

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
RAYMOND WESLEY ROGERS)

Appearances:

For Appellant: Dennis S. Weaver
Attorney at Law

For Respondent: Paul J. Petrozzi
Counsel

O P I N I O N

This appeal is made pursuant to section 18646 of the Revenue and Taxation Code from the action of the Franchise Tax Board in denying the petition of Raymond Wesley Rogers for redetermination of a jeopardy assessment of personal income tax in the amount of \$1,410 for the period January 1, 1973, through December 30, 1973.

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On December 30, 1973, officers from the Los Angeles County Sheriff's Department seized 486 kilos of marijuana from a private aircraft at the Lancaster Airport, and arrested appellant and two other suspects in connection with the seizure. In Los Angeles County Superior Court, on July 2, 1975, appellant and his co-defendants pled guilty to transportation of marijuana in violation of section 11360 of the California Health and Safety Code.

Respondent issued the jeopardy assessment in question on December 31, 1973, the day after appellant's arrest. The amount of tax assessed was based on the income estimated as necessary to purchase the quantity of marijuana seized. This figure was computed by assuming that (1) the value of the marijuana was \$63,000 (\$130/kilo); (2) appellant made a cash investment in the venture, thereby acquiring a 1/3 (\$21,000) interest in the marijuana, and (3) the source of appellant's investment was unreported taxable income received during 1973. After this appeal was filed, respondent conceded that the actual value of the marijuana was approximately \$30 a kilo rather than \$130 a kilo. Therefore, the assessment must, at the least, be modified.

The principal issue is whether respondent's reconstruction of appellant's income, as modified, was reasonable. Respondent's authority to reconstruct a taxpayer's income is found in section 17561, subdivision (b), of the Revenue and Taxation Code, and its corresponding regulation:

If the taxpayer does not regularly employ a method of accounting which clearly reflects his income, the computation of taxable income shall be made in a manner which, in the opinion of the Franchise Tax Board, does clearly reflect income. (Cal. Admin. Code, tit. 18, reg. 17561, subd. (b)(1).)

A reasonable reconstruction is presumed correct, but the presumption is rebutted if the reconstruction is shown to be arbitrary and excessive or based on assumptions which are not supported by the evidence. (Shades Ridge Holding Co., Inc., 1164,275 P-H Memo. T.C. (1964), affd. sub nom. Fiorella v. Commissioner, 361 F.2d 326 (5th Cir. 1966); Appeal of David Leon Rose, Cal. St. Bd. of Equal., March 8, 1976.) In other words, there must be credible evidence in the record which, if accepted as true, would induce a reasonable belief that the amount of tax assessed

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against the taxpayer is due and owing. (Appeal of James Godfrey Gallardo, Cal. St. Bd. of Equal., Sept. 28, 1977; Appeal of Burr McFarland Lyons, Cal. St. Bd. of Equal., Dec. 15, 1976.)

The instant assessment arises from narcotics traffic but differs from similar cases previously decided by this board in that there is no record of prior drug sales from which income was reconstructed. It is clear, of course, that appellant was involved in the transportation of narcotics on December 30, 1973, and respondent has assumed from this that appellant contributed cash to the purchase of the drugs involved, and that the purchase money consisted of unreported 1973 taxable income. Because the presumed correctness of the assessment rests entirely on these assumptions, respondent must show what evidence logically leads to this conclusion. (See Gerardo v. Commissioner, 552 F.2d 549, 554 (3d Cir. 1977).)

In the probation report prepared in appellant's criminal case, appellant stated that he had no knowledge of the source of the money used to purchase the marijuana, and that he did not know the sale or distribution plans. The same report indicates that appellant's role was confined to obtaining a van and radio for use in the venture; in addition, he was arrested some distance away from the seized aircraft. (See Probation Officer's Report, Case No. A128217, Los Angeles County Superior Court, 6, 7.) Not only does this report give weight to appellant's contention that he was not an investor/owner in the drug scheme, but it also is devoid of evidence to the contrary. The burden then is on respondent to point to facts which are the basis of its assumption. But respondent has not done this and cannot do so on the record here. Respondent has failed to support its characterization of appellant as a purchaser and owner of the marijuana.

Moreover, respondent's attempt to reconstruct appellant's income by what it has called the "net asset" method lacked a fundamental basis for computation. ^{1/} As a matter of reason, respondent could not prove that appellant bought the marijuana on December 30 with unreported 1973 taxable income, without first establishing

^{1/} Respondent's counsel stated at the oral hearing on this case that this was the method used in determining the assessment.

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appellant's cash on hand at the beginning of 1973 and the amount of appellant's 1973 receipts, and expenses. In fact, respondent's method appears to be the traditional "net worth," method under a new name and without regard* to the proof required in net worth cases.

" [A]n essential condition in cases of this type is the establishment, with reasonable certainty, of an opening net worth, to serve as a starting point from which to calculate further increases in the taxpayer's assets ... the correctness of the result depends entirely upon the inclusion in this sum of all assets on hand at the outset. " (Holland v. United States, 348 U.S. 121, 132 [99 L. Ed. 150] (1954).)

In a narcotics sales reconstruction case where the cash expenditures method was used, it was noted that the standards set forth in Holland apply to civil cases where a variation of the net worth method has been employed. (Estate of William James Gary, 1176,189 P-H Memo, T.C. (1976) ..

Here, respondent did not establish an opening net worth. The record on which respondent relied (Form FTB 3860 (3-68) dated June 1, 1974, which was submitted by appellant) merely showed appellant's income for 1971, 1972 and 1973, and monthly living expenses which were not clearly allocated to any particular year. Therefore, it is impossible to determine when appellant might have accrued the alleged purchase money. Timing is critical to respondent's calculations. (United States v. Bethea, 537 F.2d 1187 (4th Cir. 1976).)

Further, respondent has not established that the source of the funds was previously unreported 1973 income. There may be other sources which account for the money, such as savings or a gift. In a case such as this, where respondent has based its assumptions entirely on circumstantial evidence, it must have proof of a likely source of income, or at least negate reasonable explanations offered by the taxpayer. (Holland v. United States, supra; United States v. Massei, 355 U.S. 595 [2 L. Ed. 2d 5171] (1958).) Respondent concedes it knows of no sources of income other than those reported by appellant. And clearly, respondent's investigation was insufficient to produce any information contradicting appellant's evidence of his part in the narcotics transportation and the amount of his 1973 income.

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As noted earlier, respondent conceded that the value of the marijuana should be about **\$30/kilo**. While this may be disputed by appellant, the actual value is of no significance here. Calculations made on any valuation are still the product of guesswork because they are based on assumptions entirely without foundation, i.e., (1) that appellant had a 1/3 cash investment in the marijuana and (2) that appellant purchased the marijuana with previously unreported taxable income. An assessment based on such calculations is completely arbitrary and cannot be sustained. (Thomas v. Commissioner, 223 F.2d 83 (6th Cir. 1955); Appeal of Burr McFarland Lyons, supra; Appeal of David Leon Rose, supra.)

For the above reasons, we reverse respondent's action. That being so, it is unnecessary to consider appellant's arguments concerning certain deductions.

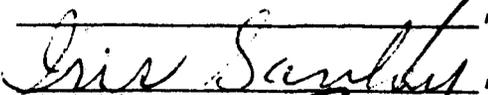
O R D E R

Pursuant to the views expressed in the opinion of the board on file in this proceeding, and good cause appearing therefor,

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IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section 18595 of the Revenue and Taxation Code, that the action of the Franchise **Tax Board** in denying the petition of Raymond Wesley Rogers' for re-determination of a jeopardy assessment of personal income tax in the amount of \$1,410 for the period January 1, 1973, through December 30, 1973, be and the **same is** hereby reversed.

Done at Sacramento, California, this 6th day of April , 1978, by the State Board of Equalization.


_____, Chairman

_____, Member

_____, Member
_____, Member