

STATE OF NEW YORK
DIVISION OF TAX APPEALS

In the Matter of the Petition
of
CARLOS DELEON

DETERMINATION
DTA NO. 830406

for Redetermination of a Deficiency or for Refund of
New York State Personal Income Tax under Article 22
of the Tax Law for the Year 2007.

Petitioner, Carlos Deleon, filed a petition for redetermination of a deficiency or for refund of New York State personal income tax under article 22 of the Tax Law for the year 2007.

On December 20, 2021 and January 3, 2022, respectively, petitioner, appearing by Cohen, Frankel & Ruggiero, LLP (Mark I. Cohen, Esq., of counsel), and the Division of Taxation, appearing by Amanda Hiller, Esq. (Christopher O'Brien, Esq., of counsel), waived a hearing and submitted this matter for determination based on documents and briefs to be submitted by February 9, 2023, which date commenced the period for the issuance of this determination.¹ After due consideration of the documents and arguments submitted, Jessica DiFiore, Administrative Law Judge, renders the following determination.

ISSUES

- I. Whether additional tax due as asserted in the notice of deficiency should be sustained.
- II. Whether fraud penalties imposed under Tax Law § 685 (e) should be sustained.

¹ Although the parties agreed to proceed by submission in this case without a hearing pursuant to 20 NYCRR 3000.12, it continues to proceed in an expedited manner under Tax law § 2008 (2) as it involves the imposition of fraud penalties.

FINDINGS OF FACT

1. On August 21, 2012, petitioner, Carlos Deleon, appeared before the Honorable Paul A. Engelmayer, United States District Court Judge for the Southern District of New York, and pled guilty to one count of Conspiracy to Defraud the United States, in violation of 18 U.S.C. § 371.

2. On May 15, 2013, Judge Engelmayer held a sentencing hearing arising from petitioner's guilty plea. During the hearing, Judge Engelmayer referenced a presentence report and a joint stipulation between the United States Attorney for the Southern District of New York and petitioner. These documents were not submitted into the record in the instant matter.

3. During the sentencing hearing, Howard S. Master, the Assistant United States Attorney assigned to the case, stated that petitioner was the person who brought fraudulently obtained tax refund checks to the bank and requested that the bank manager cash them. Petitioner was not accused of obtaining stolen identities or preparing the fraudulent tax returns. Judge Engelmayer stated "[o]f the one and a half million dollars plus that was the fruits of this scheme, I understand that it's not possible to allocate precisely how much Mr. Deleon benefited." Judge Engelmayer then asked Mr. Master if the government had an estimate. Mr. Master asserted that "cashing activities" were approximately 20 percent of the scheme, including bribes that were paid to bank employees to assist in the scheme. Judge Engelmayer then estimated that approximately \$300,000.00 was attributed to petitioner and the two bank employees involved in this scheme, with some money filtering down to the individual tellers at the bank. He then referred to the presentence report that contained proposed restitution language. The proposed restitution amount was \$1,511,961.00 with \$1,058,373.00 going to the Division of Taxation (Division) and \$453,588.00 going to the Internal Revenue Service (IRS).

Mr. Master stated that \$1,058,373.00 was the loss to the Division. There is nothing in the record indicating how such loss was calculated.

4. Judge Engelmayer sentenced petitioner to six months of incarceration and three years of supervised release. Judge Engelmayer also ordered petitioner to pay the proposed restitution, in the amount of \$1,511,961.00, jointly and severally with his convicted co-conspirators. Specifically, Judge Engelmayer ordered that petitioner pay restitution to the Clerk of the United States District Court for disbursement, with \$1,058,373.00 owed to the Division, and \$453,588.00 owed to the IRS. Petitioner was required to pay the restitution in monthly installments of not less than 20 percent of petitioner's gross monthly income, including unearned income. Judge Engelmayer waived the interest requirement for the restitution because he determined petitioner did not have the ability to pay interest. He also imposed a mandatory special assessment of \$100.00.

5. In accordance with the Judgment referenced in finding of fact 4, petitioner has been making monthly restitution payments to the United States Department of Justice, who then disburses these payments to the Division.

6. On July 11, 2019, the Division sent petitioner a letter stating that an audit of his New York State income tax return for the tax year 2007 resulted in an increase to the tax liability in the amount of \$2,984,251.00. The letter also stated that all return correspondence should be directed to Festus Anaemeje at the address provided on the letterhead.

7. A schedule enclosed with the letter provided that petitioner owed additional tax of \$1,058,373.00, penalties of \$529,186.00, and interest of \$1,396,692.00. The schedule also provided that the tax of \$1,058,373.00 was found to be due from "[u]nreported federal changes as a result of Criminal Conviction." A section entitled "Remarks," stated that petitioner failed to

file a New York State income tax return for 2007. It also provided that petitioner was convicted of Conspiracy to Cash Fraudulently Obtained Tax Refund Checks because refund checks were inappropriately cashed at two JP Morgan branches and, therefore, tax, fraud penalty, and interest were imposed. The penalty imposed was pursuant to Tax Law § 685 (e) (1).

8. On August 20, 2019, the Division issued a notice of deficiency, notice number L-050396519 (notice), to petitioner, asserting tax due of \$1,058,373.00, penalties of \$534,493.78, and interest of \$1,407,307.57 for tax year 2007. In the section of the notice entitled “Computation Section,” it states “[f]ailure to produce your records for audit resulted in issuance of this assessment. Personal expenses disallowed on the audit . . . are taxable as constructive dividends. As a further explanation of this liability, please refer to the attached correspondence. An audit of your records disclosed additional tax due.” There was no substantive attached correspondence provided in the record.

9. On October 8, 2019, petitioner’s representative, Mark I. Cohen, Esq., sent a letter to Mr. Anaemeje, stating that he had been trying to obtain his phone number to discuss petitioner’s tax liability for tax year 2017. Mr. Cohen requested in the letter that Mr. Anaemeje contact him at the number provided.

10. On January 6, 2020, petitioner submitted a request for a conciliation conference (request) to the Bureau of Conciliation and Mediation Services (BCMS) regarding notice number L-050396519.

11. On April 2, 2021, BCMS issued a conciliation order dismissing request (conciliation order), CMS number 000328336, to petitioner. The conciliation order determined that petitioner’s protest of the notice was untimely as the request was required to be filed within 30

days from the date of the August 20, 2019 notice, but BCMS did not receive the request until January 6, 2020.

12. The Division did not offer any evidence as to when the notice was mailed to petitioner or when petitioner received the notice so as to prove that petitioner did not timely file his request with BCMS.

13. On April 23, 2021, petitioner timely filed a petition with the Division of Tax Appeals that protested the BCMS conciliation order and claimed that the Division incorrectly assessed him for interest and penalties on the \$1,058,373.00 in restitution in contravention of the sentencing order issued by Judge Engelmayer. Petitioner asserted that Judge Engelmayer's order provided that interest was waived for the restitution amount. Petitioner also claimed to be making monthly restitution payments to the United States Department of Justice for disbursement to the Division.

14. On July 6, 2021, the Division of Tax Appeals received the Division's answer. In its answer, the Division admitted that petitioner pled guilty to a count of Conspiracy to Cash Fraudulently Obtained Refund Checks and was ordered to pay restitution. In its affirmative statements, the Division asserted that an audit was conducted, resulting in a notice of deficiency, L-050396519, being issued on August 19, 2019, in the amount of \$3,000,174.35 for tax, penalty and interest due.² In the remainder of the answer, the Division affirmatively stated that petitioner's request for a conciliation conference with BCMS was untimely. The answer did not affirmatively plead fraud on the part of petitioner.

15. Mr. Anaemeje, a Forensic Tax Auditor II in the Criminal Investigations Division (CID) of the Division, submitted an affidavit sworn to on February 18, 2022. Mr. Anaemeje

² The only notice in the record was issued on August 20, 2019.

participated in the investigation and audit of petitioner. CID is the investigative and law enforcement arm of the Division. Mr. Anaemeje's duties as a Forensic Auditor II in CID included the examination of financial records and tax documents relating to criminal investigation of corporations and individuals, focusing on underreporting of income from any New York State source, tax frauds, and other schemes to defraud the State of New York. Mr. Anaemeje asserted that his affidavit is based on his knowledge of the facts in this matter from participating in this investigation and upon a review of the Division's official records kept in the ordinary course of business.

16. Mr. Anaemeje averred that the Southern District of New York United States Attorney investigated petitioner for tax years 2006 and 2007 regarding the use of social security numbers issued from Puerto Rico to file Federal and New York State income tax returns. He stated "[i]t was determined [p]etitioner would obtain Puerto Rican identification information such as names, birth certificates, Social Security numbers and would use this information to generate fraudulent tax returns, claiming large tax refunds from both the [sic] Federal and New York State, (IRS and New York State Tax Department)." It is not clear from the record who made this determination or what evidence was used to reach it. Mr. Anaemeje also averred that "[p]etitioner further conspired with Chase Bank employees to facilitate the cashing of these checks. Petitioners and, [sic] or his associates would bring these checks to the Chase Bank Branch, where employees would cash them." The record also does not provide what evidence Mr. Anaemeje relied on in making this assertion. Mr. Anaemeje did not state whether petitioner filed a 2007 return or how the tax due on the notice of deficiency was determined.

SUMMARY OF THE PARTIES' POSITIONS

17. Petitioner argues that because of his extensive, unanswered efforts to contact the auditor, BCMS should honor his request and schedule a conciliation conference regarding notice L-050396519.

Petitioner also asserts that it would be inequitable to enforce notice L-050396519 because it is based on an erroneous audit and would result in an overpayment to the Division. Petitioner contends that because he is not solely responsible for the assessed tax amount with interest and penalties, enforcing the instant audit result would permit the Division to collect three times what is allegedly owed. He claims that because he is just one of many individuals involved in a larger fraud scheme, it is inappropriate for the Division to hold petitioner responsible for the entire \$1,058,373.00 loss, for which he is jointly and severally liable with his co-defendants. Petitioner asserts that the assessed tax amount does not accurately represent petitioner's financial gain from the underlying fraud scheme and that the total tax assessed never moved through petitioner's bank account and, therefore, he should not have been assessed interest and penalties on the total amount of restitution.

Petitioner also claims that the assessed tax amount does not take into consideration that petitioner has been making monthly restitution payments and will result in petitioner paying double restitution.

18. The Division asserts that petitioner was ordered to make criminal restitution in the amount equal to the underreported tax it assessed. It contends that the restitution amount was equal to the tax due and that payment of restitution does not preclude a subsequent civil liability for petitioner. It claims that the case law is clear that the Division is not restricted from issuing a statutory notice for the total amount of taxes, interest, and penalty it determines are due, even if

the amount is greater than the amount set in a criminal case as restitution based upon the same facts for the same period. The Division also contends that petitioner's claim that he should not be held jointly and severally liable for the assessment with other co-conspirators is without merit and that he is estopped from contending he owes the restitution amount. The Division claims the only issue to be determined is whether petitioner is liable for interest and penalty on the restitution.

CONCLUSIONS OF LAW

A. A properly issued notice of deficiency is presumed to be correct and the taxpayer has the burden of demonstrating by clear and convincing evidence the incorrectness of such an assessment (*Leogrande v Tax Appeals Trib.*, 187 AD2d 768 [3d Dept 1992], *lv denied* 81 NY2d 704 [1993]; Tax Law § 689 [e]). He may meet this burden by proving that the notice lacked a rational basis (*see Matter of Babel*, Tax Appeals Tribunal, March 18, 2014).

Here, petitioner has met that burden. Monies received through illegal means, such as fraud, may be included in the gross income of the recipient, even if accompanied by an obligation to repay such amounts to the rightful owner (*see James v United States*, 366 US 213, 218 [1961]). However, here, the Division has not established how it determined the gross income of petitioner. The amount of the restitution was not based upon the unreported income and resultant tax due that petitioner failed to pay to the Division, as it alleges. The restitution was the amount lost by the Division as a result of the fraudulently prepared returns and ultimately, the fraudulently cashed refund checks. The record is devoid of any evidence as to the amount of income petitioner failed to report as a result of his criminal activities or of any rational method the Division used to determine petitioner's income tax liability. The restitution amount was the dollar amount lost from payment of refund checks. If anything, it would be the income

amount petitioner failed to then report and pay tax on. Accordingly, it cannot also be the tax amount due. As the income is not known, the tax cannot be known. Additionally, as the penalty pursuant to Tax Law former § 685 (e) (1) was 50 percent of the tax, that too was not ascertainable. Accordingly, the Division did not establish a rational basis for the asserted tax, penalties and interest in the instant matter, and notice L-050396519 is cancelled.

B. Even assuming the Division had a rational basis to assess petitioner for the tax due, the Division has failed to meet its burden to sustain the fraud penalty pursuant to Tax Law former § 685 (e) (1) (*see Matter of Sener*, Tax Appeals Tribunal, May 5, 1988). For the year at issue, the fraud penalty was equal to the sum of 50 percent of the deficiency (*see* Tax Law former § 685 [e] [1]).

Fraud is not defined in the Tax Law. However, case law has held that a finding of fraud requires the Division to show, by clear evidence, willful, knowledgeable, and intentional wrongful acts or omissions constituting false representation, resulting in a deliberate underpayment of tax due (*Matter of Ellett*, Tax Appeals Tribunal, December 18, 2003; *Matter of Sener*). The Division did not put forth any facts or evidence, such as an audit report, of petitioner's alleged wrongful acts resulting in his deliberate underpayment of tax.

Moreover, the Division did not affirmatively state the imposition of fraud penalties in its answer. The Tax Appeals Tribunal Rules of Practice and Procedure require that the Division's answer "shall" contain "a statement of any additional facts to be proven by the division of taxation . . . to sustain any issue raised in the petition upon which the division of taxation has the burden of proof . . ." (20 NYCRR 3000.4 [b] [2] [ii]).

As noted above, the Division bears the burden of proof with regard to fraud and must establish 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. Yet, the Division failed to plead the required elements of fraud or include any statement of additional facts to be proved by it, to sustain its assertion of fraud. The Division simply admitted petitioner pled guilty to a count of Conspiracy to Cash Fraudulently Obtained Refund Checks and was ordered to pay restitution, and then only addressed the timeliness of petitioner's protest. The Division's answer did not even state that a fraud penalty was assessed. The Division's answer, which fails to properly plead the basis for fraud for which the Division bears the burden of proof, or even assert that a fraud penalty has been assessed, is fatally flawed (*see Matter of Sener*). Because the answer failed to properly plead the basis for fraud, the Division's fraud penalty must be cancelled.

C. Petitioner argues that because he and his co-conspirators are making payments on the restitution, enforcing the notice of deficiency would result in the tax department collecting the restitution amount twice. Case law on this issue is well settled and provides that where the issue was not previously litigated, as is the case here, the issue of the tax deficiency, penalty, and interest for 2007, is not barred by court ordered restitution on a criminal guilty plea (*see Matter of Nanni*, Tax Appeals Tribunal, July 22, 1993; *see also* Penal Law § 60.27[6]). The same rule applies for the imposition of civil interest where Judge Engelmayer waived the imposition of interest on the restitution in the criminal matter. Moreover, there is no evidence that the Assistant United States Attorney agreed that in exchange for the guilty plea, the restitution ordered by the Court would satisfy any tax deficiency, interest, or penalty imposed under the Tax Law (*see id.*). Accordingly, assuming the Division had a rational basis to issue to notice of deficiency, the imposition of tax, fraud penalty (if also properly pled and proven), and interest would have been proper.

D. The petition of Carlos Deleon is granted and notice of deficiency L-050396519, dated August 20, 2019, is cancelled.

DATED: Albany, New York
February 23, 2023

/s/ Jessica DiFiore
ADMINISTRATIVE LAW JUDGE