BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
ROBERT V. ERILANE)

Appearances:

For Appellant: Robert V. Erilane, in pro. per.

For Respondent: Karl F. Munz
Counsel

OPINION

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 Robert V. Erilane against proposed assessments of additional personal income tax and penalties in the amounts and for the years as follows:

	Years			
	1966	1967	1968	1969
Tax	$ 59.41	$ 43.55	$127.27	$114.90
Delinquent Penalty	14.85	10.89	31.82	17.24
Notice and Demand Penalty	14.85	-		
Underpayment of Estimated Tax Penalty	-	13.36	30.37	34.52
Fraud Penalty	133.59	353.78	379.64	431.45
Total	$222.70	$421.58	$569.10	$598.

Respondent has conceded that the $14.85 notice and demand penalty for 1966 and the underpayment of estimated tax penalties in the amounts of $13.36, $30.37, and $34.52, for the years 1967, 1968, and 1969, respectively, were improperly assessed and should be withdrawn.

The two primary issues for determination in this matter are: (1) whether disallowance of claimed deductions for each of the appeal years were proper; and (2) whether appellant is liable for civil fraud penalties for the years 1966, 1967, 1968, and 1969.

Shortly after he graduated from the Massachusetts Institute of Technology in 1959 appellant moved to California where he has resided ever since. He has been employed by the Aerospace Corporation in the Los Angeles area since 1962, first as an engineer and most recently in a managerial capacity. His gross salary, as reported to respondent by his employer, was $15,198.50, $16,264.50, $17,511.00, and $19,065.00 for the years 1966, 1967, 1968, and 1969, respectively. The record discloses no other sources of income in those years, during which appellant was unmarried and had no dependents;

Sometime prior to March 20, 1970, respondent made a diligent search of its files and was unable to locate personal income tax returns for appellant for the years 1966, 1967 and 1968. Respondent's files also disclosed that appellant had last filed a state income tax return in 1962. On that return appellant's income was understated. Therefore, a deficiency assessment was issued on May 24, 1966, which was finally collected on July 10, 1967, through garnishment of appellant's wages. Thereafter, appellant failed to respond to two demand letters that he file a return for 1965, and a provisional

assessment was issued as of September 29, 1967. This assessment also had to be collected by garnisheeing appellant's wages early in 1968. Similarly, respondent's files indicated that it had issued two letters in 1968 demanding that appellant file a 1966 income tax return. No return or reply was ever received pursuant to those demand letters. However, for some reason which does not appear in the record, respondent did not estimate appellant's income for 1966 nor did it levy any tax for that year.

After concluding the search of its files, respondent instituted an official income tax investigation of the matter on March 20, 1970. On that date a special agent and an auditor attempted to conduct a personal interview with appellant concerning his filing status for 1966, 1967 and 1968. They were unable to contact appellant in person but the special agent spoke to him by telephone from the lobby of the building where he worked. During the course of the conversation, as reported by the special agent, appellant stated that he had filed state income tax returns for 1966, 1967 and 1968. Appellant also, allegedly, advised the special agent that he had the cancelled checks indicating payment for those years and would mail photostatic copies of those checks to respondent's Los Angeles office the following week. No copies of any checks were ever received by respondent. Appellant denies ever making these statements.

As a result of the investigation, criminal charges were instituted against appellant. He was charged with violating section 19406 of the Revenue and Taxation Code for each of the years 1966, 1967 and 1968. Section 19406 provides that it is a felony for any person to wilfully fail to file any return with intent to evade any tax imposed by the personal income tax law. On June 5, 1970, pursuant to the advice of counsel, appellant entered a plea of guilty to the first count of violating section 19406 relating to the year 1966. As a part of appellant's plea bargain the remaining two counts relating to 1967 and 1968 were dismissed. On July 13, 1970, appellant's motion to reduce the charge to a misdemeanor was granted and he was sentenced to a suspended one-year jail sentence, a $500.00 fine, and one year's probation. As a condition to his probation appellant was required to make "restitution" to the Franchise Tax Board. At the end of his probationary period the guilty plea was expunged and a not guilty plea entered pursuant to section 1203.4 of the Penal Code.

On June 8, 1970, after his guilty plea but prior to sentencing, appellant filed delinquent returns for 1966, 1967 and 1968. He filed a delinquent return for 1969 on June 19, 1970, with which he remitted $3,017.32 as a lump sum payment of his self-assessed taxes, penalties and interest for all four years.

Respondent audited appellant's returns and disallowed, either entirely or in part, certain deductions for bad debts, educational expenses, and casualty losses that appellant had claimed. Respondent also assessed penalties for late filing, failure to file after notice and demand and for the underpayment of estimated tax. Finally, respondent determined that appellant was liable for the 50 percent fraud penalty prescribed by section 18685 of the Revenue and Taxation Code. In accordance with its determination respondent issued notices of proposed assessments for the four years in question. Appellant protested the proposed assessments and his protest was denied.

DISALLOWANCE OF DEDUCTIONS

It is well established that the taxpayer who claims a deduction has the burden of proving that he is entitled thereto. A determination by respondent that a deduction should be disallowed is supported by a presumption that it is correct. (New Colonial Ice Co. v. Helvering, 292 U. S. 435 [78 L. Ed. 1348]; Appeal of Nake M. Kamrany, Cal. St. Bd. of Equal., Feb. 15, 1972.) With one exception, which we will deal with separately, appellant has offered nothing beyond his own unsubstantiated allegations in support of his position. Therefore, we conclude that respondent's action in disallowing the unsubstantiated deductions was proper.

The only exception concerns respondent's denial of the $279.29 rental car expense claimed as part of appellant's 1966 casualty loss. In sustaining respondent's position with reference to this item it is sufficient to note that the applicable statute and regulation make no provision for an allowance for loss of use of a stolen. item. The fact that the rental expense may have been proximately related to the deductible theft loss is not controlling. (Rev. & Tax. Code, § 17206, subd. (c)(3); Cal. Admin. Code, tit. 18, regs. 17206(g), subd. (2)(A), 17206(h), subd. (3).) Accordingly, we conclude that respondent's action in disallowing this deduction was aiso correct.

Appeal of Robert V. Erilane

LIABILITY FOR CIVIL FRAUD PENALTIES

The burden of proving fraud is upon respondent, and it must be established by something impressively more than a slight preponderance of the evidence. It must be proved by clear and convincing evidence. (Valetti v. Commissioner, 260 F. 2d 185, 188; Appeal of George W. Fairchild, Cal. St. Bd. of Equal., Oct. 27, 1971.) Fraud implies bad faith, intentional wrongdoing and a sinister motive. (Jones v. Commissioner, 259 F. 2d 300, 303; Powell v. Granquist, 252 F. 2d 56, 60.), Although fraud may be established by circumstantial evidence (Powell v. Granquist, supra, at p. 61) it is never imputed or presumed, and it will not be sustained upon circumstances which, at best, create only suspicion. (Jones v. Commissioner, supra, at p. 303.)

The fraud penalty may properly be imposed when a taxpayer wilfully fails to file returns, as well as when he files intentionally false returns. (Powell v. Granquist, supra; Cirillo v. Commissioner, 314 F. 2d 478; Kahr v. Commissioner, 414 F. 2d 621.) However, to justify a fraud penalty the circumstances surrounding the failure to file returns must strongly and unequivocally indicate an intention to avoid the payment of tax. (Powell v. Granquist, supra; Cirillo v. Commissioner, supra.)

In previous cases we have held that mere failure to file, standing alone, was insufficient to sustain a finding of fraud. (Appeal of George W. Fairchild, supra; Appeal of Matthew F. McGillicuddy, Cal. St. Bd. of Equal., July 31, 1973.)

In Fairchild the appellant failed to file returns and ignored demands that he do so. After respondent commenced an official investigation, appellant filed returns and paid a self-assessed tax plus penalties and interest. Although charged with wilfully failing to file a return with intent to evade the personal income tax (Rev.. & Tax. Code, § 19406), appellant was convicted of the lesser offense of wilfully failing to file a return with or without intent to evade tax. (Rev. & Tax. Code, § 19401.)

In McGillicuddy the appellant also ignored notices and demands that he file returns although he did pay assessments when billed. Respondent maintained that various actions of appellant constituted badges of fraud which, 'when coupled with his failure to file, were sufficient to establish fraudulent intent. However,

respondent failed to establish any of these allegations as a matter of fact. Appellant pleaded guilty to three counts of wilfully failing to file a return, with or without intent to evade tax. (Rev. & Tax. Code, § 19401.)

The only substantial difference between the factual patterns presented in Fairchild and McGillicuddy and the factual pattern in the present appeal is the related criminal proceeding. Absent that one difference, we find the evidence in this case no more persuasive than we did in the earlier, cases. Appellant's conduct was clearly reprehensible and cannot be condoned. In fact, he has paid substantial penalties for such conduct. However, the fact that appellant's conduct was reprehensible does not mean that it was fraudulent. As we indicated in Fairchild, section 18682 of the Revenue and Taxation Code provides, as part of a comprehensive scheme of penalties, a penalty for failure to file after notice and demand. The same acts which would permit respondent, by timely assessment, to invoke this penalty will not be used to justify a penalty for fraud. Respondent would have us find evidence of bad faith, intentional wrongdoing, or a sinister motive in the fact that respondent had to garnish appellant's wages in 1967 and 1968 to collect deficiencies from prior years not in issue. This we cannot do in the face of appellant's unrebutted testimony that he was in serious financial difficulty during this period. (See, e. g. , Jones v. Commissioner, supra.) Finally, we do not find the contradictory evidence concerning alleged false statements to be a sufficiently compelling indication of deceitful conduct by appellant. The record does not establish, by clear and convincing evidence; that appellant possessed the specific intent to evade a tax which he knew was owing. (See generally, Jones v. Commissioner, supra; Phillip E. De Pumpo, T. C. Memo. , May 19, 1971; James W. Morrell, T. C. Memo., May 6, 1971; Renaud Ouellette, T. C. Memo. , May 6, 1971; George Gullott, T. C. Memo., March 21, 1966.) Thus, we must find appellant not liable for the civil fraud penalties unless his guilty plea is determinative.

With reference to appellant's guilty plea, respondent advances two arguments. First, respondent urges us to adopt the federal rule of collateral estoppel. Second, respondent takes the position that appellant's guilty plea relating to the year 1966 is an admission which, by itself, conclusively establishes that his failure to file returns for all years was fraudulent,

First, we will consider the issue of collateral estoppel. The effect of the doctrine of collateral estoppel is that any issue which has been determined by a court of competent jurisdiction is conclusively determined as to the parties and their privies, not only for the first action but also in subsequent actions, in which the same questions arise even though the cause of action may be different. (Bernhard v. Rank of America, 19 Cal. 2d 807, 810 [122 P. 2d 892]; Teitelbaum Furs, Inc. v. Dominion Ins. Co., Ltd., 58 Cal. 2d 601, 604 [25 Cal. Rptr. 559, 375 P. 2d 439]; see also Plunkett v. Commissioner, 465 F. 2d 299, 305, and the cases cited therein.)

It is true, as respondent maintains, that the federal courts have held the doctrine of collateral estoppel applicable not only to convictions for tax evasion after a trial on the merits (see, e.g., Tomlinson v. Lefkowitz, 334 F. 2d 262, cert. denied, 379 U. S. 962 [13 L. Ed. 2d 556]) but also to convictions based on guilty pleas. (See, e.g., Plunkett v. Commissioner, supra; Arctic Ice Cream Co., 43 T. C. 68.) The court in Arctic Ice Cream Co., supra, at page 75, stated:

> It is not material that Arctic's conviction was based upon a guilty plea, because for purposes of applying the doctrine of collateral estoppel, as well as for other purposes, there is no difference between a judgment of conviction based upon such a plea' and a judgment of conviction rendered after a trial on the merits. ... Arctic's plea of guilty to this indictment was therefore a conclusive judicial admission that its return for 1946 was false and fraudulent and that the deficiency in tax which was the necessary result of its being filed was due to fraud with intent to evade tax.

It is also true, as respondent points out, that the California courts have not determined, in a tax case, whether a plea of guilty in a prior criminal action will work a collateral estoppel in a subsequent civil proceeding. However, in a case not involving matters of taxation, the California Supreme Court has indicated that the identical question should be resolved adversely to respondent's position. (Teitelbaum Furs, Inc. v. Dominion Ins. Co., Ltd., supra; accord, O'Connor v. O'Leary, 247 Cal. App. 2d 646, 650 [56 Cal. Rptr. 1].) We see no reason, and respondent

offers none, why the result should be different in a tax matter as opposed to a nontax question.

In the Teitelbaum case, Justice Traynor stated at page 605:

> A plea of guilty is admissible in a subsequent civil action on the independent ground that it is an admission. It would not serve the policy underlying collateral estoppel, however, to make such a plea conclusive. "The rule is based upon the sound public policy of limiting litigation by preventing a party who has had one fair trial on an issue from again drawing it into controversy." (Bernhard v. Bank of America, 19 Cal. 2d 807, 811 [122 P. 2d 892].) "This policy must be considered together with the policy that a party shall not be deprived of a fair adversary proceeding in which fully to present his case." (Jorgensen v. Jorgensen, 32 Cal. 2d 13, 18 [193 P. 2d 728].) When a plea of guilty has been entered in the prior action, no issues have been "drawn into controversy" by a "full presentation" of the case. It rnay reflect only a compromise or a belief that paying a fine is more advantageous than litigation. Considerations of fairness to civil litigants and regard for the expeditious administration of criminal justice (see Vaughn v. Jonas, 31 Cal. 2d 586, 594 [191 P. 2d 432]) combine to prohibit the application of collateral estoppel against a party who, having pleaded guilty to a criminal charge, seeks for the first time to litigate his cause in a civil action.

In view of the pronouncement by the California Supreme Court in Teitelbaum, we believe 'that we are foreclosed from applying the doctrine of collateral estoppel where a taxpayer has suffered a criminal conviction pursuant to a plea of guilty, as opposed to a trial on the merits, to the same issue in a subsequent civil matter, notwithstanding the federal authorities to the contrary.

Although appellant's prior guilty plea does not work a collateral estoppel on the critical issue of fraud, it does operate as an admission against interest, even when subsequently dismissed

pursuant to section 1203.4 of the Penal Code. (Vaughn v. Jonas, 31 Cal. 2d 586, 594-596 [191 P. 2d 432].) However, appellant may contest the truth of the matters admitted by his plea of guilty, present all facts surrounding the same, including the nature of the charge and the plea, and explain why he entered such plea. (Arenstein v. California State Board of Pharmacy, 265 Cal. App. 2d 179, 191 [71 Cal. Rptr. 357].) In attempting to explain away his plea, appellant states that he did so, upon advice of counsel, to avoid an expensive trial, to attempt to- obtain a more reasonable settlement with respondent, and, because the district attorney agreed to dismiss the charges for 1967 and 1968 if he pleaded to the charge for 1966. When we weigh these statements against appellant's deliberate admission that he did, in fact, wilfully fail to file a personal income tax return for the year 1966 with the intent to evade tax, we find them wanting. We are, therefore, constrained. to hold that respondent properly asserted the civil fraud penalty for 1966.

Next, respondent urges that appellant's guilty plea for one year conclusively establishes that his failure to file returns for all years was fraudulent. In effect, respondent argues that appellant's plea, which related only to 1966, should be extended to 1967 and 1968, years for which the charges were dismissed, and to 1969, a year for which no charges were even filed. We cannot agree. It has long been held that proof of fraud in one year will not sustain the taxing authority's burden of proving fraud in another year. (Drieborg v. Commissioner, 225 F. 2d 216, 220; Thomas J. McLaughlin, 29 B. T. A. 247, 249) Accordingly we find that appellant is not liable for the civil fraud penalty in 1967, 1968 and 1969.

Finally, appellant alleges that he overpaid his tax liability for 1966 by $51.94, the amount of the notice and demand penalty he paid on his self-assessed tax for that year. The actual amount allocated to that penalty by appellant was $51.79. Respondent agrees that the $51.79 was an overpayment and accepts appellant's allegation as a claim for refund, but argues that no credit can be given because the claim is barred by the expiration of the statutory limit of section 19053 of the Revenue and Taxation Code. Section 19053 provides that no credit or refund shall be allowed unless a claim is filed within four years from the last date prescribed for filing the return or after one year from the date of the overpayment, whichever period expires the later. In view of the mandatory

language of the statute coupled with appellant's failure to comply, we are required to sustain respondent's action in disallowing any credit for the overpayment. (See Lynchburg Coal & Coke Co. v. United States, 47 F. Supp. 916.)

ORDER

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 Robert V. Erilane against proposed assessments of additional personal income tax, including penalties, of $222.70, $421.58, $569.10 and $598. 11 for the years 1966, 1967, 1968 and 1969, respectively, be and the same is hereby: (1) modified to reflect respondent's withdrawal of the notice and demand penalty for 1966 in the amount of $14.85, and the underpayment of estimated tax penalties for 1967, 1968 and 1969 in the amounts of $13.36, $30.37 and $34.52, respectively; and (2) reversed in respect to the assessment of fraud penalties in the amounts of $353.78, $379.64 and $431.45 for the years 1967, 1968 and 1969, respectively. In all other respects the action of the Franchise Tax Board is sustained.

Done at Sacramento, California, this 12th day of November, 1974, by the State Board of Equalization.

_____, Chairman

_____, Member

_____, Member

_____, Member

_____, Member

ATTEST: _____, Secretary