BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
HUBBARD D. AND CLEO M. **WICKMAN**)

For Appellants: Hubbard D. **Wickman**, in pro. per.

For Respondent: James C. Stewart
Counsel

O P I N I O N

This appeal is made pursuant to section 18593 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Hubbard D. and Cleo M. **Wickman** against a **proposed assessment** of additional personal income tax in the amount of **$11,632.81** and a fraud penalty in the amount of **$5,816.40** for the year 1974.

The issues presented, by this appeal are: (1) whether respondent's proposed assessment of additional tax based upon corresponding federal action was proper, and (2) whether a civil fraud penalty was properly imposed by respondent.

Appellants, husband and wife, filed joint state and federal income tax returns for 1974. During that year, Mr. Wickman was employed as an automobile salesman in San Jose, California, and Mrs. Wickman was a housewife. In their 1974 state return, filed on February 3, 1975, they reported salary income of $14,122, presumably derived from Mr. Wickman's automobile sales activity.

In March of 1975, a criminal complaint was filed in Santa Clara County charging Mr. Wickman (hereafter appellant) with eleven counts of violation of section 484 of the California Penal Code. Appellant pleaded guilty to all of those grand theft charges. In due course he was convicted and sentenced to state prison, where he remained from September 18, 1975, through August 16, 1977. According to a statement prepared pursuant to section 1203.01 of the Penal Code by the trial judge and the deputy district attorney who handled appellant's case, his crimes were perpetrated in the following manner:

> Mr. Wickman was a longtime automobile salesman in the San Jose area and had numerous business and social contacts. Sometime in January, 1974, he contrived a scheme to fraudulently obtain monies. The scheme was this: he approached various friends and acquaintances with the proposal that he needed monies to make payments on automobiles purchased in Europe for delivery to doctors, dentists and similarly financially situated peoples. He would show fictitious purchase orders to his victims and induce them to invest sums of money ranging from $2,400 to $44,542 with the promise of interest plus a substantial "bonus". There were eleven victims in all ranging from a college student to elderly retired couples as well as a substantial businessman. The "investments" ranged in time from January, 1974 to November, 1974. Some monies were repaid in the form of "interest" but the outstanding amount realized by the defendant was about $132,000.

Appellants reported no income from the above described activities on their federal or state income tax return for 1974.

In 1975, appellants' 1974 federal return was audited by the Internal Revenue Service. The resulting deficiency assessment was based primarily upon that agency's determination that appellants had understated their gross income for 1974 by some $113,917.1/ A 50' percent civil fraud penalty was also imposed, pursuant to section 6653(b) of the Internal Revenue Code. Appellants apparently consented to that assessment of tax and penalty. Upon being advised of the final federal determination, respondent made a corresponding increase in appellants' reported income for 1974 and recomputed their California tax liability accordingly. Respondent also added a 50 percent civil fraud penalty, pursuant to section 18685 of the Revenue and Taxation Code. Appellants protested and, in due course, respondent affirmed its entire assessment. This timely appeal followed.

The substance of Mr. Wickman's argument in opposition to the assessment of tax and penalty is that he did not realize any income from his fraudulent, money-making scheme. He contends that after the scheme got underway, it was necessary for him to continue borrowing money in order to make principal and interest payments on previous obligations he had incurred and, consequently, any profits he had hoped to make from his

1/ Although we have no information regarding the scope of the federal investigation, it appears that this determination may have been based upon information contained in the aforementioned California Penal Code section 1203.01 statement as to the "outstanding amount realized" by appellant from his unlawful activities. In arriving at the amount of his unreported income, the Internal Revenue Service apparently made some allowance for "interest" paid by appellant, reducing the amount of his estimated gains from $132,000 to $113,917. Respondent used this reduced figure in computing the state deficiency assessment, and it has indicated that if appellant were to furnish proof of his entitlement to additional interest deductions for 1974, further adjustments in the amount of the deficiency would be considered.

deception were consumed. Mr. Wickman urges that he and his wife reported all of their "true income" in the state and federal returns which they filed for 1974.

We shall first concern ourselves with the propriety of the asserted tax deficiency, which is based upon a federal audit. It is well settled that a deficiency assessment issued by respondent on the basis of corresponding federal action is presumed to be correct, and the burden is on the taxpayer to prove it erroneous. (Appeal of Excel and Veronica L. Hunter, Cal. St. Bd. of Equal., Dec. 11, 1979; Appeal of Nicholas H. Obritsch, Cal. St. Bd. of Equal., Feb. 17, 1959.) The taxpayer cannot merely assert the incorrectness of an assessment and thereby shift the burden to respondent to justify the tax and the correctness thereof. (Todd v. McColgan, 89 Cal.App.2d 509 [201 P.2d 414] (1949); Appeal of Samuel and Ruth Reisman, Cal. St. Bd. of Equal., March 22, 1971.) Other than their own self-serving statements, appellants herein have offered no evidence to show error in the federal determination that they had substantial income which they did not report on their 1974 tax return. The fundswhich Mr. Wickman fraudulentlv obtained durinq 1974 were includible in his gross income for that year.- (See James v. United States, 366 U.S. 213 [6 L.Ed.2d 246] (1961).) Under the circumstances, we must conclude that appellants have failed to show error in the federal deficiency or in respondent's corresponding assessment of additional tax due for 1974.

The 50 percent fraud penalty asserted by respondent against appellants presents a different question. The burden of proving fraud is upon respondent, and it must be established by clear and convincing evidence, something impressively more than a slight preponderance of the evidence. (Valetti v. Commissioner, 260 F.2d 185, 188 (3d Cir. 1958); Appeal of Matthew F. McGillicuddy, Cal. St. Bd. of Equal., July 31, 1973.) Fraud is actual, intentional wrongdoing, coupled with a specific intent to evade a tax believed to be 'owing. (Marchica v. State Board of Equalization, 107 Cal.App.2d 501, 509 [237 P.2d 725] (1951).) It implies bad faith and a sinister motive. (Jones v. Commissioner, 259 F.2d 300, 303 (5th Cir. 1958).) Although fraud may be, and often must be, established by circumstantial evidence (Powell v. Granquist, 252 F.2d 56, 61 (9th Cir. 1958)), it is never presumed, and a fraud penalty will not be sustained upon circumstances which, at most, create only a suspicion. (Jones v. Commissioner, supra, at p. 303;

Appeal of Eli A. and Virginia W. Allec, Cal. St. Bd. of Equal.; Jan. 7, 1975.)

Respondent acknowledges that its burden of proof on the issue of fraud cannot be sustained by mere reliance on a federal audit report in which the fraud penalty was asserted against the taxpayers. (Appeal of William G., Jr. and Mary D. Wilt, Cal. St. Bd. of Equal., March 8, 1976; Appeal of M. Bunter and Martha J. Brown, Cal. St. Bd. of Equal., Oct. 7, 1974.) Respondent maintains, however, that the supplemental documents which it has introduced establish that the tax deficiency asserted against appellant was due to fraud.[2/] In support of its position, respondent relies on the following undisputed facts: (1) appellant's fraudulent method of obtaining money, (2) his plea of guilty to eleven counts of grand theft, (3) his failure to report any of such income in his California tax return, and (4) his acceptance of the federal fraud penalty. From these facts, respondent would have us infer that Mr. Wickman knowingly and intentionally filed a fraudulent California personal income tax return for 1974. This we cannot do, for the reasons hereafter stated.

Mere failure to report income received is not sufficient proof of fraud. (L. Glenn Switzer, 20 T.C. 759, 765 (1953); Appeal of Eli A. and Virginia W. Allec, supra.) An understatement may have resulted from ignorance, bad advice, honest mistake, negligence, or misinterpretation of law, none of which in itself would constitute fraud. (See Marchica v. State Board of Equalization, supra, 107 Cal.App.2d at 510.) Appellant has expressed his belief that he had no unreported income in 1974 because he netted no profit from his money-making scheme. While we do not find this explanation terribly persuasive, neither are we convinced on

2/ Those documents consist of copies of (1) appellants' 1974 joint California personal income tax return: (2) respondent's notice of proposed assessment for 1974 based upon the federal audit report; (3) the criminal complaint charging Mr. Wickman with grand theft; and (4) the aforementioned Penal Code section 1203.01 statement prepared after Mr. Wickman's conviction by the trial judge and the deputy district attorney handling the case.

the basis of the evidence before us that Mr. **Wickman** was fully aware of the taxability of his ill-gotten gains and willfully omitted them from his 1974 return, with the specific intent to defraud the state. Insofar as the preparation of that tax return is concerned, respondent has produced no evidence of affirmative acts of concealment, misrepresentation or subterfuge on Mr. Wickman's part, and proof of grand theft simply is not clear and convincing proof of tax fraud. Mr. Wickman's consent to the federal fraud penalty is inconclusive, since we know none of the circumstances surrounding such consent. Although the facts of this case admittedly create a suspicion of a fraudulent intent to evade tax, mere suspicion is not enough. (Jones v. Commissioner, supra; L. Glenn Switzer, supra.)

For the above reasons, we conclude that appellants **have** failed to discharge their burden of establishing error in respondent's proposed assessment of additional tax for 1974, and the assessment of tax will therefore be sustained. We must reverse respondent with respect to the civil fraud penalty, however, for we cannot say, on the basis of the record before us, that respondent has established by clear and convincing evidence that the fraud penalty was properly asserted against appellants for 1974.

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 Hubbard D. and Cleo M. Wickman against a proposed assessment of additional personal income tax in the amount of $11,632.81 for the year 1974, be and the same is hereby sustained, and that the action of the Franchise Tax Board on the protest of Hubbard D. and Cleo M. Wickman against a proposed assessment of a fraud penalty in the amount of $5,816.40 for the year 1974, be and the same is hereby reversed.

Done at Sacramento, California, this 2nd day of February, 1981, by the State Board of Equalization, with Members Dronenburg, Bennett, Nevins and Reilly present.

Ernest J. Dronenburg, Jr., Chairman

William M. Bennett, Member

George R. Reilly, Member

_____, Member

_____, Member