149 F.3d 1183
Unpublished Disposition
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United States Court of Appeals, Sixth Circuit.

Jacob KALO, Petitioner-Appellant,
v.
COMMISSIONER OF INTERNAL
REVENUE, Respondent-Appellee.

No. 97-1416.
|
June 9, 1998.

On Appeal from the United States Tax Court.

Before RYAN, COLE, and GILMAN, Circuit Judges.

Opinion

RONALD LEE GILMAN, Circuit Judge.

***1** Jacob Kalo ("taxpayer") appeals the Tax Court's decision upholding the assessment by the Commissioner of Internal Revenue ("Commissioner") of penalties and interest for fraudulently failing to report income derived from interest-bearing foreign bank accounts. Since we find no error in the Tax Court's decision in this case, we AFFIRM.

I. BACKGROUND

Taxpayer and his wife, Yehiella Kalo (collectively "Kalos"), live in West Bloomfield, Michigan. He is an obstetrician and gynecologist whose patients often pay in cash for his medical services. Although a practicing physician, taxpayer does not carry medical malpractice insurance coverage. During the years 1986 through 1989, taxpayer was both a partner and an employee of Jacob Kalo, M.D. P.C. ("Kalo P.C."). Kalo P.C. operated five medical clinics in Michigan, including a clinic at 15650 E. Eight Mile Road in Detroit, Michigan ("East GYN Office"). Kalo P.C.'s business operations were in turmoil during the years 1986 through 1989 because of a legal dispute between taxpayer and his two former business partners. Taxpayer's business problems and his lack of malpractice insurance prompted him to hide a significant amount of money in foreign bank accounts.

To help him in making decisions concerning foreign investments, taxpayer consulted with an accountant and a financial advisor. The financial advisor provided financial services for taxpayer specifically tailored to foreign investment for nearly twelve years, including discussions concerning foreign interest rates and foreign investments. From these extensive dealings, the financial advisor formed the opinion that taxpayer had a better than average knowledge about foreign investments.

The Kalos filed joint income tax returns for the years 1986 through 1989. They held a number of overseas bank accounts during this period of time, particularly in Canada. For the years

1985 through 1988, taxpayer made numerous cash deposits into Canadian bank accounts, seven of which exceeded $10,000. Taxpayer, for example, deposited more than $230,000 in cash into a bank account at the Royal Bank of Canada during this three-year period. By 1989, the Kalos had deposited approximately $1 million with the Royal Bank of Canada and more than $3 million in all of their Canadian bank accounts combined.

The couple, however, neither disclosed the existence of these foreign bank accounts nor reported how much interest income they received from them when they filed their original income tax returns. In fact, when answering Question 10 on Schedule B of their income tax returns, the couple specifically denied having any foreign bank accounts until the 1988 tax year. The total amount of interest income the Kalos failed to report for the years 1986 through 1989 was $309,322.

Beginning in 1990 and continuing into 1991, the Internal Revenue Service's Criminal Investigation Division ("CID") investigated the Kalos for possible income tax violations. Prodded by the efforts of the CID's investigation, the Kalos belatedly filed amended tax returns for the years 1986 through 1989. In these amended tax returns, the Kalos reported the previously undisclosed interest income from their foreign bank accounts and paid the additional taxes due.

***2** As part of the investigation, CID special agents interviewed taxpayer on April 18, 1990. During the interview, the special agents asked taxpayer whether he had any money in foreign bank accounts. Taxpayer responded by telling the agents of a bank account in Israel that he first reported on his 1988 tax return, and that he might also have a bank account in Europe. When specifically questioned about Canadian bank accounts, taxpayer stated that the only bank account he held in Canada was a joint bank account shared with his father. At the time, this joint bank account held only $37. Taxpayer claimed that all the money in the joint bank account belonged to his father. In fact, taxpayer specifically told the special agents that he had nothing to do with this account because his father handled all of the banking transactions.

When questioned about business records for the East GYN Office, the special agents were informed by taxpayer that the state of Michigan had seized the business records during a Medicaid audit and had never returned them. In truth, the state of Michigan had never audited the business records, much less taken them. Instead, it was taxpayer who removed business records from the East GYN Office after the CID began its criminal investigation. In a further attempt to cover his tracks, taxpayer told one of his employees at the East GYN Office that if anyone asked about the records to say that the state of Michigan took the records during a Medicaid audit. In a subsequent interview with CID special agents, taxpayer indicated that the state of Michigan had returned the business records. The CID subpoenaed these records, along with records from the other Kalo P.C. clinics. Taxpayer, however, never produced the records subpoenaed.

In an interview with special agents on August 23, 1990, taxpayer stated that the East GYN Office never had a day where the cash receipts

were more than $2,000. This statement was also false. On the following day, taxpayer asked two of his employees, Minnie Malone and Marlene Parsons, to write letters to the CID stating that the daily cash flow at the clinic ranged from $40 to $800. Both employees refused, stating that those dollar amounts were false. Taxpayer nevertheless adhered to this dollar amount in subsequent discussions with the CID. Also during the August 23, 1990 interview, taxpayer informed the special agents that he believed that interest income was not taxable until withdrawn from a foreign bank because his accountant led him to believe this. When asked for his accountant's name, taxpayer's attorney interrupted and stated that it was not the accountant who gave this advice, but that his client heard or knew of it from someone else.

Taxpayer's accountant later testified that he never told taxpayer that the interest earned from foreign bank accounts was not taxable until withdrawn. In fact, when preparing the Kalos' tax returns for the years 1986 through 1989, the accountant specifically asked whether the couple had any foreign bank accounts. Taxpayer, however, never informed the accountant that the couple had any foreign bank accounts until the 1988 taxable year, when he told the accountant about the bank account in Israel. The accountant promptly reported the interest from the Israeli account on the Kalos' 1988 and 1989 income tax returns. Similarly, taxpayer never informed his financial advisor that he was receiving interest income from foreign bank accounts.

***3** In light of the accountant's testimony, taxpayer refined his story and told the CID special agents that an unnamed bank official at an unnamed Canadian bank informed him that he did not have to pay taxes on the interest income. Proof was presented, however, that the policy of the Royal Bank of Canada is not to give advice to foreigners about the taxability of interest generated in their bank accounts.

On September 9, 1992, the United States Attorney filed an information charging taxpayer with four counts of willfully failing to disclose information on his income tax returns, a violation of 26 U.S.C. § 7203. On January 29, 1993, taxpayer pled guilty to one count of violating § 7203 for the 1987 tax year. The court sentenced taxpayer to 180 days of home confinement, one year of probation, and fined him $51,318.

On October 7, 1994, the Commissioner issued a notice of tax deficiencies against the Kalos for the 1986 tax year. The notice also assessed additions to and penalties on tax against the Kalos due to fraud for the tax years 1986 through 1989. The Commissioner later withdrew the deficiency assessment after the Kalos amended their income tax return for the 1986 tax year to reflect the underpayment in tax. On November 7, 1994, the Kalos filed a petition in Tax Court seeking a redetermination of the Commissioner's additions to and penalties on tax.

The parties submitted the case for final disposition pursuant to an agreed stipulation of facts and the testimony of several witnesses. In the stipulation of facts, the parties specifically agreed that "either party has the right to object to the admission of any such facts and exhibits [set forth in the stipulation] on the

grounds of relevancy and materiality, *but not on other grounds*." (emphasis added). As part of the stipulation of facts, the parties attached documents reflecting the bank deposits and other financial records for the East GYN Office for the years 1987 through 1990.

During trial, counsel for the Kalos objected to the introduction of evidence related to the operation of the East GYN Office. Counsel asserted that the evidence was not relevant to a determination of fraud concerning foreign bank accounts and that, in any event, Tax Court Rule 36(b) precluded introduction of the evidence. The Commissioner responded by noting that "one of the indications of fraud [in this case] is that the monies that were in the foreign accounts were skimmed income [from the clinics]." The Tax Court overruled the objection and allowed the Commissioner to introduce evidence concerning taxpayer's management of the East GYN Office.

After the trial, the Tax Court issued its decision upholding the Commissioner's determinations of additions to and penalties on taxes due from taxpayer. Specifically, the Tax Court held that the Commissioner had proven by clear and convincing evidence that taxpayer underpaid his taxes for each year in question due to fraud. The Tax Court, however, disallowed the Commissioner's determinations against Yehiella Kalo. The Tax Court's judgment was entered January 7, 1997. This appeal followed.

II. ANALYSIS

***4** On appeal, taxpayer does not contest the calculation of the amount of unpaid interest income, but instead makes the following assignments of error: (1) that the admission of evidence concerning taxpayer's management of the medical clinics was barred by Tax Court Rule 36(b), (2) that the evidence concerning the medical clinics was irrelevant, and (3) that the Tax Court erred in finding that taxpayer's failure to report interest income was on account of fraud.

A. *Admission of Evidence*

Taxpayer contends that the Tax Court erred in admitting evidence concerning the financial management of the medical clinics, particularly evidence demonstrating his purported failure to maintain adequate records of cash receipts. His argument in this regard is two-pronged. First, he claims that the Tax Court's decision violated Tax Court Rule 36(b) because the Commissioner's Answer never specifically mentioned evidence concerning cash receipt records. Second, he contends that the evidence was irrelevant because the only material fact at issue was whether he failed to disclose interest income from foreign bank accounts due to fraud, not his handling of records at a medical clinic. Both arguments are without merit.

1. *Tax Court Rule 36(b)*

We review the Tax Court's interpretation and application of its own procedural rules for an abuse of discretion. *Estate of Shafer v. Commissioner,* 749 F.2d 1216, 1218-19 (6th Cir.1984).

Tax Court Rule 36(b) states in part that "the answer shall contain a clear and concise statement of every ground, together with facts in support thereof on which the Commissioner

relies and has the burden of proof." T.C. R. 36(b). It is uncontested that the Commissioner's Answer failed to mention evidence concerning cash receipt records as a fact that would sustain its assessment on account of taxpayer's fraud. Despite taxpayer's argument to the contrary, this omission does not end the analysis.

The Commissioner's failure to mention a specific factual basis to support the assessment does not mean that the Commissioner is precluded from relying upon that factual basis at trial. "The basic consideration is whether the taxpayer is surprised and disadvantaged when the Commissioner has failed to [mention a fact that is later used at trial]." *Commissioner v. Transport Mfg. & Equip. Co.,* 478 F.2d 731, 736 (8th Cir.1973). As this court has noted, "[t]here is no prohibition against the Commissioner's raising an alternative theory at the time of hearing so long as the taxpayer has an opportunity to present proof to counter the alternative theory." *BASF Wyandotte Corp. v. Commissioner,* 532 F.2d 530, 540 (6th Cir.1976).

The Commissioner argues that taxpayer was sufficiently apprised of the IRS's intended use of evidence concerning cash receipt record, because such evidence was explicitly mentioned in the agreed stipulation of facts entered into more than two months before trial. We agree. It would strain credulity to think that taxpayer was surprised about the Commissioner's use of the cash receipt records as evidence when taxpayer had previously stipulated to the use of such evidence. Moreover, to the extent the Commissioner failed to comply with the requirements of Tax Court Rule 36(b), taxpayer waived any objection he may have possessed by stipulating to the use of the evidence. *See* T.C.R. 91(d)-(e); *Estate of Quirk v. Commissioner,* 928 F.2d 751, 758-59 (6th Cir.1991) (noting that except under exceptional circumstances a party waives an issue or argument that might otherwise be contested by entering into a stipulation). Accordingly, the Tax Court did not abuse its discretion in allowing the Commissioner to introduce evidence relating to the medical clinics.

2. *Relevance*

***5** We review the Tax Court's application of the Federal Rules of Evidence for an abuse of discretion. *Estate of Shafer v. Commissioner,* 749 F.2d 1216, 1219 (6th Cir.1984). To that end, we accord the Tax Court broad discretion "in determining the relevancy of evidence and in passing upon its admissibility under Rule 401." *United States v. Dunn,* 805 F.2d 1275, 1282 (6th Cir.1986). Indeed, we will "generally accord the trial judge 'a limited right to be wrong,' and within these limits will not reverse the judge's determination, even if [we] disagree with the ruling." 2 JACK B. WEINSTEIN & MARGARET A. BERGER, *Weinstein's Federal Evidence,* § 401.03[3][a] at 401-10 (Joseph M. McLaughlin, ed., Matthew Bender 2d ed.1997) (quoting Rosenberg, *Judicial Discretion,* 38 THE OHIO BAR 819, 823 (1965)).

One of the most basic rules of evidence is that only relevant evidence is admissible. FED. R. EVID. 402. Evidence is relevant if it *tends* to prove or disprove any *material* issue of fact in a case. FED. R. EVID. 401. "Evidence need not prove conclusively the proposition for which it is offered, nor make that proposition appear

more probable than not, but it must in some degree advance the inquiry." 2 WEINSTEIN & BERGER, § 401.04[2][b] at 401-19.

Taxpayer advances the argument that evidence concerning his handling of cash receipt records and other aspects of the financial management at the medical clinics has no bearing on the question presented in this case, *i.e.,* whether his failure to report interest income from foreign bank accounts was due to fraud. We disagree. When boiled down to its essentials, taxpayer's argument turns upon the notion that the financial management of his medical clinics and the foreign bank accounts are unrelated simply because of what they are-one involves patients and medical judgments, while the other concerns banks and money. In fact, however, the common denominator of both is money.

As the Commissioner noted when addressing this issue before the Tax Court:

> What this case involves is money that was over in foreign accounts which generated interest income which was not reported. As part of the fraud case, the [Commissioner] [in]tends to show that one of the indications of fraud is that the monies that were in the foreign accounts were skimmed income [from the medical clinics] and in fact were intended to be concealed by taking them over to foreign accounts.

It was the alleged interconnection between the money received at the medical clinics and the money deposited in the foreign bank accounts that the Commissioner was trying to prove through the introduction of the cash receipt records.

If taxpayer skimmed and then redirected money from the medical clinics toward the foreign bank accounts, then evidence concerning the unorthodox method of handling cash receipt records at the medical clinics would tend to prove that taxpayer was attempting to hide the existence of foreign bank accounts by mishandling those records. In other words, such behavior would tend to prove that taxpayer mishandled and kept inadequate records in order to conceal the transfer of funds to the foreign bank accounts. This court has held that the mishandling of business records is an indica of income tax fraud. *Solomon v. Commissioner,* 732 F.2d 1459, 1461 (6th Cir.1984). Therefore, evidence related to the business management of the medical clinics, when viewed in this context, was relevant to the question of whether taxpayer's failure to disclose interest income from foreign bank accounts was due to fraud.

***6** The fact that the Commissioner's evidence on this point ultimately did not persuade the Tax Court does not affect the issue of the evidence's relevance. Again, evidence does not have to conclusively prove the proposition for which it is offered in order to be relevant. Trial judges are given broad discretion concerning the admission of evidence and evaluating its weight. The fact that the Tax Court eventually found the Commissioner's evidence unpersuasive with regard to the purported connection between the medical clinics and the foreign bank accounts only underscores this point.

Because the evidence of taxpayer's management of the medical clinics was relevant, we hold that the Tax Court did not abuse its discretion by admitting the evidence.

B. *Fraud Penalty*

Finally, taxpayer contends that the Tax Court erred in finding that his failure to report interest income was due to fraud. The Tax Court's finding of fraud is a question of fact and will only be reversed if shown to be clearly erroneous. *Solomon,* 732 F.2d at 1461. "A finding is 'clearly erroneous' when [,] although there is evidence to support it, the reviewing court on the entire evidence is left with the definite and firm conviction that a mistake has been committed." *United States v. United States Gypsum Co.,* 333 U.S. 364, 395, 68 S.Ct. 525, 92 L.Ed. 746 (1948).

For the relevant period in question, former § 6653(B) provided that "if any part of any underpayment ... of tax ... is due to fraud, there shall be added to the tax an amount equal to ... 50 percent ... of the underpayment." 26 U.S.C. § 6653(B). The Commissioner has the burden of proving by clear and convincing evidence that there was an underpayment of taxes and that some part of that underpayment was due to fraud. *Solomon,* 732 F.2d at 1461. In the present case, it is uncontested that an underpayment of taxes occurred. The only remaining issue concerns taxpayer's alleged fraudulent intent.

A court may infer fraudulent intent by looking to various kinds of circumstantial evidence. *Solomon,* 732 F.2d at 1461. Such "badges of fraud" include: (1) failure to file tax returns; (2) an understatement of income over an extended period; (3) failure to furnish the government with access to records; (4) failure to keep adequate books and records; (5) the sophistication of the taxpayer; (6) concealment of bank accounts; (7) giving implausible or inconsistent explanations of behavior; and (8) willingness to defraud another in a business transaction. *Id.* at 1461-62; *see Bradford v. Commissioner,* 796 F.2d 303, 307-08 (9th Cir.1986). While no single factor is necessarily conclusive, the combination of a number of these badges of fraud constitutes persuasive evidence of fraud. *Solomon,* 732 F.2d at 1461-62.

The Tax Court found that taxpayer: (1) understated his income over a period of four years; (2) was relatively sophisticated with respect to issues concerning foreign investments; (3) attempted to conceal his activities with respect to his foreign bank accounts by giving false statements on his tax returns; (4) pled guilty to willfully failing to disclose information concerning his foreign bank accounts; and (5) misled authorities through evasion and obfuscation concerning the existence of the bank accounts and of business records pertinent to the CID's investigation. Since many badges of fraud were present, the Tax Court held that taxpayer's underpayment of interest income was due to fraud.

***7** Taxpayer now claims that the Tax Court's findings of fact were clearly erroneous. Specifically, taxpayer claims that: (1) the Commissioner introduced no evidence that taxpayer was familiar with the tax laws; (2) his accountant lied when he testified that taxpayer failed to tell him about the foreign bank accounts; (3) the Tax Court failed to take into account that he reported interest income from his Israeli bank account for the years 1988 and 1989; (4) the Tax Court misconstrued his statements to the CID special

agents concerning the Canadian bank accounts; and (5) the Tax Court failed to consider the fact that his true purpose in hiding the money in the foreign bank accounts was not to avoid paying taxes, but to hide his assets from potential malpractice claimants and former business partners.

Taxpayer's arguments are unpersuasive. First, and foremost, taxpayer's contention regarding his true purpose in opening the foreign bank accounts only serves to implicate another badge of fraud, *i.e.,* taxpayer's willingness to defraud others in business transactions. We also find taxpayer's arguments regarding his accountant's testimony and the "true" nature of his statements to the CID agents equally unavailing. When presented with conflicting testimony, the Tax Court is free to resolve the conflict by judging the witnesses' credibility. The fact that the Tax Court believed the testimony of the accountant and the CID agents over that of taxpayer does not make the Tax Court's decision clearly erroneous. *Conti v. Commissioner,* 39 F.3d 658, 664 (6th Cir.1994). Furthermore, taxpayer's contention that the Tax Court did not adequately take into account his disclosure of the Israeli bank account is simply not supported by the record. The Tax Court explicitly acknowledged in its opinion that taxpayer had disclosed the existence of the Israeli bank account in his original income tax returns for 1988 and 1989. We cannot say that the Tax Court's refusal to give much weight to this "disclosure" was unjustified. Acknowledging the existence of this small bank account could just as easily be viewed as an attempt, albeit an unsuccessful one, to divert the Commissioner from investigating whether taxpayer had other foreign bank accounts with much larger balances.

Simply put, taxpayer's arguments go to the weight of the evidence presented and to the credibility of the witnesses who testified. "[T]he Tax Court, like any other court, may disregard uncontradicted testimony by a taxpayer where it finds that testimony lacking in credibility, ... or finds the testimony to be improbable, unreasonable or questionable." *Conti,* 39 F.3d at 664 (citations and internal quotations omitted). Given taxpayer's inconsistent and implausible statements, his large understatement of income, his guilty plea for willfully failing to disclose information on his income tax returns, and his relative sophistication, the Tax Court did not err in finding that the Commissioner had established fraud.

III. CONCLUSION

***8** For the foregoing reasons, we AFFIRM the Tax Court's decision in all respects.

All Citations

149 F.3d 1183 (Table), 1998 WL 382741, 81 A.F.T.R.2d 98-2266, 98-2 USTC P 50,514

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