

1. COMPUTATION  
BASED ON  
2. FRAUD PENALTY  
FRAUD CONVICTION



BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of )  
ROBERT C. SHERWOOD, DECEASED, )  
AND IRENE SHERWOOD )

For Appellants: Arthur N. Hews  
Attorney at Law

For Respondent: Burl D. Lack, Chief Counsel  
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 Robert C. Sherwood/deceased, and Irene Sherwood against a proposed assessment of additional personal income tax in the amount of \$513.21 and a fraud penalty in the amount of \$256.61 for the year 1951. For convenience, Robert C. Sherwood will be referred to hereafter as an appellant, although he **is now** deceased.

Mr. and Mrs. Sherwood's joint federal and joint state returns for 1951 showed \$699.45 as adjusted gross income. In 1958 Robert C. Sherwood, after a not-guilty plea, was tried and convicted of wilfully attempting to evade federal income tax by filing a fraudulent joint **income** tax return for 1951 knowing that the joint income was \$23,366.57 and not the \$699.45 reported. This constituted a felony pursuant to section '145(b) of the 1939 Internal Revenue Code.

Civil tax proceedings were also instituted for the same year, the federal authorities having determined that appellant omitted \$33,543.71 from income and that the omission was due to fraud with intent to evade **the federal** tax. (Int. Rev. Code' of 1939, § 293(b).) 'Respondent **issued** a notice of

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proposed assessment including a 50 percent penalty for fraud, based on the federal determination. Appellant protested, stating that the federal deficiency was being contested in the United States Tax Court. The Tax Court proceeding was thereafter settled by a stipulation in which appellants agreed to a specified amount of taxes and penalties. Respondent computed that the stipulated amount was equivalent to that which would be imposed on omitted income of \$23,364.45, and revised its proposed assessment accordingly.

No evidence has been presented that the state income tax assessment was in error. On brief, appellants' counsel merely denied the **existence** of any additional unreported income. Appellants' counsel maintained that a settlement of the federal civil matter was agreed to because of the condition of Mr. Sherwood's health. An oral hearing before this board was waived.

Counsel also urged in his brief that under the normal rules of evidence, a conviction of a crime is admissible only to impeach a witness or to prove a fact specifically determined by the criminal verdict. It is alleged that a conviction of income tax evasion is evidence only that the criminal defendant evaded some tax but not any particular amount.

We shall first concern ourselves with the issue of the basic tax assessment. This assessment is presumed to be correct and it is necessary for appellants to show that it is erroneous. (Cal. Admin. Code, tit. 18, § 5036; Todd v. McColgan, 89 Cal. App. 2d 509 [201 P.2d 414].) An unsupported statement that appellants had no other income does not overcome the presumption. (Hoefle v. Commissioner, 114 F.2d 713; Halle v. Commissioner, 175 F.2d 500, 'appeal dismissed and cert. denied, 338 U.S. 949 [94 L. Ed. 586]; Todd v. McColgan, supra.) Accordingly, we agree with respondent that the basic tax has been properly determined.

With respect to the fraud issue, section 18685 of the Revenue and Taxation Code provides that "If any part of any deficiency is due to fraud with intent 'to evade tax, 50 percent of the total amount of the deficiency, . . . shall be assessed...." 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]; Arlette Coat Co., 14 T.C. 751.)

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The view has been expressed in the federal courts that the criminal conviction of fraudulent understatement of income, after a not guilty plea, is, at the very least, compelling evidence of liability for the 50 percent federal civil fraud penalty for the year or years for which the defendant was convicted. (Jolly's Motor Livery Co., T.C. Memo., Dkt. Nos. 36607, 36745, 41269, and 41270, Dec. 16, 1957; Abraham Galant, 26 T.C. 354; 10 Mertens, Law of Federal Income Taxation § 55.18, pp. 107-109.)

With respect to the general question of the admissibility of criminal convictions after a *not guilty* plea, as evidence in a subsequent civil action, it was said in Stagecrafters' Club v. District of Columbia Division of American Legion, 111 F. Supp. 127 at pages 128 and 129:

. . . [W]here the issue in the criminal case was clear, the defendant appeared, was represented by counsel, had an opportunity to testify and present his witnesses and to cross-examine the witnesses against him, and was duly convicted, there is no sound reason why the judgment of conviction should not be admitted in a civil case based on the same facts as at least prima facie evidence of those facts.

\* \* \*

Where the criminal prosecution has been actively defended and no rebutting evidence is offered, the court is warranted in holding the conviction conclusive proof of the facts in the civil action.

\* \* \*

... [C]ommon sense and good judicial administration dictate that the civil court shall not retry at length ... issues which were fairly determined in the criminal proceeding, when the evidence was fresh, by a competent tribunal after full litigation by the party against whom the conviction is offered in evidence....

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More recent authority in the federal courts holds that the criminal conviction for wilfully attempting to evade income tax collaterally estops taxpayers from seeking a refund of civil fraud penalties for the same taxable year. (Tomlinson v. Lefkowitz, 334 F.2d 262; John W. Amos, 43 T.C. 50, appealed, 4 Cir., Jan. 21, 1965.) As stated in Amos, supra, at page 57 "... a conviction in a criminal case, wherein the Government is held to a more stringent burden of proof, would necessarily be dispositive of the same issue in a subsequent civil case wherein the burden of proof required is considerably less."

Where one party to a civil action has been a defendant in a criminal prosecution involving the same decisive issues, and has been convicted after a not guilty plea, the California Supreme Court has also ruled that the prior criminal conviction collaterally estops the defendant from succeeding in the civil action. (Teitelbaum Furs, Inc. v. Dominion Insurance Co., 58 Cal. 2d 601 [375 P.2d 439, 25 Cal. Rptr. 559].)

There can be no doubt that the criminal conviction is admissible in the proceedings before us, pursuant to section 5035, subdivision (c), title 18 of the California Administrative Code, which provides that any relevant evidence including hearsay evidence will be admitted if it is the sort of evidence on which responsible persons are accustomed to rely in the conduct of serious affairs. Appellants, in fact, have not objected to admission of the conviction for the purpose of establishing evasion of part of the tax. Under section 18685 of the Revenue and Taxation Code, the fraud penalty applies to the entire deficiency if any part of the deficiency is, due to fraud. The problem, therefore, is one of determining the evidentiary weight to be given the conviction.

As demonstrated by the decisions which we have cited, the courts attach considerable significance to a criminal conviction in determining the facts in a civil case. We are not unmindful of the fact that the evidence here consists of a federal rather than a state conviction. The federal and state income tax laws are substantially the same, however, and the same amounts were reported on the federal and state returns. Whether the federal conviction, is regarded as creating an estoppel or as rebuttable evidence, it is sufficient to persuade us, in the absence of any rebuttal, that the state return, like the federal return, was fraudulent.

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Our conclusion with respect to the evidentiary value of the conviction obviates any need to discuss the evidentiary effect of the stipulated settlement with the federal authorities.

Counsel has also maintained that Mrs. Sherwood should not be held liable because she was 'completely innocent, was not a party to the criminal action, and signed the settlement agreement "only with the assurance of no personal liability and with the knowledge that the trial of the case could result in the death of her former husband."

The 50 percent fraud penalty is a **civil, not a criminal, penalty.** (Heilvering v. Mitchell, 303 U.S. 391 [82 L. Ed. 917].) The express wording of *section* 18555 of the Revenue and Taxation Code, imposing joint and several liability for the tax on the aggregate income where a joint return is filed necessarily imposes this civil liability upon the wife where a joint return is filed. (Howell v. Commissioner, 175 **F.2d** 240; Boyett v. Commissioner, 204 **F.2d** 205.)

O R D E R

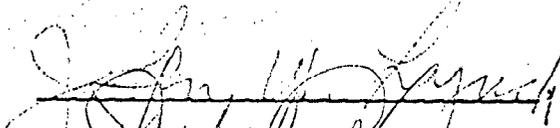
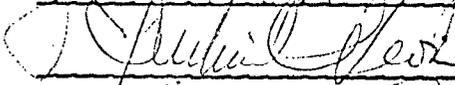
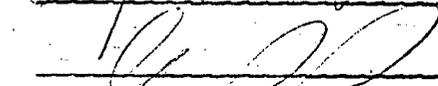
Pursuant to the views expressed in the opinion of the board on file in this proceeding, and good cause appearing therefor,

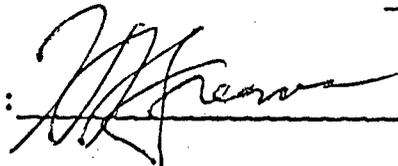
IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section 18595 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of Robert C. Sherwood, deceased, and Irene Sherwood against a **proposed assessment** of additional **personal** income tax in the **amount of** \$513.21 and a fraud penalty in the amount of

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\$256.61 for the year 1951 be and the same is hereby sustained,

Done at 'Sacramento , California, this 30th day  
of November , 1965, by the State Board of Equalization.

  
\_\_\_\_\_, Chairman  
  
\_\_\_\_\_, Member  
  
\_\_\_\_\_, Member  
  
\_\_\_\_\_, Member  
\_\_\_\_\_, Member

ATTEST:  \_\_\_\_\_, Secretary