

Appeal of Eli A. and Virginia W. Allec

Subsequent to the filing of this appeal, respondent withdrew the deficiency and fraud penalty for the year 1967. For the remaining years three primary issues are presented: (1) Whether the amounts of the deficiencies for 1965 and 1966 were conclusively determined by a probation order entered in a California court after conviction of one of the appellants of felonious tax evasion; (2) whether said conviction collaterally estops appellants from contesting liability for the civil fraud penalties for the years 1965 and 1966; **or**, if not, whether appellants are liable for the penalties; and (3) whether appellants are liable for the proposed deficiency and fraud penalty for 1964.

Appellants Eli and Virginia Allec, husband and wife, filed joint California income tax returns for all the years in question. Throughout this period Virginia was employed as a secretary to one Carl Rau, a real estate dealer in the Anaheim area. **In** addition to her normal secretarial duties she apparently also did some janitor and gardening work around the office, cooked Mr. Rau's lunch each day, and sometimes showed property to prospective customers. She also kept the books for the office, prepared all the checks on the business checking account, and assisted Mr. Rau's accountant in preparing Mr. **Rau's** personal income tax returns.

Sometime after August 1967, Virginia was charged and tried before a jury on grand theft charges resulting from an audit **of her employer's business. For the** prosecution Mr. Rau testified that the audit had disclosed a number of unauthorized checks issued to Virginia, which were covered in the books by various inaccurate entries. Eight checks were admitted into evidence. In rebuttal Virginia testified that the checks had in fact been authorized by Mr. Rau, and were entered inaccurately in the books at his direction because he did not want his wife to find out about certain expenditures. Virginia admitted having received the proceeds of the checks, but claimed that most of the money had **either been** returned directly to Mr. Rau or used to purchase food and liquor for him. Any amounts kept by her, she claimed, were given to her by Mr. Rau "out of kindness," to thank her for **the** extra work she did around the office. Virginia was acquitted of the grand theft charges.

Appeal of Eli A. and Virginia W. Allec

At the District Attorney's request, respondent then commenced to investigate appellants for possible violations of the Revenue and Taxation Code. It determined, on the basis of bank records of the disposition of checks issued from **Mr. Rau's** office to Virginia, that she and her husband had received unreported income in the following amounts:

<u>Taxable Year</u>	<u>Unreported Income</u>
1964	\$10,107.30
1965	10,812.74
1966	10,533.90
1967	6,400.00

On January 15, 1971, respondent accordingly issued proposed assessments of additional tax and fraud penalties for those years. Appellants timely protested the assessments, but action on the protest was delayed pending **appellate** review of the criminal litigation described below.

As a result of respondent's investigation, Virginia was charged with violations of Revenue and Taxation Code section 19406,^{1/} a felony, for the years 1965, 1966, and 1967. She pleaded not guilty, and was tried before a jury in the Superior Court of Orange County. Virginia was represented by counsel at this trial. As part of the case against her, the prosecution introduced into evidence approximately 40 checks issued to and cashed by Virginia, which she had not reported as income. Virginia elected not to testify in her own defense. During the course of the trial the court dismissed the charge for the year 1967, but the jury returned a **verdict** of "guilty" on the charges for 1965 and 1966.

1/ Section 19406 provides for criminal sanctions against:

Any person who, within the' time required by or under the provisions of this part, wilfully fails to file any return or to supply any information with intent to evade any tax imposed by this part, or who, wilfully and with like intent, makes, renders, signs, or verifies any false or fraudulent return or statement or supplies any false or fraudulent information,...

Appeal of Eli A. and Virginia W. Allec

At the post conviction proceedings, Virginia's lawyer advised the probation officer that, according to his calculations, Virginia owed a total of \$557.13 in unpaid taxes for 1965 and 1966. On September 25, 1970, the court placed Virginia on three years probation upon the condition, among others, that she "[p]ay to the State of California for taxes the sum of \$460.00;..." Virginia appealed, but her conviction was affirmed in an unpublished opinion by the Court of Appeal. (People v. Allec, 4 Crim. 4726 [Court of Appeal, Fourth District, Second Division, 1972].)

On March 12, 1973, respondent denied appellants' protest of its **proposed** assessments of additional tax and fraud penalties, and this appeal followed.

I. The Deficiency Assessments for the Years 1965 and 19'66.

The Franchise Tax Board's determination of the amount of a deficiency is presumed correct, and the burden is on the taxpayer to prove that it is incorrect. (Appeal of Richard A. and Virginia R. Ewert, Cal. St. Bd. of Equal., April 7, 1964.) Appellants contend that the money received from Mr. Rau was not income to Virginia because much of it was returned directly to Mr. Rau, and some was a "gift". In support of this position they contend that, since Virginia testified to that effect at her grand theft trial, and since she was acquitted, the jury must have believed her story. However, the verdict in the grand theft trial merely indicates that the prosecution failed to **prove beyond** a reasonable doubt that Virginia embezzled the checks. The jury did not necessarily find as a fact that the proceeds of the checks were not income to Virginia.

Appellants also argue that the probation order issued after Virginia's tax evasion trial, requiring her to make payments of \$460.00 "for taxes," constitutes a conclusive judicial determination of their additional tax liability. However, in using the word "**for,**" the trial court apparently intended merely to direct Virginia to make payments "toward" her tax liability, and not to determine the exact amount owed. This conclusion is supported by the fact that Virginia's attorney advised the court that he calculated her additional liability as \$557.13 for the years in question. If the trial court had meant to fix the exact amount of the deficiencies, it would not have **chosen an** amount less than Virginia admitted to be due.

Appeal of Eli A. and Virginia W. Allec

Appellants have accordingly failed to prove that respondent's determination of the amount of the deficiencies for 1965 and 1966 is incorrect. However, since Virginia was ordered to make payments under the probation order directly to the Franchise Tax Board, respondent has agreed that such payments should be allowed as a credit against its proposed assessments.

II. Fraud Penalties for the Years 1965 and 1966.

In contrast to a deficiency assessment, the Franchise Tax Board bears the burden of proving that any part of a deficiency was due to fraud. (Appeal of Richard A. and Virginia R. Ewert, supra.) Fraud is actual, intentional wrongdoing, coupled with a specific intent to evade a tax believed to be owed. (Marchica v. State Board of Equalization, 107 Cal. App. 2d 501, 509 [237 P.2d 7251.]) It implies bad faith and a sinister motive. (Jones v. Commissioner, 259 F.2d 300, 303.) Fraud must be proved by clear and convincing evidence, something impressively more than a preponderance of the evidence. (Appeal of Matthew F. McGillicuddy, Cal. St. Ed. of Equal., July 31, 1973.) Although fraud may be established by circumstantial evidence (Powell v. Granquist, 252 F.2d 56, 61), it is never presumed, and a fraud penalty will not be sustained upon circumstances which, at most, create only a suspicion.' (Jones v. Commissioner, supra.)

Respondent relies primarily on Virginia's conviction of tax evasion in the Orange County Superior Court to sustain the fraud penalty. It calls our attention to several recent decisions of the United States Courts of Appeals, the Tax Court, and the Court of Claims, which hold that a taxpayer convicted after trial of criminal tax evasion is collaterally estopped from contesting subsequent civil fraud penalties for the same taxable years. (Tomlinson v. Lefkowitz, 334 F.2d 262; Moore v. United States, 360 F.2d 353; John W. Amos, 43 T.C. 50, aff'd, 360 F.2d 358; Armstrong v. United States, 354 F.2d 274.) Respondent urges us to follow these federal authorities and hold that Virginia's conviction precludes appellants from denying fraud on this appeal.

Appeal of Eli A. and Virginia W. Allec

The effect of collateral estoppel is that any issue which has been determined by a court of competent jurisdiction is conclusively determined as to the parties and their privies in subsequent litigation where the same issue arises, even though the cause of action in the later suit may be different. "The rule is based on the sound public policy of limiting litigation by preventing a party who has had one fair trial on an issue from again drawing it into controversy." (Bernhard v. Bank of America, 19 Cal. 2d 807, 811 [122 P.2d 892].) In Bernhard, the California Supreme Court stated that collateral estoppel is appropriate where the following three requirements are satisfied: First, the issue determined in the prior case must be identical to that in the present litigation; second, there must have been a final adjudication on the merits; and third, the party to be estopped must have been a party or be in privity with a party to the prior adjudication. The court has also held that, where those requirements are met, a civil plaintiff in privity with a criminal defendant is estopped from relitigating issues determined against that defendant at a prior criminal trial. (Teitelbaum Furs, Inc. v. Dominion Ins. Co., Ltd., 58 Cal. 2d 601 [25 Cal. Rptr. 559, 375 P.2d 4391].)

Prior to Bernhard, collateral estoppel could be applied only if the party seeking to invoke the doctrine would himself have been bound by an adverse decision in the prior suit. This rule, called mutuality of estoppel, was eliminated by the decision in Bernhard. Subsequent decisions from the District Courts of Appeal, however, indicate that Bernhard is not a blanket approval of collateral estoppel in every case which lacks mutuality. (Nevarov v. Caldwell, 161 Cal. App. 2d 762 [327 P.2d 1111; O'Connor v. O'Leary, 247 Cal. App. 2d 646 [56 Cal. Rptr. 1].) As was stated in the O'Connor case:

We are of the opinion that application of the doctrine of collateral estoppel, absent the element of **mutuality... [depends]** upon whether, under the particular circumstances at hand, policy considerations restrict its use. Generally the objective of res judicata and its affiliate collateral estoppel, is to prevent "vexatious litigation with its attendant expense both to the parties and the public." [Citation.] **Where** this objective will not be aided by application

Appeal of Eli A. and Virginia W. Allec

of these doctrines, and assertion thereof would "defeat the ends of justice or important considerations of policy," they may not be invoked. [Citations.] (247 Cal. App. 2d at 649-650.)

Similar reasoning by Justice Traynor in the Teitelbaum case provided the foundation for our decision in Appeal of Robert V. Eriane, decided November 12, 1974. In that case we held that a plea of guilty to a charge of violating section 19406 did not collaterally estop the taxpayer from contesting civil liability for tax fraud because, in Justice Traynor's words:

[C]onsiderations of fairness to civil litigants and regard for the expeditious administration of criminal justice [citation] combine to prohibit the application of collateral estoppel against a party who, having pleaded guilty to a criminal charge, seeks for the first time to litigate his cause in a civil action. (Teitelbaum Furs, Inc. v. Dominion Ins. Co., Ltd., supra, 58 Cal. 2d at 605-606.)

Since the present appeal involves a criminal conviction after a trial on the merits, our decision in Eriane is not controlling. Respondent urges with some force that under the circumstances of this case, the requirements for collateral estoppel set out in Bernhard are fully satisfied. There is, however, no mutuality of estoppel. Because of the lesser degree of proof required in a civil as opposed to a criminal trial, respondent would not be bound by the judgment if Virginia had been acquitted at her tax evasion trial. (Board of Education v. Calderon, 35 Cal. App. 3d 490, 495-496 [110 Cal. Rptr. 916].) Therefore, even assuming that respondent's assertion is correct, the question remains whether the various policy considerations involved warrant application of collateral estoppel to the facts of this case. We have concluded that they do not.

Because appellants filed joint returns, Eli is jointly and severally liable for the penalties if any part of the deficiencies was due to his wife's fraud. (Appeal of Robert C. Sherwood, Deceased, and Irene Sherwood, Cal. St. Bd. of Equal., Nov. 30, 1965.)

Appeal of Eli A. and Virginia W. Allec

He was not a party to Virginia's tax evasion trial, however, nor was he in privity with her. (Henry M. Rodney, 53 T.C. 287, 309-310.) For purposes of collateral estoppel, a husband and wife are in privity only where the party-spouse in the prior litigation represented the community interest in that suit. (See Zaragosa v. Craven, 33 Cal. 2d 315, 318 [202 P.2d 73]; Bruton v. Villoria, 138 Cal. App. 2d 642, 644 1292 P.2d 638].) In her criminal trial, Virginia represented only her own interests. Accordingly, Eli cannot be estopped from contesting fraud by virtue of Virginia's conviction, and we must fully examine the merits of the case in order to assess his liability. (Moore v. United States, supra, 360 F.2d at 357.) To invoke collateral estoppel against Virginia under these circumstances would not prevent relitigation of previously tried issues, and would place Eli in the disadvantageous position of denying his wife's fraud when she cannot. It would also raise the possibility of inconsistent determinations regarding Virginia's and Eli's liability on this appeal. Since application of collateral estoppel would not further its objectives, and would tend to impede a fair adjudication of Eli's liability, the doctrine is not appropriate in this case.

While Virginia's conviction thus does not estop appellants from contesting liability, it is nonetheless admissible against them on the issue of fraud. (Appeal of Robert C. Sherwood, Deceased, and Irene Sherwood, supra; Cal. Admin. Code, tit. 18, § 5035, subd. (c); see also Evid. Code, §§ 1300, 1302.) The question before us is how much weight should be accorded to that conviction.

In her tax evasion trial, Virginia was convicted of filing a "false or fraudulent return" with intent to evade tax. (Rev. & Tax. Code, § 19406.) Such conduct is equivalent to fraud. (Murrill v. State Board of Accountancy, 97 Cal. App. 2d 709, 713-714 [218 P.2d 569]; see also In re Trombley, 31 Cal. 2d 801, 809-810 [193 P.2d 734].) She had a full and fair adjudication on this issue, was proven guilty beyond a reasonable doubt (Pen. Code, § 1096) and was convicted upon the unanimous verdict of the jury (Pen. Code, § 1164). She was represented by counsel, and her conviction was

Appeal of Eli A. and Virginia W. Allec

affirmed on appeal. Under these circumstances, the judgment against her is at least prima facie evidence of fraud (Stagecrafters' Club, Inc. v. District of Columbia Division of American Legion, 111 F. Supp. 127, 128-129) and, unless rebutted, suffices in itself to support the fraud penalty. (Appeal of Robert C. Sherwood, Deceased, and Irene Sherwood, supra.)

Appellants deny that any part of the deficiency was due to fraud, explaining that they believed the amounts received from Mr. Rau were not income. They have offered no evidence to support this contention, however, and the jury at Virginia's tax evasion trial must necessarily have found against her on this issue. When we weigh appellants' unsupported denials against Virginia's tax evasion conviction, we find them wanting. Accordingly, we conclude that respondent has met its burden of proof, and sustain the fraud penalties for the years 1965 and 1966.

III. The Deficiency and Fraud Penalty for 1964.

The question of fraud for the year 1964 was not involved in Virginia's tax evasion trial. Therefore, while her conviction may be some evidence of a fraudulent plan or scheme existing in the prior year (Abraham Galant, 26 T.C. 354, 365-366), it is not, standing alone, clear and convincing evidence. To prove fraud, respondent must establish that some part of the deficiency was due to a specific intent to evade tax. (Marchica v. State Board of Equalization, supra, 107 Cal. App. 2d at 509.) The fact that Virginia had the requisite intent in 1965 and 1966 does not prove clearly and convincingly that she also had such an intent in 1964. (Drieborg v. Commissioner, 225 F.2d 216, 220.)

Furthermore, we find no additional facts in the record to support the fraud penalty for 1964. Respondent points out that, at her grand theft trial, Virginia admitted having received some of the unreported income. However, mere failure to report income actually received is not sufficient proof of fraud. (L. Glenn Switzer, 20 T.C. 759, 765.) If it were, then any taxpayer

Appeal of Eli A. and Virginia W. Allec

who understated his income would be liable for the fraud penalty. Respondent also points out that Virginia was a bookkeeper and helped an accountant prepare her employer's income tax returns. The theory seems to be that she must therefore have known that the **money** received from Mr. Rau should have been reported as income. It is true that fraud penalties have been upheld on a similar theory against educated and successful businessmen who failed to keep accurate records of their income. (See, e.g., Appeal of George R. Wickham and Estate of Vesta B. Wickham, Cal. St. Bd. of Equal., Aug. 3, 1965.) However, we are not persuaded that such familiarity **with the** Personal Income Tax Law must necessarily be imputed to a **secretary-bookkeeper**.

The facts of this case admittedly create a strong suspicion of fraud on appellants' 1964 return. Mere suspicion, however, is not enough. (Jones . Commissioner, supra.) We cannot say, on the basis of the record before us, that respondent has shown clearly and convincingly that the 1964 deficiency was due to fraud. **We'** therefore reverse the proposed fraud penalty for that year.

Revenue and Taxation Code section 18586 provides for a four year statute of limitations on deficiency assessments, except in the case of a fraudulent return. Since respondent has failed to prove that the 1964 return was fraudulent, **the four year period applies**. Notice of the 1964 **deficiency** was not sent to appellants until January 15, 1971, more-than four years after the return was filed. The deficiency assessment for 1964 is therefore barred.

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,

