

STATE OF NEW YORK

DIVISION OF TAX APPEALS

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In the Matter of the Petitions :  
of :  
**JAMES E. ELLETT** : DETERMINATION  
for Redetermination of Deficiencies or for Refund of : DTA NO. 819472  
Personal Income Tax under Article 22 of the Tax Law :  
for the Years 2000 and 2001. :

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Petitioner, James E. Ellett, c/o 5171 Rt. 32, Catskill, New York 12414, filed petitions for redetermination of deficiencies or for refund of New York State personal income tax under Article 22 of the Tax Law for the years 2000 and 2001.

A hearing was held before Timothy J. Alston, Administrative Law Judge, at the offices of the Division of Tax Appeals, 500 Federal Street, Troy, New York, on December 10, 2003, at 10:30 A.M., which date began the six-month period for the issuance of this determination. Petitioner appeared *pro se*. The Division of Taxation appeared by Mark F. Volk, Esq. (Michelle M. Helm, Esq., of counsel).

***ISSUES***

- I. Whether petitioner's wage income was subject to New York State personal income tax.
- II. Whether the fraud penalty provided by Tax Law § 685(e) should be imposed in lieu of the Tax Law § 685(b)(1) and (2) penalties asserted by the Division of Taxation in the Notice of Deficiency issued to petitioner in respect of the tax year 2000.
- III. Whether frivolous petition penalty pursuant to Tax Law § 2018 and 20 NYCRR 3000.21 should be imposed.

***FINDINGS OF FACT***

1. In 2000, petitioner, James E. Ellett, earned \$66,081.54 in wage income from Central Hudson Gas & Electric Corporation of Poughkeepsie, New York, where petitioner works as a mechanic. Petitioner's employer withheld New York State income tax of \$2,507.12 from these wages.

2. Petitioner filed a timely 2000 New York State resident personal income tax return dated April 10, 2001. He reported \$66,081.54 in wage income on line 1 of the return. He also reported \$74.12 in taxable interest income and \$142.50 in ordinary dividends. He reported the total of these items of income, i.e., \$66,298.16, as his Federal adjusted gross income on line 18 of the return. He reported the same amount as his New York adjusted gross income on line 30 of the return. Petitioner claimed \$73,523.00 in itemized deductions on his return, consisting of \$5,240.96 in interest paid, 2,256.00 in gifts to charity and \$66,081.54, an amount equal to his wages, as a miscellaneous deduction. Petitioner thus reported zero New York taxable income and claimed a refund in the amount of New York income tax withheld by his employer, i.e., \$2,507.12. The Division of Taxation ("Division") paid the claimed refund.

3. The Division later audited petitioner's 2000 return and disallowed petitioner's deduction of his wages as a miscellaneous deduction. The Division also disallowed as unsubstantiated a portion of petitioner's other deductions. The itemized deductions which were substantiated were less than the standard deduction. Accordingly, allowing the standard deduction of \$6,500.00, the Division calculated taxable income of \$59,798.00 with tax due thereon of \$3,698.00.

4. On February 25, 2002, the Division issued to petitioner Notice of Deficiency L-020650244 which asserted \$3,698.00 in income tax due for the year 2000, plus negligence penalty pursuant to Tax Law § 685(b)(1) and (2) and interest.

5. In 2001, petitioner earned \$64,911.34 from Central Hudson Gas & Electric Corporation. Petitioner did not report such income on his timely filed 2001 New York State resident return, but instead reported zero as his income from wages on the return. Petitioner also reported zero as his New York taxable income and claimed a refund in the amount of New York income tax withheld from his wages, i.e., \$3,572.26. The Division did not issue petitioner a refund in connection with the 2001 return.

6. The Division subsequently audited petitioner's 2001 return and recalculated petitioner's taxable income including his wages from his employment. The Division allowed petitioner a standard deduction and calculated tax liability of \$3,605.00. After allowing for tax withheld, petitioner's net tax liability was \$33.00.

7. On July 15, 2002, the Division issued Notice of Deficiency L-020914891 to petitioner which asserted \$33.00 in personal income tax due for 2001, plus interest.

8. Petitioner filed two petitions with the Division of Tax Appeals in respect of the two notices of deficiency at issue. Each of the petitions made the following assertions:

New York State Tax Law Article 22 must conform to United States Tax Law. I am not liable for the income tax under United States Tax Law and therefore, not liable for New York State personal income tax under Article 22.

9. During the years at issue, no Federal income tax was withheld from petitioner's wages. Petitioner explained that such lack of withholding resulted from his claim of exemption from withholding on forms W-4 he filed annually with his employer.

10. Petitioner was born in Catskill, New York and he was a resident of Catskill, New York at all times relevant herein.

11. At the time of the hearing, petitioner was under criminal indictment in United States District Court for the Northern District of New York and charged with willfully attempting to evade and defeat Federal income tax for the years 1996 through 1999. The criminal action was pending at the time of the hearing.

***SUMMARY OF THE PARTIES' POSITIONS***

12. Petitioner noted the lack of any withholding of Federal income tax from his wages and reasoned that the Internal Revenue Service “must feel” that he has no Federal tax liability for the years in question. Accordingly, since New York State Tax Law conforms to the Internal Revenue Code, petitioner concluded that he has no New York State tax liability for the years in question either.

13. Petitioner also asserted that a determination in this matter should be held in abeyance until the Federal criminal matter is resolved because the Federal matter involves the same issue as the instant matter.

14. In its answer filed in response to the petitions and at the commencement and close of the hearing, the Division requested that, with respect to Notice of Deficiency L-020650244, the Division of Tax Appeals impose the fraud penalty pursuant to Tax Law § 685(e) in lieu of the penalty pursuant to Tax Law § 685(b)(1) and (2) asserted in the notice. The Division also requested both in its answer and at hearing that the maximum frivolous petition penalty pursuant to Tax Law § 2018 and 20 NYCRR 3000.21 be imposed.

15. In its answer the Division requested the imposition of the frivolous return penalty pursuant to Tax Law § 685(q). The Division did not raise the issue of frivolous returns at the hearing. Accordingly, this issue is deemed abandoned by the Division.

### ***CONCLUSIONS OF LAW***

A. As determined by the Tax Appeals Tribunal in three earlier cases involving petitioner, and as is patently clear, petitioner's income from his employment is subject to New York personal income tax (*see, Matter of Ellett*, Tax Appeals Tribunal, December 18, 2003 [*"Ellett 3"*]; *Matter of Ellett*, Tax Appeals Tribunal, July 3, 2002 [*"Ellett 2"*]; *Matter of Ellett*, October 18, 2001 [*"Ellett 1"*]). Accordingly, the Division's recomputation of petitioner's tax liability for the years at issue was in all respects proper.

That petitioner filed a false and erroneous W-4 Form with his employer claiming exemption from Federal withholding does not indicate, as petitioner suggested, that the Internal Revenue Service accepted petitioner's claim of exemption from tax.

Additionally, there is no reason to hold the instant matters in abeyance pending the outcome of petitioner's Federal criminal case.

B. As noted, the Division requested that the Division of Tax Appeals impose the fraud penalty pursuant to Tax Law § 685(e) with respect to the asserted deficiency for the tax year 2000. In its most recent decision involving petitioner, the Tax Appeals Tribunal explained the standard for the imposition of the fraud penalty under Tax Law § 685(e) as follows:

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*). (*Ellett 3, supra*).

Proof of "willfulness" for purposes of the fraud penalty does not require proof of an evil or bad purpose. "An act is done 'willfully' if done voluntarily and intentionally, and with the specific intent to do something the law forbids" (*United States v. Malinowski*, 472 F2d 850, 853, 73-1 US Tax Cas ¶ 9199, *cert denied* 411 US 970).

C. The Division has established that the imposition of fraud penalty with respect to the 2000 deficiency is appropriate. In his deduction of his entire amount of wage income for 2000 petitioner substantially understated his income for that year. Moreover, he has similarly understated his income from employment, in its entirety, for the five years immediately preceding 2000. Furthermore, having observed petitioner at the hearing, I am convinced that he is, at the very least, a person of average intelligence and that he is not so naive as to reasonably believe that his income from his employment was fully deductible. Further, in contrast to *Ellett 3*, wherein the Tribunal rejected the imposition of the fraud penalty, at the time petitioner filed his 2000 New York State personal income tax return, dated April 10, 2001 and due on or before April 15, 2001, the taxability of petitioner's wages for prior years had been the subject of a determination by an administrative law judge. Specifically, an administrative law judge

determination in *Matter of Ellett* was issued on April 5, 2001 which rejected a claim by petitioner, similar to the instant matter, that his 1995 wage income was not subject to New York State income tax. Petitioner thus attempted to evade payment of a tax he knew he owed under the Tax Law (*see, Hebrank v. Commissioner*, 81 TC 640). Accordingly, the imposition of the fraud penalty under Tax Law § 685(e) is proper.

D. Tax Law § 2018 authorizes the Tax Appeals Tribunal to impose a penalty “if any petitioner commences or maintains a proceeding in the Division of Tax Appeals primarily for delay, or if the petitioner’s position in such proceeding is frivolous.” Such penalty may be imposed on the Tribunal’s own motion or on motion of the Office of Counsel of the Division of Taxation (20 NYCRR 3000.21). The maximum penalty allowable under this provision is \$500 (Tax Law § 2018).

E. In the three earlier cases before the Tax Appeals Tribunal covering the years 1995 through 1999, petitioner took a position similar or identical to the position he espoused herein. The Tribunal upheld the imposition of the frivolous petition penalty in each such case (*see, Ellett 3, supra; Ellett 2, supra; Ellett 1, supra*). Petitioner filed a separate petition in protest of each of the two subject notices of deficiency. Each such petition constitutes the commencement of a proceeding in the Division of Tax Appeals (*see, 20 NYCRR 3000.3[a]*). Accordingly, a frivolous petition penalty of \$500.00 is imposed for the petition filed in protest of the Notice of Deficiency dated February 25, 2002 and a \$500.00 frivolous petition penalty is imposed for the petition filed in protest of the Notice of Deficiency dated July 15, 2002 (*see, Tax Law § 2018; 20 NYCRR 3000.21*).

F. The petitions of James E. Ellett are in all respects denied; the notices of deficiency dated February 25, 2002 and July 15, 2002, are sustained; the penalty for fraud under Tax Law

§ 685(e) is imposed in lieu of the negligence penalty pursuant to Tax Law § 685(b)(1) and (2) in respect of the Notice of Deficiency dated February 25, 2002; a frivolous petition penalty of \$500.00 is imposed for the petition filed in protest of the Notice of Deficiency dated February 25, 2002; and a \$500.00 frivolous petition penalty is imposed for the petition filed in protest of the Notice of Deficiency dated July 15, 2002.

DATED: Troy, New York  
March 18, 2004

/s/ Timothy J. Alston  
ADMINISTRATIVE LAW JUDGE