

**OFFICE OF TAX APPEALS**  
**STATE OF CALIFORNIA**

In the Matter of the Appeal of: )  
**J. COMPAGNO**<sup>1</sup> )  
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OTA Case No. 21098565

**OPINION**

Representing the Parties:

For Appellant: Steven M. Katz, Attorney  
For Respondent: Ariana Maceto, Attorney  
Bradley J. Coutinho,  
Assistant Chief Counsel

For Office of Tax Appeals: Michelle Huh, Attorney

T. LEUNG, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19045, J. Compagno (appellant) appeals an action by the Franchise Tax Board (respondent) proposing additional tax of \$66,194, plus interest, for the 2006 taxable year, \$162,247, plus interest, for the 2007 taxable year, \$201,574, plus interest, for the 2008 taxable year, \$234,675, plus interest, for the 2009 taxable year, \$185,089, plus interest, for the 2010 taxable year, and \$150,260, plus interest, for the 2011 taxable year.

Office of Tax Appeals (OTA) Administrative Law Judges Natasha Ralston, Kenneth Gast, and Tommy Leung held an electronic hearing for this matter on April 24, 2025. At the conclusion of the hearing, the record was closed and this matter was submitted for an opinion.

**ISSUE**

Whether respondent’s notices of proposed assessment (NPAs) for 2006 through 2011 (the taxable years at issue) are barred by the statute of limitations.

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<sup>1</sup> Although appellant filed joint returns with his former spouse, the former spouse is not a party to this appeal and for ease of reference, this opinion references the couples’ returns as appellant’s returns. Franchise Tax Board (respondent) granted appellant’s former spouse full innocent spouse relief pursuant to Revenue and Taxation Code section 18533(f). Because appellant does not contest or raise the issue of his former spouse’s request or grant of innocent spouse relief in his appeal letter, this appeal will not address respondent’s grant of innocent spouse relief to appellant’s former spouse.

FACTUAL FINDINGS

1. For the taxable years at issue, appellant was a resident of California and was licensed to practice medicine in this state. Appellant owned and operated John Compagno M.D., Inc., West Coast Pathology Laboratory, Inc., and Histopathology Reference Laboratory, Inc., which were all located in California.

2006 Through 2011 Tax Returns

2. During the taxable years at issue, appellant filed California personal income tax returns (Forms 540).
3. Appellant filed his 2006 Form 540 by the extended due date<sup>2</sup> and reported California adjusted gross income (AGI) of \$251,043, taxable income of \$179,781, and tax of \$11,995. After applying California income tax withholdings of \$10,748 and estimated tax payments of \$2,760, appellant reported an overpayment amount of \$1,513. Appellant requested to transfer \$640 of the overpayment amount to the following year as an estimate tax payment and refund the remaining amount of \$873.
4. Appellant filed his 2007 Form 540 by the extended due date<sup>3</sup> and reported California AGI of \$209,508, taxable income of \$135,485, and tax of \$8,023. After applying California income tax withholdings of \$4,140 and estimated tax payments of \$166, appellant reported an overpayment of \$2,166. Respondent adjusted appellant's estimated tax payments to \$4,780 to include the estimate tax payment of \$640 from the 2006 taxable year. Appellant requested to transfer \$2,000 of the overpayment amount to the following year as an estimate tax payment and refund the remaining amount.<sup>4</sup>
5. On November 30, 2009, appellant filed a 2008 Form 540 and reported California AGI of negative \$194,636, zero taxable income, and zero tax due. After applying California income tax withholdings of \$84,194 and estimated tax payments of \$2,000, appellant claimed an overpayment and refund of \$86,194.

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<sup>2</sup> Neither party provided the return filing date for the 2006 taxable year. However, respondent states in its opening brief that appellant filed his 2006 Form 540 within the automatic extension period.

<sup>3</sup> Similar to the 2006 taxable year, the parties do not disclose the return filing date for the 2007 taxable year. However, respondent states in its opening brief that appellant filed his 2007 Form 540 within the automatic extension period.

<sup>4</sup> Initially, appellant requested a refund amount of \$166, but with respondent's adjustment of the estimated tax payments, appellant received a refund amount of \$789.

6. On October 13, 2010, appellant filed a 2009 Form 540 and reported California AGI of \$2,929, zero taxable income, and zero tax due. After applying California income tax withholdings of \$7,411, appellant claimed an overpayment and refund of \$7,411.
7. On June 7, 2011, appellant filed a 2010 Form 540 and reported California AGI of \$166,178, taxable income of \$116,513 and tax of \$6,349. After applying California income tax withholdings of \$10,164, appellant claimed an overpayment and refund of \$3,815.
8. On May 15, 2012, appellant filed an amended California personal income tax return (Form 540X) for the 2010 taxable year. On the 2010 Form 540X, appellant reported an increase in California AGI from \$166,178 to \$192,923, an increase in taxable income from \$116,513 to \$143,793, and an increase in tax from \$6,349 to \$8,954, to account for retirement income of \$26,745 which was not previously included in the original return.
9. On October 15, 2012, appellant filed a 2011 Form 540 and reported California AGI of \$221,481, taxable income of \$196,802, and tax of \$13,190. After applying California income tax withholdings of \$9,185 and estimated tax payments of \$1,000, appellant reported a self-assessed tax balance of \$3,005.

#### Plea Agreement

10. On December 14, 2016, appellant and the United States Attorney's Office for the Northern District of California (U.S. Attorney's Office) entered into a plea agreement. According to the plea agreement:
  - a. Appellant agreed to plead guilty to tax evasion in violation of Internal Revenue Code (IRC) section 7201.<sup>5</sup>
  - b. From at least 2005 to 2016, appellant was the sole shareholder and chief executive officer of John Compagno M.D., Inc., West Coast Pathology Laboratory, Inc., and Histopathology Reference Laboratory, Inc.
  - c. Appellant approved and signed corporate tax returns for the 2005 through 2011 taxable years that included expenses that were not deductible.
  - d. Appellant caused the corporate tax return preparer to overstate expenses on the corporate returns for the taxable years 2005 through 2011.

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<sup>5</sup> IRC section 7201 provides:

"Any person who willfully attempts in any manner to evade or defeat any tax imposed by this title or the payment thereof shall, in addition to other penalties provided by law, be guilty of a felony and, upon conviction thereof, shall be fined not more than \$100,000 (\$500,000 in the case of a corporation), or imprisoned not more than 5 years, or both, together with the costs of prosecution."

- e. Appellant signed the corporate tax returns under penalties of perjury and filed them with the IRS.
- f. By overstating the corporate expenses on the corporate income tax returns for the 2005 through the 2011 taxable years, he understated the amount of federal corporate income tax due.
- g. Appellant approved and signed his personal tax returns for the taxable years at issue that omitted constructive dividends received from John Compagno M.D., Inc., West Coast Pathology Laboratory, Inc., and Histopathology Reference Laboratory, Inc., specifically in the amounts of \$706,736 in 2006, \$1,657,324 in 2007, \$2,359,000 in 2008, \$2,411,547 in 2009, \$1,833,674 in 2010, and \$1,536,810 in 2011.
- h. Appellant signed his Forms 540 for the taxable years at issue under penalties of perjury and filed them with the IRS.
- i. By omitting the constructive dividends, appellant understated the amount of federal individual income taxes he owed for the taxable years at issue.
- j. Appellant pled guilty to knowingly and willfully filing a false 2010 corporate tax return for John Compagno M.D., Inc., West Coast Pathology Laboratory, Inc., and Histopathology Reference Laboratory, Inc., with the IRS, that overstated corporate expenses, and thereby understated the taxes owed. Rather than accurately report the expenses and taxes owed on the corporate tax return, appellant knowingly and willfully overstated the corporate expenses and understated the taxes owed to evade the additional taxes the corporation owed.
- k. Appellant agreed that the plea agreement binds the U.S. Attorney's Office only, and does not bind any other federal, state, or local agency.

#### NPA's

- 11. Based on appellant's plea agreement with the U.S. Attorney's Office, respondent issued NPAs for each of the taxable years at issue on November 20, 2017, to include the constructive dividend income from John Compagno M.D., Inc., pursuant to R&TC sections 18622, 19057, and 19060(a).
- 12. For the 2006 taxable year, the NPA increased appellant's taxable income by \$706,736, from \$179,781 to \$886,517, and imposed additional tax of \$66,194, plus interest and penalties.

13. For the 2007 taxable year, the NPA increased appellant's taxable income by \$1,657,324, from \$135,485 to \$1,792,809, and imposed additional tax of \$162,247, plus interest and penalties.<sup>6</sup>
14. For the 2008 taxable year, the NPA increased appellant's taxable income by \$2,359,000, from negative \$260,147 to \$2,098,853, and imposed additional tax of \$201,574, plus interest and penalties.<sup>7</sup>
15. For the 2009 taxable year, the NPA increased appellant's taxable income by \$2,411,547, from negative \$49,318 to \$2,362,229, and imposed additional tax of \$234,675, plus interest and penalties.<sup>8</sup>
16. For the 2010 taxable year, the NPA increased appellant's taxable income by \$1,833,674, from \$143,793 to \$1,977,467, and imposed additional tax of \$185,089, plus interest and penalties.<sup>9</sup>
17. For the 2011 taxable year, the NPA increased appellant's taxable income by \$1,536,810, from \$196,802 to \$1,733,612, and imposed additional tax of \$150,260, plus interest and penalties.<sup>10</sup>
18. None of the NPAs imposed a fraud penalty.
19. The omitted income for each taxable year at issue exceeded 25 percent of appellant's reported gross income for each of those taxable years.
20. Appellant does not dispute respondent's computation of additional tax for each of the taxable years at issue.

#### Appellant's Protest

21. Appellant filed a protest dated January 17, 2018, for the taxable years at issue. In his protest, appellant argued that the NPAs were time-barred because R&TC section 19057

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<sup>6</sup> The additional tax amount was the total of tax of \$162,342 and a mental health service tax of \$7,928, less the reported tax amount of \$8,023 on the 2007 Form 540.

<sup>7</sup> The additional tax amount was the total of tax of \$190,585 and a mental health service tax of \$10,989.

<sup>8</sup> The additional tax amount was the total of tax of \$221,053 and a mental health service tax of \$13,622.

<sup>9</sup> The additional tax amount was the total of tax of \$184,268 and a mental health service tax of \$9,775, less the reported tax amount of \$8,954.00 on the 2010 Form 540X.

<sup>10</sup> The additional tax amount was the total of tax of \$156,522 and a mental health service tax of \$7,336, less the reported tax amount of \$13,190 on the 2011 Form 540.

- provides that taxes are assessed up to four years from the filing of the returns and the NPAs were issued beyond the four years from the filing of the returns.
22. Appellant also argued that there was no final federal determination of his federal tax liabilities within the meaning of R&TC sections 18622 or 19059, and that the amounts determined by the IRS criminal division and agreed to in the plea agreement were solely for the purposes of the criminal case and restitution.
  23. Appellant further argued that according to R&TC section 18622(d), there must be a date on which each adjustment or resolution resulting from an IRS examination was assessed pursuant to IRC section 6203, but since there was no assessment on December 14, 2016, that cannot be the date of the final federal determination.
  24. Appellant contended that he pled guilty to tax evasion for the 2010 federal corporate return and merely acknowledged that the returns overstated deductions or understated income and the understated tax due, but he did not admit to knowingly or willfully filing false returns.
  25. Appellant further argued that respondent did not satisfy its burden of proof to establish fraud by clear and convincing evidence.
  26. On August 13, 2021, respondent issued Notices of Action (NOAs) for the taxable years at issue, affirming the NPAs,<sup>11</sup> which appellant appealed.
  27. After this appeal was filed, OTA requested that the parties submit arguments on R&TC section 19058(a) and that respondent provide any additional evidence of appellant's fraudulent behavior for the taxable years at issue.
  28. In response, respondent provided the following:
    - a. Copies of appellant's federal separate account transcripts for the taxable years at issue, which shows a civil fraud penalty assessment in the 2010 taxable year.
    - b. A copy of the Preliminary Determination Letter dated May 13, 2021, stating that respondent learned of the federal court action and issued deficiency notices to the corporation based on court-admissions of understatements of income for the 2005 through 2011 taxable years and to appellant based on omitted constructive dividends for the taxable years at issue.
    - c. A copy of the Final Determination Letter dated June 17, 2021, stating that respondent would issue NOAs affirming the NPAs for the taxable years at issue.

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<sup>11</sup> Respondent removed the interest-based penalties and late filing penalties.

- d. A copy of the Information Document Request (IDR) dated January 19, 2017, requesting that appellant provide copies of all IRS Audit Reports for the 2005 through 2011 taxable years.
- e. A copy of appellant's response to the IDR dated February 1, 2017, stating that the IRS did not issue any audit reports to appellant for the 2005 through 2011 taxable years due to the criminal investigation that resulted in a plea agreement, that the IRS did not commence a civil audit of the 2005 through 2011 taxable years for appellant's corporate or personal accounts, and that appellant would attempt to find the tax returns requested in the IDR.
- f. A copy of the Audit Issue Presentation Sheet (AIPS) Numbers One, Two, and Three, dated February 27, 2017.
- g. A copy of appellant's response to the AIPS dated May 11, 2017, asserting that the language in appellant's plea agreement did not contain any admission that appellant's returns, other than the 2010 corporate return, were "false."
- h. Appellants' responses to respondent's IDR and AIPS did not include any of the requested documents.

## DISCUSSION

### Statute of Limitations

Generally, except in the case of a false or fraudulent return, an NPA must be issued to a taxpayer within four years after the return is filed. (R&TC, § 19057(a).) However, if a taxpayer omits from gross income an amount exceeding 25 percent of the amount of gross income stated on the original return, respondent may issue an NPA within six years after the return was filed. (R&TC, § 19058(a).)

Here, respondent issued its NPAs to appellant on November 20, 2017. For each of the taxable years at issue, respondent had until October 15, 2013, October 15, 2014, November 30, 2015, October 13, 2016, June 7, 2017, and October 15, 2018, respectively, to issue timely NPAs to appellant pursuant to R&TC section 19058(a). Because the parties did not execute an extension waiving the limitations period for any of the taxable years at issue (R&TC section 19067(a)), only the NPA for the 2011 taxable year was issued timely under R&TC section 19058(a).

In his brief and during the hearing, appellant concedes that the 2011 NPA was timely issued under R&TC section 19058(a). However, appellant contends that respondent waived any arguments to the application of R&TC section 19058(a) because respondent solely relied

on R&TC sections 18622, 19059,<sup>12</sup> and 19087 as exceptions to the general statute of limitations. Appellant also contends that it is inequitable to allow respondent to rely on R&TC section 19058(a) because respondent did not make this argument prior to this appeal.

When the ruling on an issue is necessary to decide an appeal, and the record contains sufficient facts to permit it, an OTA panel can raise that issue, regardless of whether the parties have pled it. (See *Barnette v. Commissioner*, T.C. Memo. 1992-595.) Furthermore, in reviewing a proposed deficiency determination, an OTA panel's primary concern is "with the question [of] whether under the law . . . [an] additional amount of tax is due," and an OTA panel is not limited to only considering respondent's theories and "the manner in which [it] determined an additional amount of tax to be due." (See *Appeal of Great Northern Railway Co.* (39-SBE-009) 1939 WL 310; see also *Appeal of Sierra Pacific Industries* (94-SBE-002) 1994 WL 14076 [if the assertion of a new theory merely clarifies or develops the original determination without being inconsistent with it or increasing the amount of the deficiency, it is not a new matter that requires the shifting of the burden of proof to respondent].)

The sole issue to be decided in this appeal is whether respondent's NPAs are timely, thereby implicating an analysis of the various statutes of limitations prescribed in Part 10.2 of Division 2 of the R&TC. Accordingly, this panel is not precluded from considering the application of R&TC section 19058(a) to the NPAs for the taxable years at issue. Thus, for the reasons discussed above, the 2011 NPA was issued timely under R&TC section 19058(a).

As for the NPAs for the 2006 through 2010 taxable years, respondent is barred by the statute of limitations from assessing against appellant for those years, unless respondent can prove that appellant filed false and fraudulent tax returns pursuant to R&TC section 19087(a), or if the plea agreement constituted a final federal determination pursuant to R&TC section 18622.

### Fraud

If any taxpayer files a false or fraudulent return with intent to evade the tax, for any taxable year, respondent, at any time, may make an estimate of the net income, from any available information, and may propose to assess the amount of tax, interest, and penalties due. (R&TC, § 19087(a).) The determination of fraud for purposes of the period of limitations on an assessment is the same as the determination of fraud for purposes of the civil fraud penalty. (See *Neely v. Commissioner* (2001) 116 T.C. 79, 85.)

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<sup>12</sup> If the taxpayer is required to report a change or correction made by the IRS within six months after a final federal determination, respondent may issue an NPA resulting from those adjustments within two years from the date of the notice, or within the periods provided in R&TC sections 19057, 19058, or 19065, whichever period is later. (R&TC, § 19059(a).)

“[F]raud is intentional wrongdoing on the part of the taxpayer with the specific intent to avoid a tax known to be owing.” (*Bradford v. Commissioner* (9th Cir. 1986) 796 F.2d 303, 307 (*Bradford*); *Powell v. Granquist* (9th Cir. 1958) 252 F.2d 56, 60 (*Powell*)). The intent must be inferred from the totality of facts and circumstances in a case. (*Appeal of Adickes* (90-SBE-012) 1990 WL 259706.) “Consistent and substantial understatements of income for several years ... is highly persuasive evidence of intent to defraud the government.” (*Powell, supra*, 252 F.2d at p. 60; *Baumgardner v. Commissioner* (9th Cir. 1957) 251 F.2d 311, 321.) The intent to conceal or mislead may be inferred from a pattern of conduct. (*Niedringhaus v. Commissioner* (1992) 99 T.C. 202, 211 (*Niedringhaus*)).

Respondent has the burden of proving the existence of fraud by clear and convincing evidence. (Cal. Code Regs., tit. 18, (Regulation) § 30219(c); *Appeal of Adickes, supra*.) “Clear and convincing” has been defined as “explicit and unequivocal,” leaving “no substantial doubt,” and “sufficiently strong to command the unhesitating assent of every reasonable mind.” (*Appeal of Adickes, supra*.) Respondent’s burden of proving fraud is met if it is shown that the taxpayer intended to evade taxes known to be owing by conduct intended to conceal, mislead, or otherwise prevent the collection of taxes. (See *Dileo v. Commissioner* (1991) 96 T.C. 858, 874.) Respondent may not satisfy its burden of establishing fraud by clear and convincing evidence merely by relying on a federal audit report. (*Appeal of Hunter and Brown* (74-SBE-041) 1974 WL 2857; *Appeal of Wilt* (76-SBE-030) 1976 WL 4046 [respondent did not satisfy its burden of proving fraud by relying entirely on the contents of a federal audit report and not conducting an independent audit or otherwise an investigation of the conclusions contained in the federal audit report].) Mere failure to report income received is not sufficient proof of fraud. (*Appeal of Wickman* (1981-SBE-014) 1981 WL 11741.) Where fraud is determined for each of several years, respondent’s burden applies separately for each of those years. (See *Johnson v. Commissioner*, T.C. Memo. 2001-182, at p. \*17 (*Johnson*); *Appeal of Eriane* (74-SBE-050) 1974 WL 2866.)

Fraud is not to be imputed or presumed, but must be established by independent evidence of fraudulent intent. (*Niedringhaus, supra*, 99 T.C. at p. 210.) Because fraudulent intent is rarely established by direct evidence, courts have inferred intent by looking at various kinds of circumstantial evidence, or “badges of fraud.” (*Bradford, supra*, 796 F.2d at p. 307.) These badges of fraud include: (1) understatement of income, (2) inadequate records, (3) failure to file tax returns, (4) implausible or inconsistent explanations of behavior, (5) concealing assets, (6) failure to cooperate with tax authorities, (7) engaging in illegal activities, (8) attempting to conceal these activities, (9) dealing in cash, and (10) failing to make estimated tax

payments. (*Bradford, supra*, 796 F.2d at pp. 307-308; see *Meier v. Commissioner* (1988) 91 T.C. 273, 298.) These badges of fraud are nonexclusive. (See *Niedringhaus, supra*, 99 T.C. at p. 211.) “These badges of fraud show a taxpayer’s intent to conceal, mislead, or otherwise prevent the collection of tax.” (*Kernan v. Commissioner*, T.C. Memo. 2014-228, at p. \*25 (*Kernan*)). “Although no single factor is necessarily sufficient to establish fraud, a combination of factors is more likely to constitute persuasive evidence.” (*Kernan, supra*, at pp. \*25-\*26.) The taxpayer’s education and business background are also relevant to the determination of fraud. (*Ericson v. Commissioner*, T.C. Memo. 2016-107.)

Respondent contends that three badges of fraud demonstrate appellant intended to evade taxes: appellant understated income, appellant’s implausible explanations of behavior, and appellant’s illegal conduct. Appellant contends that the only alleged badge of fraud that exists is the admitted understatement of income which, alone, is insufficient to satisfy respondent’s burden of proof to establish fraud by clear and convincing evidence.

#### Understatement of Income

A pattern of substantially underreporting income for several years is strong evidence of fraud, particularly if the understatement is not satisfactorily explained or due to innocent mistake. (*Vanover v. Commissioner*, T.C. Memo. 2012-79, at p. \*4; see *Johnson, supra*, at p. \*65.) Here, appellant understated the amount of tax owed for the 2006 through 2010 taxable years. Appellant omitted constructive dividends from his gross income in the amounts of \$706,736 for the 2006 taxable year, \$1,657,324 for the 2007 taxable year, \$2,359,000 for the 2008 taxable year, \$2,411,547 for the 2009 taxable year, and \$1,833,674 for the 2010 taxable year. The NPAs for the 2006 through 2010 taxable years show that appellant reported less than 10 percent of the taxes due on his original returns. The amounts that appellant omitted on his 2006 through 2010 personal returns are substantial enough to indicate fraudulent intent for each of those years. This supports a finding of fraud.

#### Implausible or Inconsistent Explanations of Behavior

A taxpayer providing implausible or inconsistent explanations of behavior is indicative of fraud. (*McClellan v. Commissioner*, T.C. Memo. 2013-251, at p. \*26.) This factor is met when a taxpayer is unable to offer any logical explanation for his or her behavior, evades basic questions, is unable to rationalize the differences in income reported on financial documents with returns filed with a taxing agency, and provides excuses as to the neglect of his or her personal income tax returns. (See *Powerstein v. Commissioner*, T.C. Memo. 2011-271, at p. \*28.) Furthermore, statements in a taxpayer’s plea agreement in a criminal case are often

relied on as evidence of fraud in a related civil fraud penalty case. (See *Fabian v. Commissioner*, T.C. Memo. 2022-94, at p. \*27.)

When a claim of ignorance or honest mistake is made, the courts consider the taxpayer's intelligence, education, and tax expertise. (*Anderson v. Commissioner*, T.C. Memo. 1995-8, at p. \*22.) However, when a taxpayer pleads guilty to willfully falsifying business tax returns for the same years that involved fraud, by knowingly failing to report substantial amounts of business gross receipts, the taxpayer has, in effect, admitted to an understanding of how gross receipts can be omitted and the unlawfulness of doing so. (*Ibid.*)

Here, the record shows that appellant was a medical doctor who was the sole shareholder and chief executive officer of three corporations. In his plea agreement, appellant admitted to approving and signing the corporate tax returns for the 2005 through 2011 taxable years that included non-deductible expenses and causing his corporate tax return preparer to overstate expenses on the corporate returns for the 2005 through 2011 taxable years. Appellant also admitted he approved and signed his personal tax returns for the taxable years at issue that omitted constructive dividends from the three corporations.

However, appellants' admissions in the plea agreement do not show any inconsistent or implausible explanation of behavior for the understatement of gross income in appellant's personal returns with respect to the 2006 to 2009 taxable years. Appellant's admissions do not provide any illogical explanation of behavior, demonstrate an evasion of basic questions or an inability to rationalize the differences in income reported on appellant's financial documents with the tax returns filed, or offer excuses for the neglect of appellant's personal income tax returns. Moreover, respondent has not provided any testimony, audit records, financial records, or correspondence from appellant to support a finding of implausible or inconsistent explanations of behavior.

In its Preliminary Determination letter, respondent stated that it issued deficiency notices to appellant's corporation based on court admissions of understatements of income and to appellant based on omitted constructive dividends. Respondent's reliance on appellant's admissions that he caused the tax preparer to overstate deductions on the corporate returns and that he signed the personal returns that omitted the resulting constructive dividends is misplaced. The admissions do not address whether appellant provided inconsistent explanations or exhibited inconsistent behavior, much less whether he omitted constructive dividends on his personal tax returns with a specific intent to evade tax. Respondent argues that appellant, as a doctor with many years of business experience, knew or should have known how to report business expenses. Respondent's reliance on appellant's admissions in his plea

agreement is not persuasive enough to prove fraud without an independent investigation of the conclusions made in the plea agreement. (See *Appeal of Wilt, supra.*)<sup>13</sup> A mere suspicion, however strong, is insufficient to demonstrate fraudulent intent for the 2006 through 2009 taxable years.

But appellant's admissions that he knew he was required to accurately report business expenses and taxes owed on the corporate return for the 2010 taxable year and he willfully and knowingly overstated the expenses on the return is strong evidence of appellant's inconsistent behavior for the 2010 taxable year. Furthermore, appellant's guilty plea for willfully falsifying his 2010 corporate tax return makes it implausible that appellant did not know the unlawfulness of overstating his corporate expenses and thereby understating the taxes owed. Accordingly, appellant's admissions and guilty plea can lead to the conclusion that appellant had the understanding and the inclination necessary to fraudulently omit a substantial amount of income from his 2010 Form 540, which led directly to his underpayment of personal income tax.

Thus, although this factor does not weigh in favor of fraud for the 2006 through 2009 taxable years, it weighs in favor of fraud for the 2010 taxable year.

#### Engaging in Illegal Activities

Fraudulent intent may be inferred when a taxpayer files a tax return intending to conceal, mislead, or prevent the collection of tax. (*Vanover v. Commissioner*, T.C. Memo. 2012-79, at p. \*6.) A criminal conviction has considerable significance in determining the facts in a civil case. (See *Appeal of Sherwood* (65-SBE-046) 1965 WL 1383.) Although a conviction as to one year does not decidedly establish fraudulent intent with respect to other years, courts have considered that crime as evidence of a propensity to defraud in other years. (*Powerstein v. Commissioner*, T.C. Memo. 2011-271, at p. \*29.) The courts may also look at evidence of prior and subsequent similar acts reasonably close to the years at issue in determining whether fraud existed. (*Tipton v. Commissioner*, T.C. Memo. 1994-624; *Le v. Commissioner*, T.C. Memo. 2020-27 [Tax Court found that taxpayer's conviction for 2006 was conclusive evidence, and circumstantial evidence of fraud for the years for which he did not plead guilty].) Because federal and state income tax laws are substantially alike and similar amounts are reported on federal and state returns, a federal conviction is highly persuasive evidence, in the absence of

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<sup>13</sup> In *Appeal of Wilt, supra*, appellants were assessed fraud penalties by the IRS and respondent, but the record did not show that husband-appellant's omissions of income and overstatement of allowable deductions from his medical practice resulted from a specific intent to evade tax. Respondent's decision to impose the fraud penalties was based entirely on its evaluation of the contents of the federal audit report rather than an independent investigation on its own. (*Ibid.*)

any rebuttal, that the state return, like the federal return, was fraudulent. (*Appeal of Sherwood, supra.*)

Here, appellant engaged in illegal conduct when he willfully and knowingly falsified his 2010 corporate tax return. Appellant pled guilty to tax evasion under IRC section 7201. Appellant's 2010 federal account transcript reflects that the IRS assessed a civil fraud penalty against appellant for the 2010 taxable year. Appellant's guilty plea for tax evasion on the corporate returns is strong evidence that he had intent in filing a false personal return for 2010.

Appellant acknowledges that he pled guilty to tax evasion based on the 2010 corporate tax return but contends that he did not admit to knowingly and willfully filing false personal returns for the other taxable years at issue. Appellant further contends that respondent cannot rely on the plea agreement to the 2010 corporate return to presume fraud for the other returns. However, appellant's guilty plea to tax evasion based on his admission that he knowingly and willfully filed a false 2010 corporate tax return is, in effect, appellant's admission to an understanding of how constructive dividends can be omitted and the unlawfulness of doing so on his 2010 personal tax return. (*See Appeal of Anderson, supra.*) This can only lead to the conclusion that appellant, as the sole shareholder of the corporations, had the understanding and the inclination necessary such that his omission of income on his personal return for the 2010 taxable year was fraudulent and that this omission led directly to the underpayment of tax. (*Ibid.*)

Nevertheless, for the 2006 through 2009 taxable years, respondent has not shown clear and convincing evidence of fraud. Although appellant's guilty plea for the 2010 taxable year can provide circumstantial evidence of fraud for the years which he did not plead guilty, appellant's guilty plea does not automatically impute fraud to the other taxable years in question. (*See Appeal of Castillo (92-SBE-020) 1992 WL 202571* ["Although fraud may be established by circumstantial evidence, it is never presumed or imputed, and it will not be sustained upon circumstances which at most create only a suspicion of fraud"].) In the absence of any evidence of concealment, misrepresentation, or subterfuge by appellant, respondent did not show that appellant "knowingly and willfully" omitted income; at most, respondent has only shown that appellant was extremely neglectful of paying his taxes. (*See Appeal of Fairchild (71-SBE-030) 1971 WL 2710.*) Respondent did not provide any evidence that shows appellant willfully and knowingly filed false personal tax returns for the other taxable years at issue. In his plea agreement, appellant admitted to omitting constructive dividends on his individual income tax returns; he did not admit to willfully and knowingly omitting constructive dividends on his individual returns. (*See Minemyer v. Commissioner, T.C. Memo. 2023-149, p. \*6* [Although the

plea agreement dropped the criminal fraud charge for the 2001 taxable year, taxpayer admitted that he engaged in the same behavior for both 2000 and 2001 of intentionally and willfully not reporting income].)

Thus, this factor does not weigh in favor of fraud for the 2006 through 2009 taxable years but weighs in favor of fraud for the 2010 taxable year.

#### Other Badges of Fraud

The record does not show that other badges of fraud are present. Appellant filed his personal tax returns by the extended due dates and made estimated tax payments for some of the taxable years at issue. Factors, such as inadequate records, concealing assets, failure to cooperate with tax authorities, attempting to conceal illegal activities, dealing in cash, or failing to make adequate estimated tax payments for each of the taxable years at issue, are inconclusive. As mentioned above, the evidence shows that appellant understated income for the taxable years at issue for his corporate and personal tax returns, and that appellant pled guilty to “knowingly and willfully” filing with the IRS a false corporate return for the 2010 taxable year that overstated expenses and thus understated the taxes owed. Although three of the factors weigh in favor of fraud for the 2010 taxable year (i.e., understatement of income, implausible or inconsistent explanation of behavior, and engaging in illegal activities), most of the factors do not weigh in favor of fraud for the 2006 through 2009 taxable years. Accordingly, this panel finds that respondent did not satisfy its burden of proving by clear and convincing evidence that appellant had fraudulent intent to evade taxes known to be owing by conduct intended to conceal, mislead, or otherwise prevent the collection of taxes, for the 2006 through 2009 taxable years. Respondent’s reliance on appellant’s plea agreement to assert fraud for the 2006 through 2009 taxable years is insufficient, especially when the record does not show that respondent conducted an independent investigation or otherwise investigated the omitted income for the 2006 through 2009 taxable years as referenced in the plea agreement.<sup>14</sup> (See *Appeal of Wilt, supra*.) Thus, because respondent did not meet its burden of proving fraud for the 2006 through 2009 taxable years, it is barred by the statute of limitations from issuing NPAs for those taxable years.

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<sup>14</sup> In the Preliminary Determination Letter, respondent stated in footnote 5 that it initially believed the receipt of additional federal information would be helpful to resolve the protest upon recognition of the additional IRS assessments, but, after further review of the assessments and the law, respondent determined that additional federal information was unnecessary.

Final Federal Determination

If the IRS makes a change or correction to “any item required to be shown on a federal tax return, including any gross income, deduction, penalty, credit, or tax for any year,” the taxpayer must report the federal change to respondent within six months after the date it becomes final. (R&TC, § 18622(a).) If the taxpayer or the IRS reports the change or correction within six months after the final federal determination, respondent may issue an NPA resulting from those adjustments within two years from the date of the notice. (R&TC, § 19059(a).) If the taxpayer or the IRS reports that change or correction after the six-month period, respondent may issue an NPA resulting from those adjustments within four years from the date of the notification. (R&TC, § 19060(b).) If the taxpayer fails to report the change or correction, respondent may issue an NPA resulting from those adjustments at any time. (R&TC, § 19060(a).) The specific statute of limitations prescribed in R&TC section 19060 overrides the general statute of limitations set forth in R&TC section 19057. (*Ordlock v. Franchise Tax Bd.* (2006) 38 Cal.4th 897.)

A federal determination is deemed final when the adjustment resulting from an IRS examination is assessed. (R&TC, § 18622(d); IRC, § 6203.) As relevant here, an IRS account transcript is a valid record of assessment. (See Treas. Reg. § 301.6203-1; Rev. Rul. 2007- 21, 2007- 14 I. R. B. 865.) The date of the final federal determination is the date that the adjustment is assessed pursuant to IRC section 6203. (R&TC, § 18622(d).) IRC section 6203 provides that the assessment is made by recording the liability on the taxpayer’s record in accordance with the rules and regulations prescribed by the IRS. Treasury Regulation section 301.6203-1 states that an assessment is made, through supporting records, by an assessment officer signing the summary record of the assessment. The summary record shall contain the identification of the taxpayer, the character of the liability assessed, the taxable period, if applicable, and the amount of the assessment. (*Ibid.*) A record of assessment includes a Master File Transcript, such as an Individual Master File or a Business Master File. (Rev. Rul. 2007-21, 2007-1 C.B. 865.) As relevant here, a final federal determination includes an IRC section 7121 closing agreement and an IRC section 6213 90-day deficiency notice. (Cal. Code Regs., tit. 18, § 19059(e).)

Based on the record, appellant’s transcripts reflect an IRS civil assessment for a fraud penalty for the 2010 taxable year; for all the taxable years at issue, there is a “restitution” notation, apparently referring to the plea agreement executed by appellant and federal prosecutors, which was approved by a federal judge, but no other IRS assessment outside of 2010. The restitution orders herein are court judgments and do not constitute final federal

determinations as defined by IRC section 6203, R&TC sections 18622(d) and 19059, and Regulation section 19059(e). Because appellant’s transcripts do not show a final federal determination, the extended statute of limitations provided by R&TC sections 19059 and 19060 are not available for the 2006, 2007, 2008, 2009, and 2011 taxable years.

In sum, respondent’s NPAs for the 2010 and 2011 taxable years are timely under R&TC section 19087(a) and R&TC section 19058(a), respectively. Respondent’s NPAs, however, for 2006 through 2009 are untimely for the reasons discussed above.

HOLDING

The NPAs for the 2006 through 2009 taxable years are barred by the statute of limitations, but the NPAs for the 2010 and 2011 taxable years are timely.

DISPOSITION

Respondent’s actions are reversed as to the 2006 through 2009 taxable years; respondent’s actions are otherwise sustained for the 2010 and 2011 taxable years.

DocuSigned by:  
*Tommy Leung*  
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Tommy Leung  
Administrative Law Judge

We concur:  
DocuSigned by:  
*Kenneth Gast*  
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Kenneth Gast  
Administrative Law Judge

Signed by:  
*Natasha Ralston*  
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Natasha Ralston  
Administrative Law Judge

Date Issued: 7/29/2025