

Appeal of Richard A. and Virginia R. Ewert

mother and business partner, Cora Ewert, knew nothing about this account. When interviewed by the Franchise Tax Board's agents, appellant admitted that **his** purpose in concealing a portion of the purchases and sales was to avoid taxes.

Because it was impossible to determine from the **partnership's** records the extent of the unrecorded transactions, the Franchise Tax Board's deficiency determinations were based upon the following computation: (1) A percentage of unrecorded to recorded purchases was determined by an examination of the partnership's **suppliers'** records, for a period covering 1951 through 1954, and a cost of goods sold figure was then developed by applying the percentage factor to the recorded purchases for the entire period in question. (2) An average markup percentage was computed on the basis of: those records considered as the best available for the purpose, the records of the **Laguna Beach** store, for the years 1951 through 1953, showing the amount by which retail prices exceeded the cost of the merchandise. (3) The markup percentage was applied to the cost of goods sold figure to determine the amount of the partnership's retail sales for **each** year.

The above computation showed that the **firm's** omitted **sales, purchases,** and gross profits were as follows:

<u>Year</u>	<u>Sales</u>	<u>Purchases</u>	<u>Profit</u>
1947	\$49,041.63	\$11,501.18	\$37,540.45
1948	40,592.85	9,715.47	30,877.38
1949	40,245.04	9,446.34	30,798.70
1950	42,501.31	7,429.87	35,071.44
1951	44,448.82	13,302.68	31,146.14
1952	44,668.10	9,527.63	35,140.47
1953	53,510.89	11,594.55	41,916.34
1954	56,367.20	13,578.66	42,788.54

Appellant and **his** wife, **Virginia**, each filed separate personal **income** tax returns for the year 1947, but filed joint returns for the years 1948 through 1954. Accordingly, respondent assessed additional taxes against **them**, individually for the year 1947, and jointly for the remainder of the period. Respondent added to each tax deficiency a penalty of 50 percent for fraud with intent to evade **tax**, pursuant to section 18685 of the Revenue and Taxation Code. All of the notices of proposed deficiency assessments were mailed more than four years after the **income** tax returns in question were filed.

At the hearing of this **matter**, appellant stated that he **did** not know why he **had** the "secret" bank account. When questioned further,, the **following colloquy** ensued:

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Q: Was it to evade taxes?

A: No sir; I **don't** believe so, in my **mind not**,

Q: You are not sure?

A: I know I was wrong now, definitely; but at the time I don't think so.

Q: You are not positive, is that it?

A: No **sir**.

The Franchise Tax Board has the burden of proving fraud by clear and convincing evidence. (Cal. Admin. Code, tit. 18, § 5036; Marchica v. State Board of Equalization, 107 Cal. App. 2d 501 [237 P.2d 725].) ~~Marchica v. State Board of Equalization~~ Failure to file a correct return **or** the omission of **taxable** items from a return do not necessarily constitute **fraud, for** there must be a specific intent to evade a tax believed to be owed. (Marchica v. State Board of Equalization, supra.)

We are of the opinion that there is ample evidence in the record to support our finding that appellant, Richard A. Ewert, fraudulently understated his reported income. The long history of intentional concealment of sales and purchases, the "secret" bank account, and appellant's previously **admitted** intention to avoid taxes, all lead to but one conclusion. The equivocal denial of fraudulent intent made by the appellant before this board was most unconvincing. We sustain the respondent's determination that each of the **deficiencies** assessed against appellant is due to fraud with intent to evade tax. Thus, appellant's argument that the deficiency assessments were barred by Revenue and Taxation Code, section 18586, because they were mailed more than four years after the returns were filed, must fall since that section is inapplicable to fraudulent returns.

There is no evidence in the record showing fraud on the part of Virginia R. Ewert. However, for those years in which she **filed** joint returns, her tax liability is joint and several. (Rev. & Tax. Code, § 18555.) We have previously held that an *innocent* spouse who is involved only because of jointly filed returns **is** nonetheless liable for penalties imposed as a result of a mate's fraud. (Appeal of Nicholas Obrutsch, Cal. St. Bd. of Tax., Feb. 17, 1959, 2 CCH Cal. Tax Cas. Par. 201-252, P-H, State & Local Tax Serv. Cal. Par: 58154. See also Irving S. Federbush, 34 T.C. 740, **aff'd**, 325 F.2d 1.)

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For 1947, however, Virginia filed a separate return. Since her 1947 return has not been shown to be fraudulent and respondent's notice of proposed assessment was mailed more than four years after such return was filed, the proposed deficiency assessment is barred by section 18586 of the Revenue and Taxation Code.

While appellant concedes that his returns materially understated his income, he contends that respondent's computation of income is excessive and cannot be sustained. Relying on Marchica v. State Board of Equalization, supra, 107 Cal. App. 2d 501 [237 P.2d 725], appellant urges that because the issue of fraud is involved, respondent has the burden of proving the correctness of the amount of additional income on which it based its proposed assessments and that respondent has failed to sustain this burden.

Appellant's reliance is obviously misplaced for the court made clear that the question of fraud and the question of the correct measure of tax are two entirely separate and distinct issues to which very different presumptions apply. (Marchica v. State Board of Equalization, supra at page 510.) This is the same treatment accorded taxpayers in federal tax litigation. (Fuller v. Commissioner, 313 F.2d 73; Valetti v. Commissioner, 260 F.2d 105; Kashat v. Commissioner, 229 F.2d 282.) While the Franchise Tax Board must prove fraud, if it is asserted, the burden of overcoming the presumed correctness of the amount of the proposed assessments of additional tax remains with the taxpayer. (Cal. Admin. Code, tit. 18, § 5036.)

In support of his argument that respondent's calculation of unreported income is excessive, appellant has put in evidence certain working papers, prepared by his accountant, which analyze the deposits and withdrawals of his "secret" bank account. These figures show an unreported profit in a total amount equal to about one-fifth that computed by the Franchise Tax Board. He contends that this analysis shows the true amount of unrecorded sales and purchases because all such items can be traced through this one account. We note, however, that appellant's self-serving statement to the effect that all unreported sales were deposited in the account and all unrecorded purchases were paid out of it, is not supported by any independent evidence. Appellant's accountant testified that he did not even know if a check had been made of the partnership's merchandise suppliers in order to reconcile the withdrawals from the account with unrecorded purchases.

Appellant also attacks the markup percentage used in respondent's formula on the ground that items which did not sell at the Laguna Beach store within a reasonable time were returned to Santa Ana and disposed of at a sacrifice. Thus, it is contended, the markup percentage for the Laguna Beach

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store would not accurately reflect the average gain on sales in the other store. Even were we to accept appellant's statement, there is no evidence from which we could determine the degree of error. We could not, without substantial evidence, attribute the entire difference between appellant's and respondent's figures to this one factor.

We conclude that under the circumstances of the instant appeal the Franchise Tax Board's method of computing unreported income was reasonable (Hyman B. Stone, 22 T.C. 893; Frank Stanoch, T.C. Memo., Dkt. No. 58193, June 28, 1959), and that appellant has failed to overcome the presumption that the amounts of the proposed assessments of tax are correct.

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 Virginia R. Ewert to a proposed assessment of additional personal income tax and penalty against her in the amount of \$113.54 for the year 1947 be reversed; and that the action of the Franchise Tax Board on the protests of Richard A. and Virginia R. Ewert to proposed assessments of additional personal income tax and penalties against Richard A. Ewert in the amount of \$234.39 for the year 1947, and against appellants jointly in the amounts of \$4415.43, \$462.98, \$702.33, \$529.22, \$314.58, \$520.23 and \$584.84 for the years 1948 through 1954, respectively, be and the same is hereby sustained.

Done at Sacramento, California, this 7th day of April, 1964, by the State Board of Equalization.

<u>Paul R. Leato</u>	Chairman
<u>John W. Lynch</u>	Member
<u>Richard Stein</u>	Member
<u>Robert Kelley</u>	Member
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Attest: [Signature], Secretary