Dellacroce v. Commissioner, 83 T. C. 269 (1984)

Hearsay evidence alone cannot support a tax deficiency notice, which must be eliminated if found arbitrary.

Summary

In Dellacroce v. Commissioner, the court ruled that a tax deficiency notice issued by the IRS based solely on hearsay evidence was arbitrary and lacked evidentiary support. Aniello Dellacroce was assessed unreported income from alleged labor racketeering payoffs in 1965 and 1968. The IRS relied on informant testimony for the 1965 claim, which the court deemed insufficient without corroborating evidence. Consequently, the 1965 deficiency was eliminated. For 1968, the court upheld the IRS's valuation of stock Dellacroce received, finding Dellacroce failed to prove the valuation incorrect.

Facts

The IRS determined Aniello Dellacroce received unreported income of $100,000 in 1965 and stock valued at $4. 875 per share in 1968 from labor racketeering. For 1965, the IRS relied on information from an informant, Frank Terranova, who claimed Dellacroce received a payoff from Martin Goldman for settling labor disputes. For 1968, Dellacroce was convicted of tax evasion for not reporting income from 22,500 shares of Yankee Plastics, Inc. stock received as payment for labor peace services.

Procedural History

The IRS issued deficiency notices for 1965 and 1968. Dellacroce filed petitions with the U. S. Tax Court, challenging the notices. The Tax Court denied Dellacroce's summary judgment motion for 1965, finding genuine issues of fact. The case proceeded to trial, where Dellacroce invoked his Fifth Amendment privilege against self-incrimination, refusing to answer questions about his income. The court ultimately ruled the 1965 deficiency notice arbitrary and upheld the 1968 stock valuation.

Issue(s)

1. Whether the IRS's determination that Dellacroce received unreported income in 1965 was arbitrary due to reliance on hearsay evidence.
2. Whether Dellacroce satisfied his burden of proving the IRS's valuation of the stock received in 1968 was erroneous.

Holding

1. Yes, because the IRS's determination for 1965 was based entirely on hearsay evidence without any admissible corroboration, making the notice arbitrary and

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requiring its elimination.
2. No, because Dellacroce failed to provide sufficient evidence to prove the IRS's valuation of the stock received in 1968 was incorrect.

Court's Reasoning

The court followed the Second Circuit's decision in Llorente v. Commissioner, which held that a deficiency notice based solely on hearsay evidence without linking the taxpayer to a tax-generating act is arbitrary. The IRS failed to provide admissible evidence beyond hearsay to support the 1965 deficiency, thus shifting the burden of proof to the IRS, which they could not meet. For 1968, the court found Dellacroce's expert testimony on stock valuation unpersuasive compared to the IRS's reliance on market quotations, despite Dellacroce's criminal conviction related to the stock. The court emphasized that the burden of proof remained on Dellacroce to disprove the IRS's valuation, which he failed to do.

Practical Implications

This decision underscores the necessity for the IRS to provide more than hearsay evidence when issuing deficiency notices, particularly in cases involving unreported illegal income. Taxpayers can challenge arbitrary notices, potentially shifting the burden of proof to the IRS. The ruling also reinforces that taxpayers bear the burden of disproving IRS valuations of assets, even in cases involving criminal convictions. Subsequent cases have cited Dellacroce when addressing the evidentiary standards required for deficiency notices and the implications of invoking the Fifth Amendment in tax disputes.

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