns to show fraudulent intent, and it is clear from all the above cited authorities that such failure alone is not enough to sustain fraud penalty. The only other fact which might conceivably bear on appellant's intent is his failure to respond to the letters demanding that he file a 1963 return. However, since a taxpayer's failure to file a return after notice and demand by the Franchise Tax Board is itself grounds for a penalty of 25 percent of the tax due, Revenue and Taxation Code, section 18682, we think the Legislature intended to deal with such failure to file and with fraud in two different ways. (See Jones v. Commissioner, supra, 259 F.2d at 320; Spies v. United States, 317 U.S. 492 [87 L. Ed. 418].) There is nothing in the statutory scheme of penalties to suggest that the identical facts furnishing grounds for a 25 percent penalty also afford a basis for a further 50 percent penalty for fraud.

When appellant's derelictions finally came to light, he fully cooperated with respondent's representatives in determining the amount of back taxes which he owed. He has now paid those taxes, along with delinquency penalties and interest and a heavy fine for his misdemeanor conviction. Since his income came almost exclusively from sources having independent records of what was paid to him, the amount of tax owed was not difficult to compute or to verify. There is no evidence of concealment, misrepresentation or subterfuge on the part of appellant. (Jones v. Commissioner, supra, 259 F.2d at 304.) In short, we do not have here a taxpayer "knowingly and willfully defiant, withholding and dedicated to a plan of nonpayment of taxes." (Powell v. Gransuist, supra, 252 F.2d at 60.) At the most, appellant was extremely neglectful of his duty to file returns and pay his taxes; Although appellant's failure to perform his known duty was reprehensible, and in fact led to very serious consequences for him, we do not think that this record contains clear and convincing proof of a bad faith motive to defraud the state. Accordingly, the fraud penalties cannot stand.

O R D E R

Pursuant to the views expressed in the opinion of the board on file; in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section 18595 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of George W. Fairchild against proposed assessments of fraud penalties in the amounts of $357.03, $359.01, $365.88, and $509.25 for the years 1963, 1964, 1965, and 1966, respectively, be and the same is hereby reversed.

Done at Sacramento, California, this 27th day of October, 1971, by the State Board of Equalization.

_____, Chairman

_____, Member

_____, Member

_____, Member

_____, Member

ATTEST: _____, Secretary