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65-SBE-031
OR PROTEST
WHERE NO
HEARING REQUESTED
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BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
GEORGE R. WICKHAM AND ESTATE OF)
VESTA B. WICKHAM)

Appearances:

For Appellants: Walter M. Campbell
Attorney at Law

For Respondent: Israel Rogers
Associate Tax Counsel

O P I N I O N

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 George R. Wickham and the Estate of Vesta B. Wickham against proposed assessments of fraud penalties in the amounts of \$72.35, \$308.59, \$431.33, \$232.76 and \$825.87 for the years 1947, 1948, 1949, 1950 and 1951, respectively. The personal income tax deficiencies on which these penalties are based are not contested.

For convenience, George R. Wickham will be referred to hereafter as if he were the only appellant.

The primary question raised by this appeal concerns the propriety of the fraud penalties proposed to be assessed. A second issue is whether appellant was improperly denied an oral hearing before respondent on his protest.

Appellant is a lawyer and, since 1948, has served as a city councilman, including two years as mayor. During the years in question, the majority of appellant's income

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was derived from oil and mining leases. In addition, he earned a relatively small amount of income from practicing law.

During the period involved, appellant kept very disorganized records of his income and expenses in the form of bank statements, cancelled checks, vouchers, invoices, receipts and other memoranda. For the year 1947, he did not file an income tax return with respondent. He prepared and filed timely joint returns for the years 1948 through 1950. For 1951, he filed a tentative return, indicating that an amended return would be filed when income for that year was determined.

Early in 1952, before appellant filed his tentative 1951 return with respondent, the Internal Revenue Service commenced an audit of his federal income tax returns for the years 1947 through 1951. Because of the poor state of his records, appellant had a set of books prepared for those years. All the accumulated data was turned over to a public accounting firm. In July 1956, after several years of work, the accountant who set up appellant's books prepared amended returns for the years 1948 through 1951, and these were filed with respondent. In 1961, at respondent's request, a return was filed for 1947, showing no tax due. A comparison of the gross and net income reported in the original and amended state returns is as follows:

	<u>Gross Income</u> <u>Original Ret.</u>	<u>Gross Income</u> <u>Amended Ret.</u>	<u>Net Income*</u> <u>Original Ret.</u>	<u>Net Income*</u> <u>Amended Ret.</u>
1947	\$21,173.94 (untimely)		\$ 4,579.41 (untimely)	
1948	30,416.83	\$38,947.06	9,538.49	\$20,272.98
1949	39,939.93	57,891.26	7,563.64	20,924.03
1950	39,720.05	41,718.04	11,887.42	9,550.56
1951	(tentative return)	60,283.99	(tentative return)	29,045.42

*After business expense deductions and itemized deductions.

After receiving amended federal returns from appellant, the Internal Revenue Service made an extensive examination and increased the reported net income by adding income in the

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form of oil lease royalties and by disallowing many business expenses, some itemized deductions and certain bad debts and other losses claimed. These adjustments resulted in annual net income figures from two to six times greater than appellant reported in his original returns. For each year, the Internal Revenue Service asserted an additional tax, a fraud penalty, and a penalty for failure to file timely declarations of estimated tax. The total amount of taxes and penalties thus asserted was \$81,394.57. Appellant contested this determination.

On April 7, 1961, respondent issued notices of proposed assessment's based on the federal adjustments. Appellant filed a protest on April 13, 1961, and further action was deferred awaiting the outcome of the federal contest. Appellant's protest did not contain a request for an oral hearing.

Before the federal case came to trial in the Tax Court, a settlement was reached by appellant and the Internal Revenue Service. In 1963, pursuant to the agreement of the parties, a stipulated judgment was entered against appellant for tax and penalties, including a fraud penalty, for each of the years 1947 through 1951. The taxes and penalties totaled \$43,026. A statement signed by appellant was made a part of the Tax Court record. In that declaration he stated that he did not admit having perpetrated any fraud against the government and that he was consenting to the imposition of the fraud penalties in order to close the case.

Respondent reduced its proposed assessments in accordance with the federal determination. Since the settlement did not specify the income on which it was based, respondent reconstructed an amount of income which would result in the agreed amount of tax exclusive of penalties. Adjusting for differences in federal and state exemptions and deductions, a corresponding state taxable income figure was determined, and tax was computed thereon. The revised taxable income figures, compared with amounts reported on the original and amended California returns, are as follows:

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	<u>Taxable Income Original Return</u>	<u>Taxable Income Amended Return</u>	<u>Revised Taxable Income</u>
1947	(\$ 7 2 0 . 5 9) (untimely)		\$12,234.46
1948	\$4,237.49	\$14,972.98	27,191.40
1949	3,663.64	17,024.03	27,488.34
1950	7,987.42	5,650.56	21,505.51
1951	(tentative return)	25,145.42	40,029.07

To the tax deficiency respondent added a 50 percent fraud penalty for each year.

Respondent mailed its notices of action revising the proposed assessments on August 30, 1963. Appellant mailed a letter on September 13, 1963, in which he requested an oral hearing.

We shall deal first with the question of whether respondent improperly denied appellant an oral hearing on his protest. Section 18592 of the Revenue and Taxation Code provides that respondent shall grant an oral hearing on a protest against a proposed assessment, "if the taxpayer has so requested in his protest." Appellant did not request an oral hearing in his protest against the proposed assessments. No such request was made until after the mailing of respondent's notices of action revising the proposed assessments. The only course then available was to file an appeal to this board. (Rev. & Tax. Code, § 18593.) Such an appeal was filed and an oral hearing thereon was granted. We agree with respondent that it acted in accordance with the law and did not improperly deny appellant an oral hearing.

Proceeding to the fraud issue, section 18685 of the Revenue and Taxation Code provides for a 50 percent penalty "If any part of a deficiency is due to -fraud with an intent to evade tax." Respondent 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]; Ariette Coat Co., 14 T.C. 751.) Because direct evidence is seldom available to prove fraudulent intent, it must generally be inferred from all the surrounding circumstances. (M. Rea Gano, 19 B.T.A. 518.)

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A taxpayer's unexplained and persistent failure to keep records which adequately show his income and expenses, and which will enable him to prepare accurate tax returns may constitute evidence of an intent to evade tax. (Merritt v. Commissioner, 301 F.2d 484; Clarence T. Slaughter, T.C. Memo., Dkt.No. 44083, June 9, 1954.) In determining whether there existed an intent to defraud, an illiterate taxpayer with only slight business experience will not be held to the same standards as a successful professional man. (Powell v. Granquist, 252 F.2d 56; E. S. Iley, 19 T.C. 631; Albert N. Shahadi, 29 T.C. 1157, 1169, aff'd, 266 F.2d 495.)

During the years in question, appellant derived substantial income from various sources. He is an attorney, a man of business affairs, and a public official. His failure to keep proper records and to properly report his income, or to obtain professional assistance in doing so, cannot be excused on the grounds of ignorance.

It is well established that consistent and substantial understatements of income or overstatements of deductions,, without satisfactory explanation, are persuasive evidence of fraud. (Holland v. United States, 348 U.S. 121 [99 L. Ed. 150] reh. denied, 348 U.S. 932 [99 L. Ed. 731]; Rogers v. Commissioner, 111 F.2d 987.)

Appellant consistently failed to report in his original federal returns the bulk of his legal fees, omitting from 60 percent to 97 percent of them each year in amounts ranging from several hundred to several thousand dollars. The same omissions appear in his original state returns for 1948, 1949 and 1950, the only original state returns that were timely and purportedly complete.' He explained only the largest omission, in the amount of \$3,600 for the, year 1948, which he attributed to inadvertence.

He testified that most of the income added by the Internal Revenue Service consisted of certain oil lease royalties which he regarded as his son's income. These royalties, amounting to several thousand dollars a year, were omitted from both his original and amended federal and state returns. He stated that his son received the royalties for a time and that when his son moved to Seattle during the war, appellant's wife received the payments pursuant to the son's

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order and that, upon her death, appellant received them, again at his son's direction. He alleged that the money has been accounted for between him and his son. In support of his testimony, he submitted a copy of a royalty agreement dated in 1941, in which his son was designated as the owner of an oil lease and the person to whom royalties were to be paid.

Each year appellant deducted thousands of dollars for expenses incurred in taking moving pictures at resort areas throughout the country, reporting receipts of \$58.60 from this, activity. Appellant testified that these, costs constituted the majority of the business expenses disallowed by the Internal Revenue Service. He stated that he regarded his activity as a business of making travelogues and that he sold some of his products after the years in question.

Although the circumstances surrounding appellant's motion picture operation make his deductions questionable, it is conceivable that he did in fact regard the operation as a business. It is also conceivable that appellant could have omitted a portion of his legal fees through inadvertence-. The omission of the bulk of those fees year after year, however, cannot be accounted for on that ground. Nor is it at all clear why appellant's son should have ordered royalties paid to appellant and his wife unless it was understood that appellant and his wife were entitled to them. Placing property in the name of another is a common means of tax evasion. Without further elaboration and corroboration, which should have readily been obtainable from his son, appellant's explanation concerning the royalties is unsatisfactory.

Considering the record as a whole, the discrepancies cannot reasonably be attributed solely to negligence or mistake of law. Appellant's records were maintained in a manner that facilitated concealment of income; and there were in fact substantial and consistent omissions without adequate explanation. We cannot escape the conclusion that a considerable part of the deficiency for each year was attributable to fraud.

