



BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeals of)
)
ALFRED M. SALAS AND BETTY LEE REYES)

Appearances:

For Appellants: William A. Dougherty
Attorney at Law

For Respondent: Jean Ogrod
Counsel

O P I N I O N

These appeals are made pursuant to section 18646 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the petition of Alfred M. Salas for reassessment of a personal income tax jeopardy assessment in the amount of \$15,996 for the period January 1, 1976, to November 19, 1976, and on the petition of Betty Lee Reyes, aka Betty Lee Salas, for reassessment of a personal income tax jeopardy assessment in the amount of \$5,436 for the period January 1, 1976, to November 19, 1976.

Appeals of Alfred M. Salas and Betty Lee Reyes

The issues are whether appellants received unreported income from illegal sales of narcotics and, if so, whether respondent properly reconstructed the amount of that income.

An outstanding federal arrest warrant, issued April 14, 1976, charged appellant Alfred **Salas** (hereinafter "**Salas**") with 14 counts of possession and distribution of heroin. **Salas** was believed to be in the company of Betty Lee **Salas**, also known as Betty Lee Reyes (hereinafter "**Reyes**"), who is **Salas**' wife and partner, and the couple's two children. On or about November 19, 1976, an informant disclosed to authorities that appellants were dealing in narcotics in the Sacramento area. Based upon the above information, on November 19, 1976, appellants were placed under arrest by agents of the Drug Enforcement Administration (hereinafter "**DEA**") in Sacramento. A search of appellants' automobile, residence, and storage bin produced **\$14,002.11** in cash, 278.6 grams gross weight of heroin, 41 grams gross weight of marijuana seeds, and various drug-related paraphernalia (e.g., measuring spoons, grinders, and toy balloons). In addition, appellants had in their possession two semi-automatic pistols and a Doberman pinscher dog, -trained to attack.

At the time of the arrest, **Salas** agreed to give a statement describing his activities. **Salas** thereupon stated that while living in southern California he had trafficked in large quantities of heroin and that he had been arrested, convicted, and sentenced to federal prison in 1971 for those narcotics activities. He stated that after his release from prison in 1974, he continued to traffic in heroin, first in the southern California area and, in 1975, in Mexico. Moving to Sacramento in late February or early **March** of 1976, **Salas** stated that he supported himself and his family with the profits obtained from the heroin trafficking activities. **Salas** also stated that he had never held a job.

Based upon the above, **Salas** was indicted for unlawfully, knowingly, and intentionally possessing with intent to distribute 278.6 grams gross weight of heroin. Reyes was indicted for knowingly aiding, abetting, and causing that offense. Both appellants pleaded guilty and were convicted of those offenses.

After being informed of appellants' arrests, respondent terminated appellants' 1976 taxable year and issued jeopardy assessments in the amounts of \$27,260 for **Salas** and \$9,660 for Reyes. Thereafter, respondent

Appeals of Alfred M. Salas and Betty Lee Reyes

reduced the jeopardy assessments to \$15,996 for **Salas** and \$5,436 for **Reyes**. In issuing the jeopardy assessments, respondent found it necessary to estimate appellants' income for the appeal period. Utilizing the available evidence, respondent determined that appellants' total taxable income from heroin sales during the period May 1, 1976, through **November 19, 1976**, was \$153,600 for **Salas** and \$57,600 for **Reyes**.^{1/}

The California Personal Income Tax Law requires a taxpayer to state specifically the items and amount of his gross income during the taxable year. Gross income includes all income from whatever source derived unless otherwise provided in the law. (Rev. & Tax. Code, § 17071.) Gross income includes gains derived from illegal activities, including the illegal sale of narcotics, which must be reported on the taxpayer's return. (United States v. Sullivan, 274 U.S. 259 [71 L.Ed. 1037] (1927); Farina v. McMahon, 2 Am.Fed.Tax R.2d 5918 (1958).) Each taxpayer is required to maintain such accounting records as will enable him to file an accurate return. (Treas. Reg. § 1.446-1(a)(4); former Cal. Admin. Code, tit. 18, reg. 17561, subd. (a)(4) (repealer filed June 25, 1981; Register 81, No. 26).) In the absence of such records, the taxing agency is authorized to compute his income by whatever method will, in its judgment, clearly reflect income. (Rev. & Tax. Code, § 17561, subd. (b).) The existence of unreported income may be demonstrated by any practical method of proof that is available. (Davis v. United States, 226 F.2d 331 (6th Cir. 1955); Appeal of John and Codelle Perez, Cal. St. Bd. of Equal., Feb. 16, 1971.) Mathematical exactness is not required. (Harold E. Harbin, 40 T.C. 373, 377 (1963).) Furthermore, a reasonable reconstruction of income is presumed correct, and the taxpayer bears the burden of proving it erroneous. (Breland v. United States, 323 F.2d 492, 496 (5th Cir. 1963); Appeal of Marcel C. Robles, Cal. St. Bd. of Equal., June 28 1979.)

In the instant appeals, respondent used the projection method to reconstruct appellants' income from the illegal sale of heroin. In short, respondent projected a level of income over a period of time. Because of the

^{1/} It should be noted that these figures reflect a 50 percent cost of "goods" sold deduction. However, as explained in footnote 2, infra, this deduction is now statutorily prohibited.

Appeals of Alfred M. Salas and Betty Lee Reyes

difficulty in obtaining evidence in cases involving illegal activities, the courts and this board have recognized that the use of some assumptions must be allowed in cases of this sort. (See, e.g., Shades Ridge Holding Co., Inc., ¶ 64,275 P-H Memo. T.C. (1964), affd. sub nom., Fiorella v. Commissioner, 361 F.2d 326 (5th Cir. 1966); Appeal of Burr MacFarland Lyons, Cal. St. Bd. of Equal., Dec. 15, 1976.) It has also been recognized, however, that a dilemma confronts the taxpayer whose income has been reconstructed. Since he bears the burden of proving that the reconstruction is erroneous (Breland v. United States, supra), the taxpayer is put in the position of having to prove a negative, i.e., that he did not receive the income attributed to him. In order to ensure that use of the projection method does not lead to injustice by forcing the taxpayer to pay tax on income he did not receive, the courts and this board have held that each assumption involved in the reconstruction must be based on fact rather than on conjecture. (Lucia v. United States, 474 F.2d 565 (5th Cir. 1973); Shapiro v. Secretary of State, 499 F.2d 527 (D.C. Cir. 1974), affd. sub nom., Commissioner v. Shapiro, 424 U.S. 614 [47 L.Ed.2d 278] (1976); Appeal of Burr MacFarland Lyons, supra.) Stated another way, there must be credible evidence in the record which, if accepted as true, would "induce a reasonable belief" that the amount of tax assessed against the taxpayer is due and owing. (United States v. Bonauro, 294 F.Supp. 750, 753 (E.D.N.Y. 1968), affd. sub noted United States v. Dono, 428 F.2d 204 (2d Cir. 1970).) If such evidence is not forthcoming, the assessment is arbitrary and must be reversed or modified. (Appeal of Burr MacFarland Lyons, supra; Appeal of David Leon Rose, Cal. St. Bd. of Equal., March 8, 1976.)

In these appeals, the evidence relied upon by respondent in reconstructing appellants' income was derived from the results of the DEA investigation and statements given by appellants. Specifically, respondent determined that: (i) appellants had been in the "business" of selling heroin in Sacramento from at least May 1, 1976, through November 19, 1976; (ii) appellants sold heroin for \$50 per "spoon" or balloon; (iii) appellants sold 571 "spoons" or balloons of heroin per week during the period under appeal; and (iv.) appellants realized gross income of \$685,200 during the period under appeal.^{2/}

^{2/} Pursuant to Revenue and Taxation Code section 17297.5, effective September 14, 1982, to be applied with respect to taxable years which have not been closed by a statute of limitations, res judicata, or otherwise, no deduction for the cost of "goods" sold from illegal sales of controlled substances is allowed. (Appeals of Manuel Lopez and Miriam Chaidez, Cal. St. Bd. of Equal., Jan. 3, 1983.)

Appeals of Alfred M. Salas and Betty Lee Reyes

We believe that **Salas'** statements to investigators regarding appellants' heroin operations are credible and that, together with the other evidence obtained from the DEA investigation, they support the reasonableness of each of the above elements of respondent's formula. We note that **Salas** had a previous and extensive history of selling heroin. Indeed, **Salas** had been arrested and convicted in 1971 for his narcotics activities. He admitted that after his release from prison in 1974, he continued to traffic in narcotics, supporting himself and his family entirely from that income. He had never held a job. At the time of their arrest, both appellants possessed various drug-related paraphernalia, together with pistols and an attack dog, all of which is indicative of those persons who deal in narcotics. Clearly, appellants have been engaged in the business of selling heroin for a substantial period of time, and the records establish that appellants resided in Sacramento since March of 1976.. The second element of the projection of income method pertains to appellants' selling price. Data supplied by the Bureau of Narcotics Enforcement indicates the "street price" of heroin of the quantity and quality sold by appellants during the period at issue was \$50 per balloon. The amount and purity of the heroin which they possessed at the time of their arrest cut to "street standards" support the conclusion that appellants were selling 571 balloons per week. (See Appeal of Clarence P. Gonder, Cal. St. Bd. of Equal., May 15, 1974.) Accordingly, the estimate of appellants' gross income during this period appears reasonable. Moreover, since respondent may properly determine that a single member of a group engaged in criminal activity producing income can be charged with the entire income, respondent's allocation of income between appellants is also reasonable. (Ronald L. Miller, ¶ 81,249 P-H Memo. T.C. (1981).)

Notwithstanding the above analysis, appellants argue that the requisite "credible evidence" is not present in this matter. First, appellants argue that the information (DEA and police reports) upon which respondent relies is based upon hearsay statements and should, accordingly, be disregarded here. However, we have previously found such documents to be "credible evidence." (See, e.g., Appeals of Manuel Lopez and Miriam Chaidez, Cal. St. Bd. of Equal., Jan. 3, 1983; Appeal of Bernie Solis, Jr., and Lucy Solis, Cal. St. B*E Equal., June 23, 1981.) In addition, we have held that the technical rules of evidence do not preclude our consideration of the entire record for purposes of deciding these appeals. (Appeal of Marcel C. Robles, supra.) While these reports

Appeals of Alfred M. Salas and Betty Lee Reyes

are hearsay, they are nonetheless admissible evidence in a proceeding before this board, (Appeal of David Leon Rose, supra; see also Cal. Admin. Code, tit. 18, § 5035, subd. (c).)

Next appellants argue that utilizing statements made by appellants and the DEA reports violates certain constitutional guarantees (e.g., Fifth Amendment, Sixth Amendment) of appellants. However, we believe the adoption of Proposition 5 by the voters on June 6, 1978, adding section 3.5 to article III of the California Constitution, precludes our determining that utilization of the evidence is unconstitutional. Moreover, this board has a well-established policy of abstaining from deciding constitutional questions in appeals involving deficiency assessments. (Appeal of Leon C. Harwood, Cal. St. Bd. of Equal., Dec. 5, 1978; Appeal of Iris E. Clark, Cal. St. Bd. of Equal., March 8, 1976.) However, even in cases in which such constitutional questions have been considered, it has been held that the Fifth Amendment privilege **does not** relieve appellant of his burden of proof. (Roger D. Wilkinson, 71 T.C. 633 (1979); Lonnie Lee Stradling, ¶ 81,173 P-H Memo. T.C. (1981).)

We further conclude that appellants cannot prevail before this board on the basis of their two remaining arguments. Appellants' counsel challenges the assessments on the grounds that the funds respondent collected from the DEA were funds belonging to him and not belonging to appellants. Appellants' counsel states that appellants owed him \$13,502.11 pursuant to a retainer agreement. Therefore, he argues, respondent should return those funds to him rather than apply those funds against appellants' tax liability. We note, however, that this board does not have jurisdiction to consider that claim but is, instead, concerned solely with the amounts of appellants' tax liabilities during the period in question. Accordingly, we cannot consider that claim as part of the instant appeals. (See, e.g., Appeal of Calvin Vase Valrie, Cal. St. Bd. of Equal., Dec. 10, 1981.)

Lastly, appellants contend that respondent's utilization of jeopardy assessments in these matters was improper and that this board should order respondent to return those funds. Respondent's authority to issue jeopardy assessments and to terminate the taxable period of appellants' is conferred by Revenue and Taxation Code sections 18641 and 18642, respectively. We note that respondent's decision to issue the assessments for the period under appeal is not subject to review by this board. (Appeal of Karen Tomka, Cal. St. Bd. of Equal., May 19, 1981; Appeal of John and Codelle Perez, supra.)

Appeals of Alfred M. Salas and Betty Lee Reyes

Based on the above, and in view of the provisions of Revenue and Taxation Code section 17297.5, we conclude that appellants received a total of \$685,200 in unreported taxable income from the illegal sale of heroin during the appeal period. This is sufficient to sustain the subject jeopardy assessments in their entirety.

Appeals of Alfred M. Salas and Betty Lee Reyes

O R D E R

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

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 on the petition of Alfred M. Salas for reassessment of a personal income tax jeopardy assessment in the amount of \$15,996 for the period January 1, 1976, to November 19, 1976, and on the petition of Betty Lee Reyes, aka Betty Lee Salas, for reassessment of a personal income tax jeopardy assessment in the amount of \$5,436 for the period January 1, 1976, to November 19, 1976, be and the same is hereby sustained.

Done at Sacramento, California, this 28th day of February, 1984, by the State Board of Equalization, with Board Members Mr. Nevins, Mr. Dronenburg, Mr. Collis, Mr. Bennett and Mr. Harvey present.

Richard Nevins - -, Chairman
Ernest J. Dronenburg, Jr. , Member
Conway H. Collis - - , Member
William M. Bennett , Member
Walter Harvey* , Member

*For Kenneth Cory, per Government Code section 7.9