BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
) No. 82J-1870-KP
ROLAND ARANDA GARCIA)

For Appellant: Janyce Keiko Imata Blair
Attorney at Law

For Respondent: Philip Farley
Counsel

O P I N I O N

This appeal is made pursuant to section 18646[1/] of the Revenue and Taxation Code from the action of the Franchise Tax Board in denying the petition of Roland Aranda Garcia for reassessment of a jeopardy assessment of personal income tax and penalty in the total amount of $12,366.87 for the year 1978, and for reassessment of a jeopardy assessment of personal income tax in the amount of $8,421.50 for the period January 1, 1980, to September 16, 1980.

1/ Unless otherwise specified, all section references are to sections of the Revenue and Taxation Code as in effect for the year and period in issue.

Appeal of Roland Aranda Garcia

The issues presented by this appeal are whether appellant received unreported income from the illegal sale of narcotics during 1978 and the period January 1, 1980, to September 16, 1980; whether respondent properly reconstructed the amount of that income; and whether respondent properly satisfied its assessment with funds confiscated from appellant's residence,

On August 20, 1980, Detective Sullivan of the Los Angeles Police Department purchased one P.C.P.-laced cigarette from appellant pursuant to an undercover drug investigation. Following that sale, a confidential reliable informant (CRI) reported to G. Olson, an agent of the Bureau of Narcotics Enforcement of the California Department of Justice (BNE), that on August 31, 1980, the CRI observed appellant selling two P.C.P.-laced cigarettes to a third party.

On September 4, 1980, Agent Olson, in investigating appellant's activities; contacted the police department which had-jurisdiction over appellant's neighborhood. The agent was told by a detective that the local police'had known of appellant's drug selling for. some time and one of the patrol officers recalled that he had made several arrests of persons near appellant's residence who possessed P.C.P. -laced cigarettes purchased from appellant. The officer stated that appellant had been in "business" for 2 1/2 to 3 years and had been selling about 2 ounces of P.C.P. a day.

Later that day, Agent Olson met with the CRI. The CRI estimated that from what he had seen of appellant's drug-selling operation, appellant sold approximately 2 ounces of P.C.P. a day. The CRI also agreed to participate in a controlled buy of two P.C.P.-laced cigarettes from appellant. As a result of that controlled buy and the above-described information, a search warrant for appellant's residence was obtained.

On September 12, 1980, on the way to serve the warrant, BNE agents and police officers spotted appellant across from the local police station and arrested him. Subsequently, various criminal charges. were filed against him. Eventually, all of the charges were dismissed.

After appellant's arrest, the officers proceeded to his residence and executed the warrant. Several items were seized during the raid. In the southeast bedroom, the police discovered L.S.D., three S-ounce bottles containing P.C.P. residue, various weapons, and a strong box

containing L.S.D., various receipts in appellant's name, and $9,135 in cash, including a marked $20 bill paid to appellant by the CRI during the controlled buy on September 4. Various personal effects of Raul Garcia, appellant's father, were found throughout the house, including the southeast bedroom.

Respondent was subsequently informed of the above events and information and determined that appellant had received unreported income from the illegal sale of narcotics. Based on the police officer's estimate that appellant had been in business for 3 years, respondent determined that appellant had been selling drugs since 1978. Respondent also estimated that he had been selling approximately 2 ounces of P.C.P. a day during that period at $300 an ounce. On September 16, 1980, by virtue of these estimations, appellant was attributed with unreported income of $95,550 for 1978, $127,400 for 1979, and $85,750 for 1980. The appropriate assessments were issued. It was also determined that collection of the tax would be jeopardized by delay. An order to withhold was issued and the money seized in the raid was recovered by respondent.'

On September 17, 1980, respondent received a letter from Agent Olson correcting some of the above information. Agent Olson reported that the patrol officer he spoke to regarding appellant's activity subsequently stated that appellant had not been operating in 1979 because he had been in jail for that year. Agent Olson also wrote that the CRI now stated that appellant had been in business for approximately 3 years. These two facts were previously unknown to respondent.

Respondent withdrew its assessment for 1979, the year appellant had been incarcerated. Thereafter, appellant requested a redetermination of the remaining assessments. Respondent reviewed its determination and affirmed the remaining assessments. This appeal followed.

The first question presented by this appeal is whether appellant received any income from the illegal sale of narcotics. Although appellant does not directly attack the finding that he received unreported income from the illegal sale of narcotics, he states that the southeast bedroom of the residence that was searched was occupied by his parents during the period in question. Appellant implies that all of the drugs and drug

paraphernalia were for the personal use of the occupants of the house.

Appellant's argument is unpersuasive. The investigation of appellant's activities began with appellant selling a P.C.P. cigarette to an officer of the Los Angeles Police Department. Next, the CRI observed appellant selling P.C.P. cigarettes to a third party. Appellant then sold P.C.P. cigarettes to the CRI during a controlled buy supervised by Agent Olson. When the search warrant was executed, drugs and drug paraphernalia were discovered in the residence from which appellant sold drugs. Further, appellant has never denied that he was a resident of that house, but only that the bedroom in which the contraband was discovered was not his. Although others at that residence may have been involved in the sale of narcotics, it is clear from the record that appellant was a principal seller of drugs. If appellant intended to argue that he received only part or none of the funds generated by the drug sales emanating from his residence, the burden is upon him to prove this fact. (Miller v. Commissioner, ¶ 81,249 T.C.M. (P-H) (1981).) Since he failed to present any evidence in this connection, he is chargeable with receipt of the entire amount of sales generated by the drug-sale activities. (Miller v. Commissioner, supra.)

Appellant next contends that since he was not convicted of selling narcotics, all of the information used in the police reports connecting him with drug sales is meaningless hearsay. We disagree.

Respondent may adequately carry its burden-of proof that a taxpayer received unreported income through a prima facie showing of illegal activity by the taxpayer. (Hall v. Franchise Tax Board, 244 Cal.App.2d 843 [53 Cal.Rptr. 597] (1966); Appeal of Richard E. and Belle Hummel, formerly Belle McLane, Cal. St. Bd. of Equal., Mar. 8, 1976.) The objection to the use of evidence contained in police reports as unreliable was addressed by this board in the Appeal of Carl E. Adams, decided on March 1, 1983, where we noted that this board may consider any relevant evidence, including hearsay evidence, provided that "'it is the sort of evidence on which responsible persons are accustomed to rely in the conduct of serious affairs.'" (Appeal of Carl E. Adams, supra, citing Cal. Admin. Code, tit. 18, reg. 5035, subd. (c).) While the reports of the police department in the instant appeal are hearsay, such documents are credible evidence (Appeals of Manuel Lopez Chaidez and Miriam Chaidez, Cal.

St. Bd. of Equal., Jan. 3, 1983) and admissible in a proceeding before this board. (Appeal of David Leon Rose, Cal. St. Bd. of Equal., Mar. 8, 1976.) Further, the fact that the criminal charges against appellant were dismissed does not indicate that the illegal activity did not occur, but only that the occurrence of the illegal activity could not be proven in a criminal case by admissible evidence beyond a reasonable doubt. (Appeal of Carl E. Adams, supra.) Accordingly, a conviction is not required to support the conclusion that a prima facie case has been established that a taxpayer received unreported income from an illegal activity. (Appeal of Carl E. Adams, supra.) Consequently, we find that respondent has established at least a prima facie showing that appellant was selling narcotics and that he received unreported income from those sales.

The next issue for our consideration is whether respondent properly reconstructed the amount of said taxable income. Under the California Personal Income Tax Law, a taxpayer is required to specifically state the items of his gross income during the taxable year. (Rev. & Tax. Code, § 18401.) As in the federal income tax law, gross income is defined to include "all income from whatever source derived," unless otherwise provided in the law. (Rev. & Tax. Code, § 17071; I.R.C. § 61.) Gain from the illegal sale of narcotics constitutes gross income. (Farina v. McMahon, 2 A.F.T.R.2d (P-E) ¶ 58-5246 (1958); Galiuzzo v. Commissioner, ¶ 81,733 T.C.M. (P-E) (1981).)

It is well settled that both federal and state income tax regulations require each taxpayer 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 reliable books or records, the taxing agency is given great latitude to determine a taxpayer's income by whatever method will, in its opinion, clearly reflect income. (Rev. & Tax. Code, § 17561, subd. (b); Giddio v. Commissioner, 54 T.C. 1530 (1970).) The choice as to the method of reconstructing income lies with the taxing agency, the only restriction being that the method be reasonable under the circumstances. (Carson v. United States, 560 F.2d 693 (5th Cir. 1977); Schellenbarg v. Commissioner, 31 T.C. 1269 (1959).) Moreover, where a taxpayer has failed to maintain any books or records of his transactions, respondent's method need not compute net income with mathematical exactness in order to be

reasonable. (Gordon v. Commissioner, 63 T.C. 51 (1974); Harbin v. Commissioner, 40 T.C. 373 (1963).) "Under such circumstances, approximation in the calculation of net income is justified." (Harris v. Commissioner, 174 F.2d 70, 73 (4th Cir. 1949).) Thus, so long as some reasonable basis has been used to reconstruct income, respondent's determination will be presumed correct, and the taxpayer bears the burden to disprove such computation even though it is crude. (Breland v. United States, 323 F.2d 492 (5th Cir. 1963).)

In general, the existence of unreported income may be demonstrated by any practical method of proof that is available in the circumstances of a particular case. (Davis v. United States, 226 F.2d 331 (6th Cit. 1955); Appeal of Karen Tomka, Cal. St. Bd. of Equal., May 19, 1981.) In the instant matter, respondent employed the now familiar projection method to reconstruct appellant's income from the alleged sale of P.C.P. The projection method based upon statistical analysis and assumptions gleaned from the evidence is an acceptable method of reconstruction; (Mitchell v. Commissioner, 416 F.2d 101 (7th Cir. 1969); Fiorella v. Commissioner, 361 F.2d 326 (5th Cir. 1966); Appeal of David Leon Rose, Cal. St. Bd. of Equal., Mar. 8, 1976.) However, in order to ensure that the use of the projection method does not lead to injustice by forcing the taxpayer to pay tax on income that he did not receive, 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); Willits v. Richardson, 497 F.2d 240 (5th Cir. 1974); 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 McFarland Lyons, Cal. St. Bd. of Equal., Dec. 15, 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 against the taxpayer is due and owing. (United States v. Bonaguro, 294 F.Supp. 750 (E.D.N.Y. 1968), affd. sub nom., United States v. Dono, 428 F.2d 204 (2d Cir. 1970); Appeal of Burr McFarland Lyons, supra.) If the reconstruction is found to be based on assumptions lacking corroboration in the record, the assessment is deemed arbitrary and unreasonable. (Shades Ridge Holding Co., Inc. v. Commissioner, ¶ 64,275 T.C.M. (P-H) (1964), affd. sub nom., Fiorella v. Commissioner, supra.) In such instance, the reviewing authority may redetermine the taxpayer's income on the facts adduced from the record. (Mitchell v. Commissioner,

supra; Whitten v. *Commissioner*, ¶ *80,245 T.C.M.* (P-H) (1980); Appeal of David Leon Rose, supra.)

Inasmuch as appellant has not disclosed his income from the sale of narcotics, respondent was forced to rely upon the reports and information obtained from the BNE to reconstruct his taxable income from such illegal sources. First, respondent determined that appellant was engaged in the business of selling drugs. Because we have already found that appellant received income from narcotics trafficking, it follows from that discussion that appellant was engaged in that illegal business. Thus, we find sufficient credible evidence in the record to sustain this first assumption.

The second assumption in the assessment was that appellant sold 2 ounces of P.C.P. a day at a price of *$300* an ounce. This computation was based on the estimate of appellant's business by the CRI, the price appellant charged the CRI and the police officer during the controlled sales, and an estimation by Agent Olson, as an experienced narcotics officer, that 20 cigarettes may be treated by *an ounce* of P.C.P. As stated above, we find the information provided by a CRI that leads to the subsequent seizure of contraband and the arrest of a taxpayer credible. (Appeal of Clarence Lewis Randle, Jr., Cal. St. Bd. of Equal., Dec. 7, 1982.) Further, Agent Olson made his estimate based on his experience as a narcotics officer and there is nothing in the record nor argument by appellant to contradict his figure. Therefore, we find that the number of daily sales and the price per sale are supported by the record.

As for the third assumption of the assessment, respondent determined that appellant was engaged in the illegal sale of P.C.P. for most of 1978 and the period January 1, 1980, to September 12, 1980. This determination was based upon information provided to the BNE from the CRI and the local police department.

It is true that authority exists for reliance upon data acquired from informants to reconstruct a taxpayer's income from illegal activities, provided that there do not exist "substantial doubts" as to the informant's reliability. (Cf. Nolan v. United States, 49 A.F.T.R.2d (P-H) ¶ 82-493 (1982); see also Appeals of Siroos Ghazali, Cal. St. Bd. of Equal., Apr. 9, 1985; Appeal of Clarence Lewis Randle, Jr., supra.) In the Appeal of Clarence Lewis Randle, Jr., supra, we upheld the assumption that the taxpayer had been in business for

the prior 46 weeks on the basis of a statement of a single informant. There was reason to believe, however, that the information was reliable since other intelligence provided by the informant resulted in the seizure of 78 grams of narcotics and the subsequent conviction of the taxpayer. Similarly, in the Appeal of Carl E. Adams, supra, we sustained respondent's assumption that the taxpayer had been selling cocaine from his restaurant in the 13 months prior to his arrest. In that case, the duration of the taxpayer's illegal activities was substantiated by a single tipster, but other information he provided to a detective led to a seizure of contraband and the taxpayer's arrest. In addition, during the prior 10 months, two other confidential reliable informants had disclosed to the same detective that they had purchased controlled substances from the taxpayer and one of them participated in a police-supervised buy.

With the above decisions in mind, we do not find either the BNE reports or the information provided in the letter of September 17, 1980, a reliable guide for the length of time appellant was dealing drugs. First, we note that the CRI never mentioned the duration of appellant's operation prior to appellant's arrest-; It was only after the arrest and search that he suddenly "remembered" that appellant had been selling drugs for about three years. We find such belated information of dubious value as "none of the information contained in the letter .. . was demonstrated to have been reliable by any subsequent seizure or arrest." (Appeals of Siroos Ghazali, Cal. St. Bd. of Equal., Apr. 9, 1985.) (Emphasis added.) This information could easily be an after-the-fact attempt to bolster respondent's assessments.

In the same vein, the patrol officer originally stated that he had known of appellant's activities for the past 3 years; that he had observed many people come and go from appellant's home; and that he had arrested many individuals after they had stopped at appellant's house and those arrested almost always named appellant as the one from whom they bought P.C.P. cigarettes. Yet, the officer originally made no mention of the fact that in 1979, one of those 3 years he "knew" appellant was selling drugs, appellant had been incarcerated the entire year and was unable to sell anything. Further, no evidence was Presented to substantiate the "numerous" arrests that allegedly occurred outside of appellant's residence., We also find it unlikely that the officer never attempted to arrest appellant during the 3-year period appellant was "known" to have been selling drugs.

Further, we find it suspicious that in a letter sent to respondent 5 days after appellant's arrest, the patrol officer suddenly remembered that appellant had been in jail in 1979 and was not dealing drugs during that time. (See Appeals of Siroos Ghazali, supra.) It would seem that an officer so knowledgeable about appellant's activities would have been aware of a l-year gap in his selling prior to his arrest.

Accordingly, without the corroboration necessary to support respondent's determination that appellant was selling drugs in 1978, we must reverse that assessment in its entirety. Furthermore, as most of respondent's assessment for the period January 1, 1980, to September 12, 1980, is based on the same dubious information, that assessment must be modified to include the only known period of drug sales conducted by appellant: from the time of the first purchase by the undercover officer of the Los Angeles Police Department to the date of appellant's arrest.

In regards to the last issue on appeal, appellant contends that respondent has no right to the funds confiscated by the police pursuant to the search warrant and that respondent's jeopardy assessment was issued simply to harass him.

We need not address either of these contentions. Respondent's authority to issue jeopardy assessments is conferred by section 18641, and its decision to issue the assessment for the appeal periods in question is not subject to review by this board. (Appeal of Karen Tomka, supra; Appeal of John and Codelle Perez, Cal. St. Bd. of Equal., Feb. 16, 1971.) Furthermore, appellant's contention that respondent's receipt of the funds used to satisfy the subject jeopardy assessment was improper is also not reviewable by this board. (See Appeal of Bruce James Wilkins, Cal. St. Bd. of Equal., May 4, 1983; Appeals of Manuel Lopez Chaidez and Miriam Chaidez, supra.) Our only consideration on appeal is the propriety of the deficiency actually determined by respondent for the periods of assessment. (Appeal of Karen Tomka, supra; Appeal of John and Codelle Perez, supra.) Appellant must look elsewhere to satisfy his other grievances.

In summary, we find that respondent's projection of appellant's income from the illegal sale of narcotics for the period August 20, 1980, to September 12, 1980, to be reasonable when scrutinized against the record in this appeal and that appellant has failed to

carry his burden of proving otherwise. In contrast, we find that respondent's projection of appellant's income for 1978 and the period January 1, 1980, to August 19, 1980, to be unsupported by the record on appeal and that these portions of the assessments must be reversed. Respondent's action in this matter will be modified accordingly.

Appeal of Roland Aranda Garcia

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;

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 petitions of Roland Aranda Garcia for reassessment of a jeopardy assessment of personal income tax and penalties in the total amount of $12,366.87 for the year 1978, and for reassessment of a jeopardy assessment of personal income tax in the amount of $8,421.50 for the period January 1, 1980, to September 16, 1980, be and the same is hereby reversed with respect to the assessments for the year 1978 and the period January 1, 1980, to August 19, 1980. In all other respects, the action of the Franchise Tax Board is sustained.

Done at Sacramento, California, this 4th day of March, 1986, by the State Board of Equalization, with Board Members' Mr. Nevins, Mr. Collis, Mr. Dronenburg and Mr. Harvey present.

_____, Chairman

Conway H. Collis, Member

Ernest J. Dronenburg, Jr., Member

Walter Harvey*, Member

_____, Member

*For Kenneth Cory, per Government Code section 7.9