

Appeal of William G., Jr. , and Mary D. Wilt

<u>Year</u>	<u>Additional Tax</u>	<u>Fraud Penalty</u>
1955	\$ 211.86	\$121.34
1956	552.19	276.09
1957	746.65	449.21
1958	1,025.77	564.95
1959	1,518.29	759.14
1960	1,414.64	707.32

Appellants, husband and wife, filed joint federal and California personal income tax returns for the years 1955 through 1960. During that period Mr. Wilt (hereafter appellant), a medical doctor, conducted a private medical practice in California. Sometime in 1962 the Internal Revenue Service initiated an extensive audit of the federal returns, leading ultimately to the assessment of deficiencies and fraud penalties for the years in question. The federal adjustments were due primarily to appellant's omission of receipts from his medical practice and the disallowance of alleged business expenses deducted by appellant. Formal notification of the federal action was forwarded to appellants on June 16, 1965, and the federal action became final on September 16, 1965.

Respondent issued proposed assessments based on the federal action on December 31, 1965. The proposed assessments included the 50 percent fraud penalty provided for in section 18685 of the Revenue and Taxation Code. Subsequently, respondent conducted a protest hearing at which appellants' representative denied generally that appellants were liable for any additional tax or penalties. Respondent affirmed the proposed assessments and penalties and this appeal followed. Pursuant to the request of appellants, acquiesced in by respondent, the appeal was submitted for decision on the basis of the memoranda filed therein and without oral hearing before this board.

The issues presented for determination are: (1) whether the proposed assessments are barred by the applicable statute of limitations; (2) whether respondent's determination of deficiencies based upon corresponding federal action was proper; and (3) whether appellants are liable for civil fraud penalties for the years in issue.

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Appellants contend that respondent is barred by the statute of limitations from assessing additional tax for the years 1955 through 1960. However, the record on appeal indicates that appellants failed to report to respondent the fact that adjustments were made by the Internal Revenue Service to their federal returns for the years in question, as required by section 18451 of the Revenue and Taxation Code. Section 18586.2 of the Revenue and Taxation Code provides, in effect, that where the taxpayer fails to report such federal adjustments as required by section 18451, a notice of proposed deficiency assessment based upon the federal action may be issued by respondent within four years after such action, (Appeal of M. Hunter and Martha J. Brown, Cal. St. Bd. of Equal., Oct. 7, 1974; Appeal of Mary R. Encell, Cal. St. Bd. of Equal. , April 21, 1959.) Here, the Internal Revenue Service notified appellants of the final federal adjustments for the years in issue on June 16, 1965. Respondent's notices of proposed assessment based on the federal action were issued December 31, 1965, well within the applicable four year limitations period set out in section 18586.2.

Appellants also contend that respondent's proposed assessments of additional tax for the years 1955 through 1960 were improperly based entirely upon the federal investigation and adjustments for those years. We have consistently held that a deficiency assessment issued by respondent on the basis of corresponding federal action is presumed to be correct, and that the burden is upon the taxpayer to show that it is incorrect. (Appeal of Paritem and Janie Pooniah, Cal. St. Bd. of Equal. , Jan. 4, 1972; Appeal of J. Morris and Leila G. Forbes, Cal. St. Bd. of Equal. , Aug. 7, 1967; Appeal of Nicholas H. Obritsch, Cal. St. Bd. of Equal., Feb. 17, 1959.) Appellants have not offered any evidence to show wherein the federal determination was erroneous. In fact, they have offered no explanation or information concerning the instant appeal except their general denial of liability. Consequently, we must conclude that respondent's action with reference to the deficiency assessments for the years 1955 through 1960 was correct.

With respect to the fraud penalties assessed against appellants, a different question is presented. The burden of proving fraud is upon respondent, and it must be established by clear and convincing evidence. (Valetti v. Commissioner,

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260 F. 2d 185, 188; Appeal of George W. Fairchild, Cal. St. Bd. of Equal., Oct. 27, 1971..) Fraud implies bad faith, intentional wrongdoing, and a sinister motive; the taxpayer must have the specific intent to evade a tax believed to be owing. (Jones v. Commissioner, 259 F. 2d 300; 303; Powell v. Granquist, 252 F. 2d 56, 60. Although fraud may be established by circumstantial evidence (Powell v. Granquist, supra at 61) it is never presumed or imputed, and it will not be sustained upon circumstances which, at most, create only suspicion. (Jones v. Commissioner, supra at 303.)

The record on appeal contains no evidence that appellant's omissions of income and 'overstatement of allowable deductions resulted from a specific intent to evade tax. Respondent's decision to impose the fraud penalties was based entirely upon its evaluation of the contents of the federal audit report concerning appellants' federal returns. Respondent did not conduct an independent audit or otherwise investigate the conclusions contained in the federal audit report. We have previously held that respondent may not satisfy its burden of establishing fraud by clear and convincing evidence merely by relying upon a federal audit report. (Appeal of M. Hunter and Martha J. Brown, supra.)

In conclusion, **it is our determination that the proposed assessments of additional tax for the years in issue were timely and proper, and that the action of respondent in this respect must be sustained.** However, we cannot say, on the basis of the record before us, that respondent has established by clear and convincing evidence that the civil fraud penalty contained in section 18685 of the Revenue and Taxation Code was properly asserted against appellants for any of the years in issue. Therefore, respondent's assessment of the fraud penalties for the years in issue must be reversed.

ORDER

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

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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 William G. , Jr. , and Mary D. Wilt against proposed assessments of additional personal income tax in the amounts of \$211.86, \$552. 19, \$746.65, \$1,025.77, \$1,518.29, and \$1,414.64 for the years **1955, 1956, 1957, 1958, 1.959,** and 1960, respectively, be and the same is hereby sustained, and that the action of the Franchise Tax Board on the protest of William G. , Jr. , and Mary D. Wilt against proposed assessments of fraud penalties in the amounts of \$121.34, \$276.09, \$449.21, \$564.95, \$759.14, and \$707.32 for the years 1955, 1956, 1957, 1958, 1959, and 1960, respectively, be and the same is hereby reversed.

Done at Sacramento, California, this 8th day of March, 1976, by the State Board of Equalization.

Stallan to. Burns, Chairman
Paul Her, Member
George Sperry, Member
_____, Member
_____, Member

ATTEST: W. W. Dunlop, Executive Secretary