STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
MICHAEL J. FAHY	:	DECISION
for Redetermination of a Deficiency or for Refund of Personal Income and Unincorporated Business Taxes under Articles 22 and 23 of the Tax Law for the Years 1972 and 1973.	:	

Petitioner, Michael J. Fahy, R.D. 3, Sauquoit, New York 13456, filed an exception to the determination of the Administrative Law Judge issued on February 9, 1989 with respect to his petition for redetermination of a deficiency or for refund of personal income and unincorporated business taxes under Articles 22 and 23 of the Tax Law for the years 1972 and 1973 (File No. 800078). Petitioner appeared pro se. The Division of Taxation appeared by William F. Collins, Esq. (Mark Volk, Esq., of counsel).

Petitioner filed a brief. The Division filed a letter in lieu of a brief. Petitioner did not request oral argument.

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

ISSUES

I. Whether the Division properly determined additional tax due from petitioner.

II. Whether the imposition of the fraud penalty herein pursuant to Tax Law § 685(e) was proper.

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge and such facts are stated below except that finding of fact "8" is modified as shown.

On October 13, 1978, following an audit, the Division issued to petitioner, Michael J. Fahy, a Notice of Deficiency which asserted total additional personal income and unincorporated

business taxes due of $4,289.90 for the years 1972 and 1973, plus fraud penalty pursuant to TaxLaw § 685(e). A Statement of Audit Changes, dated August 22, 1977, and issued to petitioner more specifically set forth petitioner's asserted liability as follows:

	1972	1973
Personal Income Tax Due	$574.27	$2,158.88
Unincorporated Business Tax Due	333.45	1,223.30
Penalty Due @ 50%	453.87	1,691.09

Petitioner filed documents with the Division, dated April 15, 1973 and April 15, 1974, which consisted of New York State income tax resident returns (Form IT-201) for 1972 and 1973. The IT-201 for 1972 had petitioner's name, address, social security number and occupation ("self-employed") filled in. On line 8 ("Exemptions") petitioner wrote in "$650.00". The form was signed by petitioner and dated. The rest of the form was blank. The IT-201 for 1973 listed petitioner's name, address, social security number, county of residence and filing status. Written on the lines along the right side of the form were the words "Fifth Amendment". Attached to one of the IT-201's (the record is unclear as to which) was a statement by petitioner that the personal income tax was unconstitutional and therefore he refused to pay. He also attached to the return various newspaper articles regarding the abortion issue and a statement (attached to the return as Exhibit "A") which listed various reasons why the income tax was improper. Among the reasons listed were the following:

> "I wish to state that I earned less than $600.00 in constitutional, lawful United States money in the year 1970, and therefore owe no income tax. (Exhibit B [attached to the return])
>
> I further wish to state that even if I had earned $600.00 in lawful United States money, I would have to refuse payment of any income tax because I would be compelled thereby to participate in a program which is killing thousands of unborn children. This would be a violation of my rights under the first amendment which states, 'Congress shall make no law respecting an establishment of religion, or prohibiting the free exercise thereof;.....'
>
> Exhibit 'C' [attached to the return] makes it abundantly clear that the highest authority of the Catholic Church, of which I am a member, look upon abortion as murder and Exhibit 'D' [attached to

the return] makes it clear that both New York State and the Federal Government are using tax money to pay for abortions.

* * *

The Communist Manifesto, written by Karl Marx in 1948 [sic], lists 10 specific planks that will destroy the God-given rights of Americans to life, liberty and the pursuit of happiness--guaranteed by the Constitution of the United States. Their program for destruction of Sovereign America lists the number 2 method as: 'A heavy progressive or graduated income tax.' Number 5: 'Centralization of credit in the hands of the state by means of a national bank with State capital and an exclusive monopoly.' Today, both programs are accomplished fact [sic].

The Federal Reserve Banks create Federal Reserve notes (promises to pay) simply by bookkeeping entries, paying only for costs of paper and ink which is less than 1¢ per note, yet it was only ten months after the 16th Amendment was ratified, Law 12 USC 531 exempted the Federal Reserve Banks from paying taxes on income -- a gross discrimination.

* * *

The U.S. government printing offices has printed documentation that there are over 350,000 tax exempt organizations. There are

fourteen in the Rockefeller family. Nelson Rockefeller, New York's Governor, paid only $685 income taxes for the year '66.

The XVI Amendment says 'The Congress shall have power to lay and collect taxes on incomes, from whatever source derived.....'"

The Division subsequently attempted to audit petitioner with respect to his 1972 and 1973 tax liability. At that time, petitioner was under investigation by the Division regarding his tax liability for 1969 through 1971. Petitioner did not cooperate with the Division and the matter was subsequently referred for criminal prosecution. Following a trial, petitioner was convicted in Oneida County Supreme Court on November 24, 1976 of two counts of failure to file New York State income tax resident returns with intent to evade payment thereon and two counts of failure to file New York State unincorporated business tax returns with intent to evade payment thereon. All four counts upon which petitioner was convicted were misdemeanors. Petitioner was convicted in respect of his 1972 and 1973 personal income and unincorporated business tax liability.

On December 30, 1976, petitioner was sentenced to pay a fine of $500.00 on each count, for a total of $2,000.00, and to file personal income and unincorporated business tax returns for 1972 and 1973. He was also placed on probation for one year.

On May 3, 1977, petitioner was ordered by the court to pay the fines and to file the returns for the years in question by June 6, 1977.

Petitioner filed personal income and unincorporated business tax returns for 1972 and 1973 on June 21, 1977.

On July 20, 1977, petitioner's probation was revoked and he was sentenced to 90 days in the Oneida County Jail. At that time, the court signed a show cause order returnable on August 3, 1977, and an order staying the execution of the sentence.

We modify finding of fact "8" of the Administrative Law Judge's determination to read as follows:

> On or about August 1, 1977, petitioner paid the fines imposed by the court and, on August 22, 1977, he paid tax, interest to August 15, 1977, and 50 percent penalty in respect of the amounts shown due on the returns filed on June 21, 1977. Petitioner's wife paid the tax owed with a check marked "payment in full". The Tax Department tendered the check.[1]

On August 31, 1977, the sentence imposed on July 20, 1977 was vacated and the original sentence imposed on December 30, 1976 was reinstated. Petitioner had filed returns for 1972 and 1973 and paid fines as ordered by the court. He had also submitted to an audit pursuant to court order.

The audit resulting in the deficiency herein was commenced on or about August 8, 1977. The audit was conducted in respect of petitioner's returns for 1972 and 1973, which were filed on June 21, 1977. During 1972 and part of 1973, petitioner owned and operated "M. J. Fahy Kitchens", a sole proprietorship engaged in the business of selling kitchen equipment. On audit, the Division examined petitioner's available books and records, including both his personal and business bank statements. The Division determined that petitioner's records were "disorganized and not well-related to records of income and expense".

The Division's review of petitioner's records for 1972 resulted in the following adjustments:

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[1]The Administrative Law Judge's finding of fact "8" read as follows:

> "On or about August 1, 1977, petitioner paid the fines imposed by the court and, on August 22, 1977, he paid tax, interest to August 15, 1977, and 50 percent penalty in respect of the amounts shown due on the returns filed on June 21, 1977."

We modified this finding by adding the last two sentences to more completely reflect the record.

(a) Petitioner's gross receipts were reconstructed by totaling deposits in petitioner's business checking account and totaling his cash expenses per his books. Audited gross receipts were thus determined to be $183,597.42, as compared to reported gross receipts of $173,576.36.

(b) Petitioner's cost of goods sold was increased to $126,452.01 from $121,594.44 because of computational errors in petitioner's records.

(c) The Division reduced petitioner's claimed auto expenses of $5,130.00 to $2,700.00 based on the existing standard mileage rates.

(d) The Division also disallowed petitioner's bad debt deduction of $950.02. The Division contended that, as a cash basis taxpayer, petitioner was not entitled to that deduction.

(e) Further, the Division disallowed $552.59 of petitioner's claimed utilities expense deduction of $3,572.85. This disallowance amounted to 80 percent of $690.73 in utilities expenses paid on petitioner's personal residence and claimed as a business deduction.

(f) The above-noted adjustments for 1972 resulted in an increase in petitioner's taxable income for personal income tax purposes of $9,096.10 and (after a 20 percent allowance for petitioner's personal services) an increase in petitioner's taxable business income for unincorporated business tax purposes of $7,276.88.

The audit of petitioner's 1973 records resulted in the following adjustments:

(a) Petitioner's gross receipts were reconstructed by totaling business checking account deposits, cash expenses per books, and the sale of the business's inventory. Audited gross receipts thus totaled $102,471.38. Reported gross receipts were $72,797.51. Regarding the sale of inventory, petitioner terminated his sole proprietorship on June 7, 1973 and sold his inventory to Fahy Kitchens, Inc., a corporation controlled by his wife. In exchange for the inventory, petitioner received a note in the amount of $15,184.98.

(b) Petitioner's reported cost of goods sold was increased by $8,687.19 to $59,614.09. This adjustment resulted from computational errors in petitioner's records and the reduction in

petitioner's ending inventory to zero because of the sale of the proprietorship's inventory to the corporation.

(c) The Division also disallowed $270.15 of petitioner's utilities expense deduction of $1,931.28. As with the audit of the 1972 returns, this disallowance represented 80 percent of $337.69 in utilities expenses paid on petitioner's personal residence and claimed on his return as a business deduction.

(d) The Division also determined that $8,100.00 of commissions earned by petitioner as a salesman for Fahy Kitchens, Inc. were properly subject to unincorporated business tax.

(e) With respect to petitioner's schedule D for 1973, the Division allowed petitioner's claimed short-term capital loss of $375.50 on a silver contract and disallowed a claimed long-term capital loss of $1,896.00 on First Federated Community Trust stock. The long-term loss was disallowed because the company's stock was not declared valueless in 1973. The company was placed in receivership and petitioner received consideration for his stock in 1975 and 1976. The Division also disallowed a long-term capital gain on petitioner's sale of inventory to Fahy Kitchens, Inc. As noted above, on audit, the proceeds of this sale were included as part of petitioner's gross receipts (and therefore were treated as ordinary income). Since, following the audit, petitioner had a short-term capital loss, petitioner's reported capital gain modification of $507.93 was reversed.

(f) As a result of the foregoing adjustments, petitioner's taxable income for personal income tax purposes was increased by $18,209.29 and his taxable business income for unincorporated business tax purposes was increased by $24,933.83.

The audited returns herein were prepared by G. M. Morgan, petitioner's accountant, and signed by petitioner.

At hearing, petitioner presented no evidence to refute any of the specific adjustments to his taxable income made on audit by the Division. Petitioner reiterated his constitutional and moral

objections to the imposition of the personal income and unincorporated business taxes which were attached to his original 1972 and 1973 "returns" and summarized, in part, in our findings of fact, infra.

OPINION

In the determination below, the Administrative Law Judge dismissed the petition of Michael Fahy, finding that petitioner failed to prove that the Division's audit of petitioner's books and its adjustment of his taxes was improper. The Administrative Law Judge also found that petitioner fraudulently failed to pay his taxes in 1972 and 1973; he found petitioner's constitutional arguments frivolous, and his religious objections to paying taxes without merit.

On exception, petitioner disagrees with all of the Administrative Law Judge's findings and argues that paying New York taxes is voluntary. Petitioner also argues that since the check used to pay part of his 1972 and 1973 tax bill was marked "paid in full" and because the Division cashed the check, he satisfied his 1972 and 1973 tax liability at that time. The Division argues that petitioner's admission that he deliberately refused to pay his taxes and his criminal conviction for not having done so support the finding of fraud and the imposition of the fraud penalty. The Division also argues that petitioner's reason for not paying his taxes -- his disagreement with the law which provides payment for Medicaid abortions -- is insufficient to relieve him of his duty to pay the tax owed, as is petitioner's constitutional argument in support of his protest. We agree with the Division and affirm the determination below.

It is well-settled that use of an indirect audit method to determine deficiencies is proper when the taxpayer's books and records do not clearly reflect his income (Matter of Giuliano v. Chu, 135 AD2d 893, 521 NYS2d 883, 885-886). Petitioner has the burden of proving that the audit method used to determine his tax was improper (Matter of Scarpulla v. State Tax Commn., 120 AD2d 842, 502 NYS2d 113; Tax Law § 689[e]). Petitioner was audited by use of the bank deposits plus cash expenditures method. The Division's witness testified that petitioner's records were disorganized and poorly related to income and expense accountings, warranting the indirect

audit. Petitioner offered no proof whatsoever to show that the Division's use of bank statements and cash expenditures to determine his tax was inappropriate. Nor did he offer proof to substantiate his taxes as he reported them. Petitioner, therefore, failed to meet his burden of proving that the audit method was improper.

If any part of a tax deficiency is proven to have been due to fraud, a penalty equal to fifty per cent of the tax is added to the deficiency (Tax Law § 685[e]). The Division has the burden of proving the elements of fraud with clear and convincing evidence (Matter of Ilter Sener, Tax Appeals Tribunal, May 5, 1988). A prior criminal conviction, however, may preclude a petitioner from litigating his or her civil liability (S.T. Grand, Inc. v. City of New York, 32 NY2d 300, 344 NYS2d 938). This is so when the issues in both proceedings are identical, when the issue was necessarily decided in the prior proceeding, and when the petitioner was given a full and fair opportunity to litigate the issue in the prior proceeding (S.T. Grand, Inc. v. City of New York, supra, 344 NYS2d 938 at 941 quoting Schwartz v. Public Admin. of County of Bronx, 24 NY2d 65, 298 NYS2d 955, 960). The principle of collateral estoppel, more recently known as "issue preclusion", applies to administrative as well as judicial proceedings (Berstein v. Birch Wathen School, 71 AD2d 129, 421 NYS2d 574, 575 affd without opinion, 51 NY2d 932, 434 NYS2d 994).

The issue litigated in petitioner's criminal case was identical to the issue here -- whether petitioner intentionally and wrongfully failed to pay his taxes in 1972 and 1973. A finding of civil liability for fraud requires proof of "willful, knowledgeable and intentional wrongful acts resulting in deliberate nonpayment or underpayment of taxes due and owing" (Matter of Cinelli, Tax Appeals Tribunal, September 14, 1989). Defendant's conviction for evasion of his taxes required proof beyond a reasonable doubt that he intended to evade and failed to pay his taxes (see, former Tax Law § 695). Therefore, the determinative facts in each case were also the same. Petitioner's willful failure to pay his 1972 and 1973 taxes was litigated and proven beyond a reasonable doubt

in a misdemeanor trial. That conviction, therefore, collaterally estops him from disputing that he committed civil fraud in failing to pay his taxes for the very same years. Our conclusion is in accordance with federal law on collateral estoppel (see, Gray v. Commr., 708 F2d 243, cert denied 466 US 927, 83-1 USTC ¶ 9391, at 87,112; see also, Moore v. United States, 360 F2d 353, cert denied 385 US 1001, 66-1 USTC ¶ 9131). The fraud penalty was therefore properly imposed.

Even if petitioner was not collaterally estopped from relitigating the fraud issue, we would still find his argument that he acted without culpable intent pursuant to his First Amendment rights without merit. First Amendment rights are "neither absolute nor unlimited" (People v. Stover, 12 NY2d 462, 240 NYS2d 734, 739) and they do not extend to protests of government action through tax resistance (see, United States v. Malinowski, 472 F2d 850, 73-1 USTC ¶ 9199, cert denied 411 US 970; Autenrieth v. Cullen, 418 F2d 586, 69-2 USTC ¶ 9724, cert denied 397 US 1036; Fahy v. Commr., T.C. Memo 1982-37, 43 TCM 387, 394; Bouck v. Commr., T.C. Memo 1975-352, 34 TCM 1536). In addition, proof of "willfulness" within the meaning of the statute does not require proof of an evil or bad purpose. "An act is done 'willfully' if done voluntarily and with the specific intent to do something the law forbids" (United States v. Malinowski, supra, 73-1 USTC ¶ 9199, at 80,334).

Petitioner's argument that his cancelled check is an accord and satisfaction of his tax liability is also without merit. Sections 171 eighteenth and eighteenth-a of the Tax Law provide specific procedures for compromising a tax deficiency with the Division. An accord and satisfaction is not among the formal or correct procedures for settling tax claims outlined in Tax Law § 171 eighteenth or eighteenth-a (Matter of Patricia W. Heath, State Tax Commn., October 5, 1984; see, Bowling v. United States, 510 F2d 112, 75-1 USTC ¶ 9333, at 86,786). In fact, no theory founded upon general concepts of accord and satisfaction can be used to impute a compromise settlement of a tax case (see, Bowling v. United States, supra). The United States Tax Court has held that principles of accord and satisfaction from ordinary contract law simply do

not apply to tax law (see, Colebank v. Commr., T.C. Memo 1977-046, 36 TCM 200, affd. without opinion 610 F2d 999, cert denied 449 US 953).

Petitioner's argument that paying income taxes is voluntary is also without merit. The states retained their power, as sovereigns, to tax and the taxing power of a state is coextensive with its sovereignty (McCulloch v. Maryland, 4 Wheat 316, 4 L Ed 579). Acting within its taxing power, New York State enacted enforcement procedures to compel taxpayers to comply with the taxing statute, under one provision of which petitioner was convicted for tax evasion. Thus, the payment of New York State taxes is not "voluntary" since "external compulsion" exists within the taxing statute (see, Webster's New Collegiate Dictionary 1322 [9th ed. 1987]).

Contrary to petitioner's argument that paying his income tax interferes with his constitutional right to freedom of religion, paying taxes does not interfere with his free exercise of religious practice. "The distinction between freedom of religious beliefs and the practice thereof is well-settled" (Fahy v. Procaccino, 50 AD2d 690, 375 NYS2d 470, 471, appeal dismissed 39 NY2d 832, 385 NYS2d 1029; see, Cantwell v. Connecticut, 310 US 296). "It is clear . . . that a taxing statute is not contrary to the provisions of the First Amendment unless it directly restricts the free exercise by an individual of his religion" (Muste v. Commr., 35 TC 913, at 918; Russell v. Commr., 60 TC 942, 946). No facts were presented to show that petitioner was prevented from exercising his religious practice by paying his income tax. This issue is therefore without merit.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of petitioner, Michael Fahy, is in all respects denied;
2. The determination of the Administrative Law Judge is affirmed;
3. The petition of Michael Fahy is denied; and

4. The Notice of Deficiency issued October 13, 1978 is sustained.

DATED: Troy, New York
April 5, 1990

/s/John P. Dugan
John P. Dugan
President

/s/Francis R. Koenig
Francis R. Koenig
Commissioner

/s/Maria T. Jones
Maria T. Jones
Commissioner