STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
JAMES E. ELLETT	:	DECISION DTA NO. 818858
for Redetermination of a Deficiency or for Refund of Personal Income Tax under Article 22 of the Tax Law for the Year 1999.	:	

Petitioner James E. Ellett, c/o 5171 State Route 32, Catskill, New York 12414, filed an exception to the determination of the Administrative Law Judge issued on March 20, 2003. Petitioner appeared *pro se*. The Division of Taxation appeared by Mark F. Volk, Esq. (Kathleen O'Connell, Esq., of counsel).

Petitioner did not file a brief in support of his exception. The Division of Taxation filed a brief in opposition. Oral argument was not requested.

After reviewing the entire record in this matter, the Tax Appeals Tribunal renders the following decision.

ISSUE

Whether the fraud penalty provided by Tax Law § 685(e) should be imposed in lieu of the Tax Law § 685(b)(1) and (2) penalty asserted by the Division of Taxation in the Notice of Deficiency issued to petitioner.

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge except for finding of fact "7" which has been modified. The Administrative Law Judge's findings of fact and the modified finding of fact are set forth below.

In 1999, petitioner, James E. Ellett, earned $63,658.08 in wage income from Central Hudson Gas & Electric Corporation of Poughkeepsie, New York. Petitioner's employer withheld New York State income tax of $3,446.10 from these wages.

Petitioner filed a timely 1999 New York State resident personal income tax return. He reported $63,658.08 in wage income on line 1 of the return and $2,517.14 in taxable interest income on line 2, and by adding these two amounts arrived at Federal adjusted gross income of $66,175.22, which he reported on line 18 of the return. Petitioner then subtracted interest income on United States government bonds in the amount of $2,470.72 from his Federal adjusted gross income on line 26 as a "New York subtraction." This resulted in reported New York adjusted gross income of $63,704.50. After taking an itemized deduction in the amount of $72,261.56, the return reported zero New York taxable income and claimed a refund in the amount of New York income tax withheld by his employer, i.e., $3,446.10. The Division of Taxation ("Division") paid the claimed refund.

Petitioner's itemized deductions consisted of amounts claimed for taxes, interest and gifts to charities. The itemized deductions also included on line 7, "other miscellaneous deductions," an amount equal to his wage income of $63,658.08.

The Division later audited petitioner's 1999 return and disallowed the claimed itemized deductions when petitioner failed to respond to the Division's request for documentation

supporting the itemized deductions. The Division thus determined petitioner's 1999 New York adjusted gross income to be $63,704.00. After allowing a standard deduction of $6,500.00, the Division calculated taxable income of $57,204.00 with tax due thereon of $3,523.00.

On December 11, 2000, the Division issued to petitioner a Notice of Deficiency which asserted $3,523.00 in income tax due for the year 1999, plus penalty under Tax Law § 685(b)(1), (2), and interest.

On November 23, 1998, petitioner signed and filed with his employer a Withholding Exemption Certificate, Form W-4, which claimed he was exempt from the imposition of Federal income tax for the year 1999. Petitioner's Wage and Tax Statement, Form W-2, for the year at issue indicates that no Federal income tax was withheld.

Following the issuance of the Notice of Deficiency, petitioner filed a request for a conciliation conference with the Bureau of Conciliation and Mediation Services ("BCMS"). BCMS issued an order sustaining the statutory notice and petitioner subsequently filed a petition with the Division of Tax Appeals which made the following assertions:

a) That the Commissioner of Taxation and Finance made the incorrect assumption that petitioner was a person liable for the Federal income tax, and therefore subject to New York State personal income tax.

b) That petitioner is not a United States citizen and is not a person liable for the Federal individual income tax and therefore, not a person liable for the New York State personal income tax.

We modify finding of fact "7" of the Administrative Law Judge's determination to read as follows:

> In its answer filed in response to the petition and at the commencement and close of the hearing, the Division requested that the Division of Tax Appeals impose a fraud penalty pursuant to Tax Law § 685(e) in lieu of the penalty asserted on the Notice of Deficiency pursuant to Tax Law § 685(b)(1) and (2), impose the penalty pursuant to Tax Law § 685(q) for filing a frivolous return, and impose the maximum penalty for filing a frivolous petition pursuant to Tax Law § 2018 and 20 NYCRR 3000.21.

Petitioner was born in the United States of America. At all times relevant herein he was a New York resident.

THE DETERMINATION OF THE ADMINISTRATIVE LAW JUDGE

In his determination, the Administrative Law Judge rejected petitioner's argument that he was not subject to New York personal income tax because he is not a United States citizen. The Administrative Law Judge found that since petitioner was born in the United States, he was a citizen of the United States and his wage income was properly subject to both Federal and New York State personal income tax. The Administrative Law Judge noted that petitioner's position had previously been rejected and deemed frivolous by the Tax Appeals Tribunal and the Federal courts. The Administrative Law Judge imposed a penalty of $500.00 against petitioner pursuant to Tax Law § 2018 because his position in this proceeding was frivolous. The Administrative Law Judge noted that the Tax Appeals Tribunal had sustained a $500.00 frivolous position penalty against this petitioner on two previous occasions. The Administrative Law Judge did not consider the Division's request for the imposition of penalty pursuant to Tax Law § 685(q).

The Administrative Law Judge upheld the Division's request for the imposition of a fraud penalty pursuant to Tax Law § 685(e) in lieu of the Tax Law § 685(b)(1) and (2) penalties asserted in the Notice of Deficiency issued to petitioner. The Administrative Law Judge found that the Division had met its burden to prove by clear and convincing evidence that petitioner

failed to report additional income on his State personal income tax return and that his failure to report this additional income was with the intent to evade tax.

The Administrative Law Judge found that petitioner knowingly and willfully submitted a false Form W-4 claiming exemption from Federal withholding for the year at issue. In addition, and without basis, petitioner claimed as an itemized deduction a category entitled "other miscellaneous deductions," in an amount equal to his wage income of $63,658.08.

ARGUMENTS ON EXCEPTION

On exception, petitioner argues that the Administrative Law Judge improperly imposed the fraud penalty. Petitioner claims that he did not file a false W-4 Form.

OPINION

The only issue raised on exception by petitioner is whether the fraud penalty was properly imposed against him. Tax Law § 685(e) provides that if any part of a deficiency of income tax is due to fraud, a penalty of 50% of the deficiency shall be added to the tax in lieu of the penalties imposed by Tax Law § 685(a) or (b).

For the Division to establish fraud by a taxpayer, it must produce "clear, definite and unmistakable evidence of every element of fraud, including willful, knowledgeable and intentional wrongful acts or omissions constituting false representation, resulting in deliberate nonpayment or underpayment of taxes due and owing" (***Matter of Sener***, Tax Appeals Tribunal, May 5, 1988; ***see also***, ***Schaffer v. Commissioner***, 779 F2d 849, 86-1 USTC ¶ 9132; ***Matter of Cousins Serv. Sta.***, Tax Appeals Tribunal, August 11, 1988).

The Division need not establish fraud by direct evidence, but can establish it by circumstantial evidence by surveying the taxpayer's entire course of conduct in the context of the

events in question and drawing reasonable inferences therefrom (***Plunkett v. Commissioner***, 465 F2d 299, 72-2 USTC ¶ 9541; ***Biggs v. Commissioner***, 440 F2d 1, 71-1 USTC ¶ 9306; ***Matter of Cinelli***, Tax Appeals Tribunal, September 14, 1989, citing ***Korecky v. Commissioner***, 781 F2d 1566, 86-1 USTC ¶ 9232).

Among the factors that have been considered in finding fraudulent intent are consistent and substantial understatement of taxes (***Foster v. Commissioner***, 391 F2d 727, 68-1 USTC ¶ 9256; ***Merritt v. Commissioner***, 301 F2d 484, 62-1 USTC ¶ 9408). Understatement alone is not sufficient to prove fraudulent intent but, where other factors indicate fraudulent intent, the size and frequency of the omissions are to be considered in determining fraud (***see***, ***Foster v. Commissioner***, ***supra***).

The Division bases the imposition of a fraud penalty on petitioner's "knowing" filing of a false W-4 form for 1999 and his claiming an itemized deduction equal to his wages on his personal income tax return for 1999. The Division argues that petitioner had taken a similar position as to his non-taxable status for prior years and, as to those years, petitioner knew that both the Division and BCMS disagreed with his position and maintained that petitioner's wage income was subject to tax.

We agree with the Administrative Law Judge that petitioner's position that his wages are not subject to tax is, at best, frivolous and contrary to law. However, we do not find that the record supports the imposition of a fraud penalty against petitioner in this instance.

At the time petitioner submitted the W-4 Form at issue to his employer claiming to be exempt from the imposition of federal tax for 1999, and at the time that he filed his New York State personal income tax return for 1999 (on or before April 15, 2000), the taxability of

petitioner's wages for prior years had not yet been the subject of a determination by an Administrative Law Judge nor a final decision from this Tribunal. While petitioner was incorrect to file a W-4 indicating that he was exempt from taxation and to claim the entire amount of his wages as an itemized deduction from his income, the Division has not shown by clear and convincing evidence that petitioner's misguided actions were "willful, knowledgeable and intentional" wrongful acts that resulted in deliberate nonpayment or underpayment of taxes due and owing. As a result, we reverse the Administrative Law Judge's imposition of the fraud penalty and affirm the imposition of the penalty asserted in the Notice of Deficiency pursuant to Tax Law § 685(b)(1) and (2).

In all other respects, we find that the Administrative Law Judge completely and adequately addressed the issues presented to him and we see no reason to modify them in any respect.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of James E. Ellett is granted;

2. The determination of the Administrative Law Judge is reversed to the extent that the imposition of the fraud penalty is canceled and the Tax Law § 685(b)(1) and (2) penalty is reinstated, but in all other respects is sustained;

3. The petition of James E. Ellett is denied;

4. The notice of deficiency dated December 1, 2000 is sustained; and

5. Penalty in the amount of $500.00 imposed for filing a frivolous petition is sustained.

DATED: Troy, New York
December 18, 2003

/s/Donald C. DeWitt
Donald C. DeWitt
President

/s/Carroll R. Jenkins
Carroll R. Jenkins
Commissioner