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7 **BOARD OF EQUALIZATION**  
 8 **STATE OF CALIFORNIA**

10 In the Matter of the Appeal of: ) **HEARING SUMMARY**  
 11 ) **PERSONAL INCOME TAX APPEAL**  
 12 **MAUREEN T. SCARBERY AND** ) Case No. 480106  
 13 **BRIAN E. SCARBERY<sup>1</sup>** )  
 14 \_\_\_\_\_ )

<u>Years</u>	<u>Proposed Assessments</u>	<u>Fraud Penalties</u>
1999	\$162.00	\$140.83
2000	\$2,446.00	\$2,098.70
2001	\$4,516.00	\$3,755.78
2002	\$4,956.00	\$3,717.00

19 Representing the Parties:

21 For Appellants: Curtis Alexander, Jr., Enrolled agent  
 22 For Franchise Tax Board: Raul A. Escatel, Tax Counsel

24 **QUESTIONS:** (1) Whether appellants have shown that the proposed assessments for the 1999, 2000,  
 25 2001, and 2002 tax years are erroneous.  
 26 (2) Whether respondent has shown that it properly imposed the fraud penalties  
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28 <sup>1</sup> Appellants reside in Willits, Mendocino County, California.

1 pursuant to Revenue and Taxation Code (R&TC) section 19164.<sup>2</sup>

2 HEARING SUMMARY

3 Background

4 Appellant-wife<sup>3</sup> was employed as an office manager by Dr. John Scoggins (Perkins  
5 Street Dental) between 1999 and 2002. Appellant-wife embezzled funds during the course of her  
6 employment. According to the Ukiah Police Department, appellant used checks from Perkins Street  
7 Dental to pay personal bills. Appellant-wife obtained credit cards from the same bank that issued credit  
8 cards to the dental office and then used company-issued checks to pay her credit card bills. The matter  
9 was investigated by respondent, the Ukiah Police Department, and the Mendocino County District  
10 Attorney's office. (Resp. Opening Br., p. 1.)

11 On October 16, 2002, Dr. Scoggins filed a civil complaint against appellants for the funds  
12 embezzled. As a means of resolving that litigation, Dr. Scoggins and appellants entered into a  
13 Settlement Agreement and Mutual Release (Settlement Agreement).<sup>4</sup> The parties agreed that a payment  
14 of \$148,000 by appellants would resolve the civil litigation and the \$148,000 payment was described in  
15 the Settlement Agreement as "new money" in which appellants would not "receive any credit . . . for  
16 any monies or property that was paid or given to Scoggins in the past." The Settlement Agreement also  
17 provided that a restitution order in the amount of \$148,000 would be entered in the criminal action  
18 (summarized below) against appellant-wife. (Resp. Opening Br., p. 3; Exhibit C, pp. 1-3.) The parties  
19 also acknowledged and agreed that the execution of the Settlement Agreement was "the result of  
20 compromise" and was "not to be considered an admission of liability." (Resp. Opening Br., Exhibit C,  
21 p. 7.)

22 On November 18, 2003, the Mendocino County District Attorney's Office filed a  
23 \_\_\_\_\_

24 <sup>2</sup> In its opening brief, respondent states the issue as whether the penalty was properly assessed pursuant to R&TC section  
25 19705. R&TC section 19705 is the applicable criminal statute for the prosecution of an individual for fraud.

26 <sup>3</sup> Although both Brian Scarbery and Maureen Scarbery are parties and appellants in this appeal, the term "appellant-wife"  
27 will also be used in this hearing summary to describe the actions of appellant Maureen Scarbery which resulted in the  
assessments at issue.

28 <sup>4</sup> Respondent attached the Settlement Agreement as Exhibit C to its opening brief but did not include the signature page (page  
9) of the agreement. Respondent states that the Settlement Agreement was dated August 5, 2004. (Resp. Opening Br., p. 3,  
fn. 7.)

1 criminal complaint against appellant-wife. The district attorney charged appellant-wife with grand theft  
2 embezzlement under Penal Code sections 487 and 503, use of a computer to facilitate a theft under Penal  
3 Code section 502(c)(1), money laundering in the amount of \$360,000 from a financial institution under  
4 Penal Code section 186.10(a), the filing of false income tax returns for tax years 1999, 2000, 2001, and  
5 2002 under R&TC section 19705, and various other violations of the Penal Code.<sup>5</sup> (Resp. Opening Br.,  
6 Exhibit B.) Appellant-wife was convicted of grand theft embezzlement, use of a computer to facilitate a  
7 theft, and the filing of a false income tax return and was sentenced to serve a total of two years and eight  
8 months in state prison. (Resp. Opening Br., p. 3; Exhibit D, p. 3.)

9 In its audit, respondent, and the district attorney's office, concluded that appellant-wife  
10 embezzled \$349,077. (Resp. Opening Br., p. 2, fn. 4; p. 4.) In summary, respondent concluded the  
11 following in its audit (Resp. Opening Br., pp. 4, 5):<sup>6</sup>

	(A) Alleged Embezzled Amount	(B) Amount Unreported By Appellants Relating To Embezzlement	(A – B) Amount Reported by Appellants as Additional Income
1999	\$24,782	\$2,680	\$22,102
2000	\$95,686	\$26,326	\$69,360
2001	\$174,071	\$48,561	\$125,510
2002	\$54,538	\$54,538	\$0
Total	\$349,077	\$132,105	\$216,972

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18 Based upon the audit results, respondent issued Notices of Proposed Assessment (NPA's)  
19 for 1999, 2000, 2001, and 2002, reflecting the assessment of additional taxable income, relating to  
20 appellant-wife's embezzlement, of \$2,680, \$26,326, \$48,561, and \$54,538 for these tax years,  
21 respectively (assessments which total \$132,105). (Resp. Opening Br., pp. 6-7; Exhibits K, L, M, & N.)  
22 The NPA's were protested and respondent subsequently issued Notices of Action for 1999, 2000, 2001,  
23

24  
25 <sup>5</sup> Respondent asserts that the criminal complaint (Resp. Opening Br., pp. 4-5) does not specify that appellant-wife embezzled  
26 \$349,000. Appeals Division staff (staff) notes, however, that the criminal complaint does assert that appellant-wife  
27 committed the criminal act of money laundering in the amount of \$360,000.

28 <sup>6</sup> Staff notes that the record fails to include return information for 2001 and 2002 which clearly identifies the amount of  
additional income reported by appellants relating to the embezzlement. It appears the reported amounts were \$125,510 and  
\$0, respectively. The parties should clarify at the oral hearing whether these amounts are correct. Appellants' 1999 and 2000  
amended returns reflect additional income of \$22,102 and \$69,360 of additional income from Perkins Street Dental. (Resp.  
Opening Br., Exhibits F & G.)

1 and 2002 on January 14, 2009, affirming the NPA's. (Resp. Opening Br., pp. 6-7; Exhibits Q, R, S, &  
2 T.) This timely appeal followed.

3 Contentions

4 In their opening brief,<sup>7</sup> appellants admit that appellant-wife embezzled funds from her  
5 former employer. Appellants assert that court records reflect that Dr. Scoggins was paid \$243,000,  
6 \$50,000 of which was for legal fees, and that the Settlement Agreement shows he accepted this amount  
7 as payment in full. Appellants further assert that the amount of funds the district attorney alleged as  
8 embezzled was merely an accumulation of all of the checks appellant-wife signed while working for Dr.  
9 Scoggins. In other words, appellants contend that the district attorney's total included expenses of the  
10 dental practice and, as such, was inaccurate. (App. Opening Br. (Oct. 14, 2007), pp. 1-2.) Appellants  
11 also argue that the district attorney did not follow through on the amount she asserted had been  
12 embezzled. Appellants assert that such amount was merely charged but not proven by the district  
13 attorney. Moreover, appellants assert that it was the district attorney who entered the \$148,000  
14 restitution amount in the criminal record. (App. Opening Br. (Nov. 3, 2008), pp. 1-2.)

15 In their reply brief, appellants assert that (1) respondent disregarded all input from  
16 appellants while, at the same time, relying on several other sources to compute the amount embezzled;  
17 (2) appellant-wife admitted to the embezzlement and appellants voluntarily amended their returns and  
18 paid tax to report the embezzled amounts as income; and (3) respondent has alleged different amounts  
19 embezzled from each of its sources (the Ukiah Police Department, the district attorney's office, and Dr.  
20 Scoggins). (App. Reply Br., pp. 1-2.) In addition, appellants contend that the amount embezzled totaled  
21 \$221,405.36, that Dr. Scoggins was repaid cash totaling \$70,000.00, the unreported taxable amount  
22 totaled \$151,404.36,<sup>8</sup> and that appellants paid tax on \$250,000.00 of additional income. (App. Reply  
23 Br., pp. 2-3.)

24 Respondent asserts that the Ukiah Police Department concluded appellant-wife

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27 <sup>7</sup> For purposes of this hearing summary, staff considers appellants' opening brief to be appellants' letters dated October 14,  
28 2007, and November 3, 2008.

<sup>8</sup> This amount is appellants' calculation, which staff notes is off by \$1.00 (i.e., \$221,405.36 - \$70,000.00 = \$151,405.36).

1 embezzled \$367,935 from Dr. Scoggins via payments made on a variety of credit card accounts<sup>9</sup> and  
2 that the district attorney's office concluded that appellant-wife embezzled \$349,077 over the four-year  
3 period. (Resp. Opening Br., pp. 2, 4.) In addition, respondent asserts that appellant-wife admitted to  
4 embezzling between \$221,405 and \$235,250. (Resp. Opening Br., p. 2.) Respondent states that, based  
5 upon the police department's determination that appellants had not reported the embezzled funds on  
6 their 1999, 2000, 2001, and 2002 income tax returns, the district attorney included a criminal charge of  
7 filing false tax returns for these years. (Resp. Opening Br., p. 2.) Respondent contends that, in addition  
8 to paying Dr. Scoggins \$148,000 in the settlement of the civil litigation, appellants also made other  
9 payments to Dr. Scoggins totaling \$98,000 as repayment of the embezzled funds. (Resp. Opening Br.,  
10 p. 3.)

11 Respondent contends it is clear from the evidence that appellant-wife embezzled money  
12 from Dr. Scoggins. Respondent asserts that appellants contend that appellant-wife embezzled  
13 approximately \$243,000, while respondent contends that the embezzled amount was \$349,077. In  
14 support of its position, respondent points to the evidence provided by the Ukiah Police Department and  
15 the district attorney's office. (Resp. Opening Br., p. 8.) Respondent also asserts that because the district  
16 attorney's office did not include the \$349,077 amount in the criminal record, but only the Settlement  
17 Agreement amount of \$148,000, appellant-wife did not have to account for the difference in the two  
18 amounts in the criminal proceeding. (Resp. Opening Br., p. 4.)

19 Respondent argues that the \$148,000 Settlement Agreement amount is merely restitution  
20 which appellants agreed to pay Dr. Scoggins and this restitution amount was only entered into the  
21 criminal record so appellants would not seek to discharge that amount in a bankruptcy proceeding. As  
22 such, respondent contends that this amount is not indicative of the amount embezzled by appellant-wife.  
23 (Resp. Opening Br., pp. 8-9.) Respondent also contends, regarding the \$148,000 settlement amount, that  
24 parties in civil litigation often settle matters for less than the amount in controversy. Respondent argues  
25 the fact that appellants settled with Dr. Scoggins for a certain amount does not detract from the evidence  
26 that appellant-wife embezzled more funds than the amount agreed upon in the Settlement Agreement.

27  
28 <sup>9</sup> On this same page of respondent's opening brief, respondent states that the Ukiah Police Department found that appellant-wife embezzled \$364,194.92.

1 (Resp. Opening Br., p. 9.) Respondent contends the Settlement Agreement does not state that the  
2 agreed-upon amount was the total amount of money embezzled. Moreover, respondent asserts that the  
3 Ukiah Police Department believes the total amount embezzled may actually be closer to \$500,000 over  
4 the four-year period. (Resp. Opening Br., p. 9.)

5 Respondent also asserts that in her mitigation statement, relating to her sentencing in the  
6 criminal matter, appellant-wife admitted to having taken, and reported as income, approximately  
7 \$250,000 and that appellant-wife “paid taxes on that amount and put the difference on her bankruptcy  
8 schedule (\$155,000).” (Resp. Opening Br., p. 10, Exhibit V, p. 2.) Respondent contends appellant-  
9 wife’s statement implies at a minimum that she might be responsible for embezzling an additional  
10 \$155,000 from Dr. Scoggins.

11 Respondent also contends that the police investigator went over his findings with  
12 appellant-wife to verify what he found. Respondent asserts that it was only after appellant-wife agreed  
13 with the detective’s findings that he submitted the findings to the district attorney’s office as evidence  
14 for the criminal proceeding. As a result of this, respondent contends that the district attorney’s office  
15 then notified respondent that appellant-wife embezzled at least \$349,000. (Resp. Opening Br., p. 11.)

16 Respondent also argues that appellants should not be allowed any deductions relating to  
17 the embezzlement, such as attorney’s fees for the criminal and civil proceedings. Respondent asserts  
18 that R&TC section 17282 prohibits deductions related to illegal activities. (Resp. Opening Br., p. 12.)

19 Regarding the assessments of the fraud penalty, respondent asserts that appellant-wife’s  
20 admissions regarding her criminal conduct, including her guilty plea, together with respondent’s  
21 determination that substantial amounts were not reported as income, support the imposition of the  
22 penalty. Respondent also asserts that the criminal conviction for embezzlement and for filing false  
23 income tax returns is also evidence of appellant-wife’s specific intent to evade taxes. In summary,  
24 respondent argues that the totality of the circumstances clearly support the imposition of the fraud  
25 penalty for each year in issue. (Resp. Opening Br., pp. 13-14.)

### 26 Applicable Law

#### 27 Embezzled Funds As Income

28 R&TC section 17071 incorporates Internal Revenue Code (IRC) section 61, which

1 defines “gross income” as all income from whatever source derived. It is well-settled law that illegal  
2 gains, including gains from embezzlement, are gross income for tax purposes. (*James v. United States*  
3 (1961) 366 U.S. 213.) The test for receipt of illegal income, like any other type of income, is whether  
4 the taxpayer had dominion and control over it. (*Wood v. United States* (5th Cir. 1989) 863 F.2d 417,  
5 419.)

#### 6 Deductions Allowed

7 R&TC section 17282 provides, in pertinent part, that no deduction shall be allowed to  
8 any taxpayer on any of his gross income directly derived from illegal activities (including theft and  
9 embezzlement), as defined in various provisions of the Penal and Health and Safety Codes, or from his  
10 gross income derived from any other activities that directly lead to promote or to further, or are directly  
11 connected with those illegal activities.

#### 12 Burden Of Proof

13 It is well settled that a presumption of correctness attends respondent’s determinations as  
14 to issues of fact and that appellant has the burden of proving such determinations erroneous. (*Appeal of*  
15 *Oscar D. and Agatha E. Seltzer*, 80-SBE-154, Jun. 29, 1980.) This presumption is, however, a  
16 rebuttable one and will support a finding only in the absence of sufficient evidence to the contrary.  
17 (*Appeal of Oscar D. and Agatha E. Seltzer, supra.*) Respondent’s determination cannot, however, be  
18 successfully rebutted when the taxpayer fails to present uncontradicted, credible, competent, and  
19 relevant evidence to the contrary. (*Appeal of Oscar D. and Agatha E. Seltzer, supra.*) To overcome the  
20 presumed correctness of respondent’s findings as to issues of fact, a taxpayer must introduce credible  
21 evidence to support his assertions. When the taxpayer fails to support his assertions with such evidence,  
22 respondent’s determinations must be upheld. (*Appeal of Oscar D. and Agatha E. Seltzer, supra.*) A  
23 taxpayer’s unsupported assertions are not sufficient to satisfy his burden of proof. (*Appeal of James C.*  
24 *and Monablance A. Walshe*, 75-SBE-073, Oct. 20, 1975.)

#### 25 Fraud penalty

26 R&TC section 19164, subdivision (c), states that “a fraud penalty shall be imposed . . .  
27 and shall be determined in accordance with the provisions of Section 6663 of the Internal Revenue Code  
28 . . . .” IRC section 6663 provides for a penalty equal to 75 percent of the portion of the underpayment

1 which is attributable to fraud.

2 The burden is upon respondent to prove, by clear and convincing evidence, that  
3 appellants have committed civil fraud. (*Appeal of Robert F. and Helen R. Adickes*, 90-SBE-012, Nov.  
4 27, 1990; *Appeal of Barbara P. Hutchinson*, 82-SBE-121, June 29, 1982; *Appeal of George W.*  
5 *Fairchild*, 71-SBE-030, Oct. 27, 1971; *Appeal of Hubbard D. and Cleo M. Wickman*, 81-SBE-014,  
6 Feb. 2, 1981.) “Clear and convincing” has been defined as “explicit and unequivocal,” leaving “no  
7 substantial doubt,” and “sufficiently strong to command the unhesitating assent of every reasonable  
8 mind.” (*Appeal of Robert F. and Helen R. Adickes, supra.*)

9 Fraud implies bad faith, intentional wrongdoing, and a sinister motive; the taxpayer must  
10 have the specific intent to evade a tax believed to be owing. (*Jones v. Commissioner* (5th Cir. 1958) 259  
11 F.2d 300; *Powell v. Granquist* (9th Cir. 1958) 252 F.2d 56; *Marchica v. State Board of Equalization*  
12 (1951) 107 Cal.App.2d 501, 509.) Consistent and substantial understatements of income for several  
13 years are “highly persuasive evidence of intent to defraud the government.” (*Powell v. Granquist,*  
14 *supra*, 252 F.2d at p. 60.) Although fraud may be established by circumstantial evidence, it is never  
15 presumed or imputed, and it will not be sustained upon circumstances that at most create only a  
16 suspicion of fraud. (*Jones v. Commissioner, supra; Valetti v. Commissioner* (3d Cir. 1958) 260 F.2d  
17 185; *Appeal of George W. Fairchild, supra.*)

18 STAFF COMMENTS

19 Respondent asserts that over the four-year period here, appellants had embezzled income  
20 totaling \$349,077. Respondent has proposed assessments based on \$132,105 of additional taxable  
21 income to appellants over the four-year period. (See the table on page 3 of the Hearing Summary.)  
22 Staff notes that, not only have appellants admitted to the embezzlement, but claimed to have already  
23 reported \$250,000 of additional income on their returns relating to the embezzlement. Between the  
24 amount of alleged embezzlement (\$349,077) and the amount assessed (\$132,105), respondent has  
25 implied that appellants have already reported \$216,972 of additional income for these years (i.e.,  
26 \$349,077 - \$132,105). As such, the Board must determine the correct amount of additional unreported  
27 income.

28 With this in mind, respondent cites evidence in its opening brief of checks written by

1 appellant-wife totaling \$364,194.92 (respondent's Exhibit A) from the Ukiah Police Department's  
2 investigation and the transcript of the detective's testimony (respondent's Exhibit W). (Resp. Opening  
3 Br., p. 2, fn. 4; p. 10, fn. 40.) However, neither of these exhibits was attached to respondent's opening  
4 brief. The checks which respondent asserts were written by appellant-wife are direct evidence in  
5 support of respondent's assessment and respondent should submit this documentation to the Board  
6 Proceedings Division and appellants no later than 14 days prior to the hearing.<sup>10</sup>

7 Respondent has provided evidence of the amount of the settlement between appellants  
8 and Dr. Scoggins. Respondent, however, has not provided any evidence of the amount that appellant-  
9 wife's former employer sought to recover in the civil litigation.

10 Attached to respondent's opening brief is a portion of a mitigation statement from  
11 appellant-wife relating to her sentencing as a result of the criminal charges. In the mitigation statement,  
12 appellant-wife states that, immediately after admitting to the embezzlement to Dr. Scoggins, appellants  
13 paid him \$70,000 in cash and transferred their vehicle to him, for transfers totaling \$95,000. (Resp.  
14 Opening Br., Exhibit V, p. 1.) Appellant also stated that

15 Randy Johnson, the investigator, told [appellant-wife] if the case was resolved on the  
16 civil side that he would not continue with any further investigation. She tried to resolve  
17 the case in the civil context. He told her what he had determined she had taken. She  
18 admitted and acted on that figure, approximately \$250,000. She paid taxes on that  
amount and put the difference on her bankruptcy schedule (\$155,000).  
(Resp. Opening Br., Exhibit V, p. 2.)

19 Appellant-wife also describes the \$148,000 Settlement Agreement amount as \$100,000 for restitution  
20 and \$48,000 for attorney's fees. (Resp. Opening Br., Exhibit V, p. 4.)

21 Finally, in its reply brief, appellants reference an Exhibit 1, Internal Revenue Service  
22 (IRS) transcripts for the years in question. Appellants assert that these transcripts demonstrate how the  
23 embezzled funds were handled differently by the IRS. However, these transcripts were not attached to  
24 appellants' briefs. In addition, appellants reference an Exhibit 2, appellants' computation of the tax due  
25 for the year at issue, which likewise was not attached to the brief. Appellants should submit this  
26 documentation to the Board Proceedings Division and respondent no later than 14 days prior to the  
27

28 <sup>10</sup> This documentation should be sent to Claudia Madrigal, Board Proceedings Division, Board of Equalization. P.O. Box 942879 MIC:80, Sacramento, CA 94279-0080. (See Cal. Code Regs., tit. 18 § 5523.6, subd. (b).)

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28 <sup>11</sup> This documentation should be sent to Claudia Madrigal, Board Proceedings Division, Board of Equalization. P.O. Box 942879 MIC:80, Sacramento, CA 94279-0080. (See Cal. Code Regs., tit. 18 § 5523.6, subd. (b).)