



BEFORE THE STATE BOARD OF EQUALIZATION  
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of' )  
DAVID CHOW ) No. **81A-1199-SW**

Appearances:

For Appellant: David Chow,  
in pro. per.  
Dennis L. Campbell  
Certified Public Accountant

For Respondent: Jon Jensen  
Counsel

O P I N I O N

This appeal is made pursuant to section 18593<sup>1/</sup> of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of David Chow against proposed assessments of additional personal income tax and penalties in the total amounts of **\$3,267.60, \$1,039.95, and \$11,501.70** for the years 1968, 1969, and 1972, respectively.

1/ Unless otherwise specified, all section references are to sections of the Revenue and Taxation Code as in effect for the years in issue.

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Two issues are presented in this appeal. The first issue is whether respondent's assessments based on federal assessments are correct, The second issue is whether respondent **properly** imposed civil fraud penalties.

On September 5, 1975, appellant pled guilty to a charge of willfully attempting to evade federal income taxes. The plea was entered in a federal district court in California and allegedly relates to the years in issue. The guilty plea ended a lengthy federal criminal fraud investigation of appellant's business affairs for the period 1966 through 1974.

Based on the criminal proceedings, the Internal Revenue Service (IRS) began an audit to determine appellant's proper tax liabilities. As a result of this **audit**, the **IRS** added unreported income **from** appellant's real estate partnerships and disallowed numerous business expense deductions, either because the expenses were personal expenses or because appellant could not substantiate them. For 1972, a large capital gain from the sale of stock was added to income, Finally, civil fraud penalties were imposed. Ultimately, appellant and the IRS reached an agreed settlement of his federal income tax liability.

The IRS notified respondent of the agreed audit changes and respondent issued proposed assessments which incorporated the changes. Appellant protested, contending that he had not agreed to the federal adjustments on the merits but for settlement purposes only. Respondent affirmed its assessments and this timely appeal resulted.

Appellant contends that respondent's assessment should not be based on the IRS settlement for several reasons. First, appellant contends that the settlement was forced upon him as a result of entrapment. Secondly, the IRS settlement allowed net operating loss carrybacks and carryforwards which California law does not allow. Finally, appellant contends that he has unreported expenses which were not considered. Appellant also argues that the income from the stock transaction was properly reported in 1973 **because** even though he received the money in 1972, the funds were placed in escrow in case there was a legal problem with **the sale** and appellant would be required to return the money.

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A deficiency assessment issued by respondent on the basis of a federal audit report is presumed to be correct as to issues of fact, and the burden is on the taxpayer to prove that respondent's determination is in error. (Todd v. McCobigan,, 89 Cal.App.2d 509 [201 P.2d 414] (1949).) Appellant initially contends that respondent incorrectly relied on the federal audit because the IRS applied net operating loss carrybacks and California did not. We have consistently held that where taxpayers agreed to federal adjustments which did not result in substantial federal tax liability because of net operating loss carrybacks, the presumption of correctness still attaches to the assessment. (Appeal of Von Housen Motors, Cal. St. Bd. of Equal., Mar. 3, 1982.)

Appellant also contends that the settlement upon which the state assessments are based was forced upon him and should not be binding. Again, we have held that where the final federal action resulted from a settlement agreement which the taxpayer made with the IRS, the **presumption** of correctness remains in effect. (Appeal of Robert B. and Patricia Silver, Cal. St. Bd. of Equal., Oct. 14, 1982.)

Appellant next argues that he incurred business expenses which were never reported. No evidence, however, has been presented to support this contention. Without this evidence, we cannot conclude that respondent's action is incorrect. (See Appeal of Barbara P. Hutchinson, Cal. St. Bd. of Equal., June 29, 1982.)

Finally, we must resolve the question of whether the income from the sale of certain stock should be reported in 1972 or 1973. The facts indicate that appellant actually received the money from the sale of the stock in 1972. Because of potential legal problems, appellant placed the funds in a trust fund until 1973. Appellant regarded the funds as income for 1973 as he kept the proceeds in a trust fund during 1972.

Section 17571, the California counterpart to Internal Revenue Code section 451(a), provides as follows:

(a) The amount of any item of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under the method of accounting used in computing taxable income,

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such amount is to be properly accounted for as of a different period. (Emphasis added.)

It is well established that, as a general rule, the gains, profits, and income of a cash basis taxpayer shall be included in gross income for the taxable year in which they are received.' (Appeal of J. Bryant and MaryAnn Kasey, Cal. St. Bd. of Equal., Feb. 26, 1969.) Appellant received the funds in 1972. Because he was . . . concerned over potential legal problems, upon the advice of his accountant and attorney he placed the funds in a trust account. He was not, however, required to do so. Because his actions were voluntary, we must conclude that his right to the funds was not restricted in any way and that **when** he received the money in 1972, the amounts were **properly** held to be **includible** in his 1973 gross income. (North American Oil Consolidated v. Burnet, 286 U.S. 417 [76 L.Ed. 1197] (11932).)

The final issue in this appeal is whether a fraud penalty, **as** authorized by section 18685, was properly imposed. While the burden of proving fraud is upon respondent, we have **held** that a prior guilty plea operates as an admission against interest which, by itself, can justify a fraud penalty if not adequately explained away by the taxpayer. (Appeal of Robert V. Erilane, Cal. St. Bd. of Equal., **Nov. 12, 1974.**) **In this** case, appellant pled guilty to federal criminal charges of willfully attempting to evade federal income taxes. Although appellant contends that this plea was forced upon him because of an entrapment by federal agents, no evidence has been presented in support **of this** contention. Under these circumstances, the action of respondent as to the fraud penalty must be sustained.



