



BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
HOSSEIN A. HAMZAVI) No. 81J-1134-SW

For Appellant: Hossein A. Hamzavi,
in pro. per.

For Respondent: Philip M. 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 Hossein A. Hamzavi for reassessment of a jeopardy assessment of personal income tax in the amount of \$2,828 for the period January 1, 1980, to October 23, 1980.

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

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The issues presented in this appeal are whether appellant received unreported income from illegal sales of narcotics and, if he did, whether respondent properly reconstructed the amount of that income.

Appellant, who was born and raised in Iran, first came to the United States in 1965 to attend the Columbia Institute of Technology in Arlington, Virginia. In 1974, following his arrest on a drug charge, he was deported. In 1979, appellant reentered the United States illegally through Canada. He was prosecuted for this offense and incarcerated in federal prison until December 1981. Appellant is, at the time of this appeal, employed **as a** foreign car mechanic for **Mauricio's** Import Car Service in San Rafael.

On October 7, 1980, Mrs. Patricia Moody, a real estate agent, and Mrs. Pat Glasner visited appellant's residence at 258 "D" Street in San Rafael. Mrs. Moody **had been** contacted by the owners of the property who wanted to sell the house. Appellant and his wife, Ruth, were renting the house at that time. During her inspection of the house, Mrs. Moody entered the garage. **She** observed an area that was occupied by a **table**, upon which were a lamp, a **bunsen** burner, and numerous test tubes. Several minutes later a prospective buyer arrived. When asked if they could inspect the garage, appellant adamantly and repeatedly refused them access, stating that he had private things in there which would be out by Thursday.

Mrs. Moody contacted Detective Jerry Hasser of the San Rafael Police Department and expressed her concern that narcotics were present in the residence. On October 21, 1980, Ronald Silveira, attorney for the owners of the house, contacted Fred G. Castillo, San Rafael Police Officer, and asked if any investigation was being conducted. The next day, San Rafael Fire Marshal Kenneth Mazza visited appellant's premises, and reported to Officer Castillo that appellant was using ether in the garage. Mr. **Mazza** told appellant that it was extremely dangerous to have ether near an open flame such as the **bunsen** burners appellant had in the garage. **Mr. Mazza** advised appellant that if he failed to eliminate the hazard, the police would be contacted. Appellant repeatedly stated that he used the ether in his glass blowing business and that it **was** safe. As neither Mr. **Mazza** nor Officer Castillo knew whether ether was used in glass blowing, they contacted a Mr. Lynn Griffin of the Stanford Glass Blowing Lab. **He** stated that in his 40 years in the

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glass blowing business to his knowledge ether would not be used in the glass blowing process.

Officer Castillo was informed by the United States Customs Office in San Francisco and the Immigration officials that appellant was an Iranian citizen who had been arrested for possession of cocaine. They also informed Officer Castillo that appellant had been denied entry into the United States in 1978. Based on this information, Officer Castillo and Fire Marshal **Mazza** visited appellant's residence. Upon arriving at the house, both **men detected** the odor of ether coming from the premises. Officer Castillo knocked repeatedly on the door until Mrs. Hamzavi opened the door and allowed them entry. Appellant then emerged from the garage and asked if Officer Castillo had a search warrant. Officer Castillo replied that he did not have a warrant but that one was not needed due to the fact that there were special circumstances regarding a hazardous situation in the residence. An inspection of the garage revealed two loaded guns and the following:

- (1) a glass **jar** containing the **flowering tops** of, marijuana;
- (2) paraphernalia commonly associated with the storage and **use of** marijuana such as pipes, heat lamps, sifters used to sift heroin prior to packaging, baggies, scales, and other weighing devices;
- (3) a plastic, heat-sealed bag containing cocaine and various narcotic paraphernalia such as razor blades, milk sugar, straws, lactose, balloons, scales, paper bindles used to package drugs for sale, measuring devices and containers commonly associated with the storage of narcotics;
- (4) a metal canister of ether, which can be used to refine the impurities from cocaine or to manufacture **PCP**;
- (5) oxygen tanks;
- (6) a hand-held welding torch; and
- (7) butane and propane canisters.

Both appellant and his wife were arrested.

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Officer Castillo checked the serial number on the revolver appellant had in his garage and found that it was a stolen weapon. A search warrant was obtained for the residence and the above-listed items were seized. Also obtained during the search was \$27,668, business cards, a VISA card issued to Ruth D. Hamzavi, six grams of heroin, a wallet with numerous cards issued to appellant, note paper with narcotic transaction notes indicating sales in amounts from \$50 to \$2,000, letters to appellant, and bullets and shells for the weapons.

On October 23, 1980, respondent was informed of the above information. Based upon this evidence, respondent determined that appellant's taxable California income for the period January 1, 1980, through October 23, 1980, was \$34,918. This figure was calculated on the following:

1. Cash on hand	\$27,668.00
2. Cost of living (9 1/2 months x \$500/month) =	4,750.00
3. Cost of cocaine based on the price sheets provided by California's Department of Justice Training Center	1,000.00
4. Cost of heroin (6 grams) based on 50% of a cost of \$500/gram.	<u>1,500.00</u>
	\$34,918.00

It was determined that collection would be jeopardized by delay in assessment so a jeopardy tax assessment was issued on October 24, 1980, for \$2,828. This amount was secured by issuing an order to withhold on the San Rafael Police Department, which had seized \$27,668 in cash from appellant's residence.

On December 8, 1980, appellant's representative filed a petition for reassessment asking for an oral hearing. Subsequently, respondent accepted the petition and requested appellant's representative to provide the evidence necessary to substantiate his claim that the jeopardy assessment was in error. A hearing was held on February 16, 1982. Attorney Carl Shapiro, representing appellant, stated that the money was sent to appellant from Iran on July 16, 1978. A copy of a cashier's check for \$31,190 and a transfer receipt dated July 16, 1978,

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were presented. Respondent subsequently denied appellant's petition for reassessment.

On August 31, 1982, appellant was tried and convicted for possession of heroin and cocaine, and being a felon in possession of a firearm.

The initial question presented by this appeal is whether appellant earned any income from the illegal sale of cocaine, heroin, or marijuana during the period at issue. The reports submitted by Officer Castillo, the results of the search of appellant's **house**, and the conviction of appellant for possession of firearms, heroin, and cocaine establish at least a prima facie case that appellant received unreported income from the sale of drugs during the appeal period. As appellant has presented no evidence to refute this prima facie showing, we must conclude that he did receive unreported income from the sale of illegal drugs during the appeal period.

The second issue is whether respondent properly reconstructed the amount of appellant's taxable income from drug sales. 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-H) ¶ 58-5246 (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 a taxpayer's 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 in the circumstances of the particular situation. (Davis v. United States, 226 F.2d 331, 336 (6th Cir. 1955); Appeal of Carl E. Adams, Cal. St. Bd. of Equal., Mar. 1, 1983.) Mathematical exactness is not required. (Harbin v. Commissioner, 40 T.C. 373, 377 (1963).) Furthermore, a reasonable reconstruction of income, is presumed correct, and the taxpayer bears the

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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 view of the inherent difficulties 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. v. Commissioner, ¶ 64,275 T.C.M. (F-H) (1964), affd. sub nom., Fiorella v. Commissioner, 361 **F.2d** 326 (5th Cir. 1966); Appeal of David Leon Rose, Cal. St. Bd. of Equal., Mar. 8, 1976.)

It has also been recognized that a dilemma confronts the taxpayer whose income has been reconstructed. Since the taxpayer bears the burden of proving that the reconstruction is erroneous, the taxpayer is put in the position of having to prove that he did not receive the income so attributed. In order to ensure that the taxing authority's reconstruction 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, 574 (5th Cir. 1973); Shapiro v. Secretary of State, 499 **F.2d** 527, 533 (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.) 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. Bonaguro, 294 **F.Supp.** 750, 753 (E.D.N.Y. 1968), affd. sub nom., 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 McFarland Lyons, supra.) In essence, appellant challenges the jeopardy assessments as being arbitrary.

In the instant appeal, respondent has used what is known as the cash expenditure method in reconstructing appellant's income from the illegal sales of narcotics. This method, which was approved by the court in United States v. Johnson, 319 U.S. 503 (87 L.Ed. 1546) (1943), is used to indirectly prove the receipt of unreported taxable income and does not require evidence of sales activity. The cash expenditure method is devised to reach the type of taxpayer who consumes his self-determined tax-free dollars during the year and winds up no wealthier than before. This method establishes the

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amount of the taxpayer's purchases of goods and services which are not attributable to the resources at the beginning of the year or to nontaxable receipts acquired during the year. (Taglianetti v. United States, 398 F.2d 558, 562 (1st Cir. 1963).) The beginning and ending net worth positions must be identified with sufficient particularity to rule out or account for the use of a taxpayer's capital to pay for his purchases. (Taglianetti v. United States, supra, 398 F.2d at 563.)

The courts recognized that the use of the cash expenditure method places the taxpayer at a distinct disadvantage; therefore, certain safeguards were established. (Holland v. United States, 348 U.S. 121 [99 L.Ed. 150] (1954).) One of the safeguards is that the government is required to establish "with reasonable certainty... an opening net worth, to serve as a starting point from which to calculate future increases in the taxpayer's assets." (Holland v. United States, supra, 348 U.S. at 132.) Before the government can show the existence of unreported income, it must compare the sum of available funds with the total expenditures. Only if the expenditures exceed the sources of available funds has the government established the existence of unreported income. The court in Dupree v. United States, 218 F.2d 781 (5th Cir. 1955), a case involving income tax fraud, defined "available funds" as including (1) the funds available to the taxpayer at the beginning of the period, (2) the income acquired during the period as reported on the taxpayer's return, and the tax-exempt receipts received during the same period. Unless the government can show with a reasonable degree of certainty the source of a taxpayer's "available funds," it cannot conclude that a taxpayer, no matter how great his expenditures, has unreported income.

This has also been held to apply to civil cases in which the burden of proof is on the taxpayer rather than the government. (Thomas v. Commissioner, 223 F.2d 83, 86 (6th Cir. 1955).) In such cases, the burden of proof remains on the taxpayer, but the record must contain at least some proof which "makes clear the extent of any contribution which beginning resources or a diminution of resources over time could have made to expenditures." (Taglianetti v. United States, supra, 398 F.2d at 565.) If such proof is lacking, the government's determinations are arbitrary and cannot be sustained. (Thomas v. Commissioner, supra; Taglianetti v. United States, supra.)

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In the appeal before us, respondent determined that (i) appellant had \$27,668 in cash; (ii) appellant needed \$4,750 to cover his living expenses; and (iii) appellant had in his possession **\$1,000 worth** of cocaine and \$1,500 worth of heroin. There is not, however, any evidence in the record which establishes the net worth of appellant at the beginning of the period in issue. Respondent has not, like the government did in Ford v. United States, 210 **F.2d** 313 (5th Cir. 1954), contacted the local banks to determine if appellant had any checking **accounts**, savings accounts, or safe deposit boxes. It did not secure any witnesses who could testify as to appellants expenditures or prior **accumulations** and it did not contact county officials to check for ownership of property or sales of property. Likewise, respondent did not check the probate records for possible inheritances or insurance agencies for any payments. Therefore, respondent's conclusion that appellant had unreported income of \$34,918 for the period January 1, 1980, through October 23, 1980, is pure conjecture, and its reconstruction of income is arbitrary and cannot be sustained.

For the above reasons, 'respondent's action 'must be reversed.

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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 petition of Hossein A. Hamzavi for reassessment of a jeopardy assessment of personal income tax in the amount of \$2,828 for the period January 1, 1980, to October 23, 1980, be and the same is hereby reversed.

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