

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
MARJORIE **LILLIE** DAVIS) **No. 84J-1309-KP**

For Appellant: Chris P. Andrian
Attorney at Law

For Respondent: Lorrie K. Inagaki
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 Marjorie **Lillie** Davis for reassessment of a jeopardy assessment of personal income tax in the amount of \$22,758 for the period January 1, 1983, to July 21, 1983.

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

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The issues presented by this appeal are whether appellant received income from the illegal sale of controlled substances and whether respondent has properly reconstructed appellant's income from such drug sales to support the resulting jeopardy assessment.

Some time in early June 1983, a confidential reliable informant (CRI) provided information to the Sonoma County Sheriff's Department that appellant had been selling marijuana from her house for 'several years.' On June 3, 1983, an officer working undercover and the CRI went to appellant's residence to purchase marijuana. The CRI completed a controlled buy of an eighth of an ounce of marijuana for \$40.

On June 13, 1983, the undercover officer completed another controlled purchase of an eighth of an ounce of marijuana for \$45. During the sale, the officer offered to pay appellant for a \$13 debt owed her by the CRI. Appellant indicated she was happy to receive payment because she had "a \$40,000 loss on the books." Subsequently, two more controlled purchases of a quarter ounce of marijuana were completed for \$90 each.

On July 21, 1983, a search warrant for appellant's house was obtained and executed. During the raid, appellant was arrested. A search of her house revealed approximately 28 ounces of marijuana packaged for sale, \$1,583 in currency, which included \$60 in recorded county funds from the undercover sales, notebooks recording some of appellant's marijuana sales, and a scale. Further investigation of appellant's bank accounts revealed numerous deposits of varied amounts since 1980.

Upon being informed of the above information, respondent examined its records and discovered that appellant had failed to file any income tax returns for a number of years. Based upon the above, respondent determined that appellant's activities had resulted in unreported taxable income for the period January 1, 1983, to July 21, 1983, the date of her arrest. The determination of taxable income was derived from an estimated sales price of \$240 per ounce of marijuana times 32 ounces (which respondent assumed were her weekly sales) times the number of weeks during 1983 she was known to have been in business. It was further determined that the collection of tax would be jeopardized by delay in assessment. An assessment was issued and partially satisfied against appellant's known bank accounts and the cash found during the search of appellant's residence.

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Appellant filed a petition for reassessment. Respondent requested a complete financial disclosure from appellant. In response to the questions, appellant **claimed that** her only assets were her house, which she owned free-and-clear since 1980, her 1971 car, and \$1,000 of furniture. She claimed to have made only \$300 in sales of marijuana during 1983. Appellant went on to say that she had no income and had been living off \$30,000 left to her on the death of her husband in 1980 and loans from her sons. Respondent requested substantiation of her claimed sources of cash but received no reply. The assessment was affirmed and this appeal followed.

The initial inquiry presented by this appeal is whether appellant received any income from the illegal sale of narcotics during the period at issue. The answer to the question is plain, since appellant admits that she sold marijuana and that she pled guilty to one count of the sale of marijuana. What appellant takes exception to is the amount of income respondent attributes to her drug-selling activities.

Consequently, the next issue is whether respondent properly reconstructed appellant's income during the period at issue. 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.) Gross income is defined to include all income from whatever source derived, unless otherwise provided in the law. (Rev. & Tax. Code, § 17071.) It is well established that any gain from illegal sales 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).) 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, § 17651, subd. (b); I.R.C., § 446(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., **Fr. 13, 1971**.) **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 burden of proving it is erroneous. (Breland v. United States, 323 **F.2d** 492, 496 (5th

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Cir. 1963); Appeal of Marcel C. Robles, Cal. St. Bd. of Equal., June 28, 1979.)

Because of the 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. v. Commissioner, ¶ 64,275 T.C.M. (P-H) (1964), affd. sub nom., Fiorella v. Commissioner, 361 F.2d 326 (5th Cir. 1966); Appeal of Burr McFarland Lyons, Cal. St. Bd. of Equal., Dec. 15, 1976.) It has been recognized 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 such a reconstruction of income does not lead to injustice by forcing the taxpayer to pay tax on income he did not receive, the courts and this board require that each element of the **reconstruction be** based on fact rather than on conjecture. (Lucia v. United States, 474 F.2d 565 (5th Cir. 1973); Appeal of Burr McFarland 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. Bonaguro, 294 F.Supp. 750, 753 (E.D.N.Y. 1968), affd. sub nom., United States v. Dono, 428 F.2d 204 (2nd Cir. 1970).) If such evidence is not forthcoming, the assessment is arbitrary and must be reversed or modified. (Appeal of Burr McFarland Lyons, supra; Appeal of David Leon Rose, Cal. St. Bd. of Equal., Mar. 8, 1976.)

In the instant appeal, respondent relied upon information resulting from the police investigation of appellant's activities and from evidence obtained in her residence in reconstructing her income by the projection method. Specifically, respondent determined that: (1) appellant was involved with the illegal sale of **marijuana**; (2) the duration of appellant's narcotics sales activities was from January 1, 1983, to July 21, 1983; and, (3) the volume of appellant's sales was 32 ounces a week and the selling price per ounce was \$240.

We have **discussed** above that there was a basis for respondent's conclusion that appellant was involved with the illegal sale of drugs. Furthermore, appellant does not dispute this point.

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The **second** factor relied upon in respondent's assessment was that appellant had been involved in the sale of narcotics from January 1, 1983, to the date of her arrest. This figure was arrived at by considering several sources of information. First, the **CRI** stated that appellant had been in business for "several years" prior to her arrest. We have held that information from an informant can be considered reliable if the information ultimately results in the seizure of narcotics and **appellant's** arrest and subsequent conviction. (See, e.g., Appeals of Siroos Ghazali, Cal. St. Bd. of Equal., Apr. 9, 1985; Appeal of Clarence Lewis Randle, Jr., Cal. St. Bd. of Equal., Dec. 7, 1982.) Furthermore, appellant herself admitted that she had been in business for the four months prior to her arrest, and a notebook found during the raid shows **sales** of marijuana from early February 1983. Assessments which are supported by the appellant's own records are appropriate. (Appeal of James Eugene Ely, Cal. St. Bd. of Equal., Sept. 30, 1980.) While the records and the confession do not go back to January 1, 1983, combining those records with the **CRI's** statement and the fact that appellant made numerous bank deposits-in odd amounts during the three years prior to her arrest, even though she **had no** known source of income since 1970, we find that the record supports respondent's determination that she had been selling marijuana since at least January 1, 1983.

The third factor respondent relied upon in its assessment was the amount of weekly sales made by appellant. While not specifically defending the figure used in its assessment, respondent argues that the facts of this case would support a much larger assessment. Respondent points out that the undercover officer making the controlled buys from appellant was charged \$90 per quarter ounce of marijuana, or \$360 an ounce. By multiplying that figure by the 28 ounces of marijuana discovered in the raid on appellant's residence, appellant was found to have been holding \$10,080 worth of marijuana. It is "reasonable to assume that a dealer would only have on hand the amount of drugs which could easily and quickly be disposed of." (Appeal of Clarence P. Gonder, Cal. St. Bd. of Equal., May 15, 1974.) Further, we have previously found an **inventory turn-over rate of once a week** to be reasonable. (See, e.g., Appeal of Gregory Flores, Sr., Cal. St. Bd. of Equal., Aug. 1, 1984.) Consequently, appellant could have been found, through the projection method, **to have** sold \$282,240 *worth* of marijuana during the appeal period. Rather than using the above formula, respondent used a more conservative figure of \$240 an

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ounce while estimating appellant's weekly sales at **32 ounces**. While there is no explanation for the differences between the formulas, we note that the four-ounce discrepancy in the estimation of the amount sold per week and the amount discovered during the raid is more than adequately compensated for by the lower price per ounce (\$240) used in respondent's calculations versus the higher actual price (**\$360**) charged by appellant. Therefore, as respondent argues, the evidence obtained during appellant's arrest could support a finding that appellant had a gross income almost \$60,000 more than respondent's present determination. Accordingly, we find that there is adequate evidence to support respondent's conclusion that appellant received over \$220,000 in unreported income during the period in question.

Appellant' claims that she only received \$300 from marijuana sales prior to her arrest and that she is obviously destitute and, therefore, could not have received the amount of money claimed by respondent. Appellant further points to the fact that her only asset is her house, which was paid off prior to the known **sales**, and that her bank account **records**, copies of which were provided to us, do not show total deposits approximating respondent's projected income. Finally, appellant points to her plea bargain where she **agreed** that she sold **marijuana** for \$45. Appellant states that it is absurd to project sales of \$220,000 from such a **small transaction**.

Appellant's claim of only receiving \$300 during the four months of narcotics sales prior to her arrest **lacks** credibility. The sheriff's department began undercover purchases only **one month prior to her arrest** and bought \$278 of marijuana from her in that short period. Appellant **was found** with **marijuana** worth over \$10,000 when she was arrested, which would indicate an involvement in the drug trade greater than an occasional sale. Also, appellant failed to explain the origin of many of the deposits in her bank accounts going back several years, as well as the reason for such irregular deposits totalling thousands of dollars. Coupling this evidence with the lack of support of her claims, we find that appellant's unsupported statement that she received only \$300 from the illegal sale of marijuana during the appeal period does not satisfy her burden of proving that respondent's reconstruction was **erroneous**. (Breland v. United States, supra; Appeal of Marcel C. Robles, supra.)

Finally, we emphasize that none of the criminal charges constitute the basis of the subject jeopardy

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assessment. **Even** though appellant argues that it is incredible to deduce over \$220,000 in sales from a single \$45 sale, we note that the jeopardy assessment was based in part upon appellant's admissions of other involvement in narcotics sales during the appeal period. The arrest and plea bargain simply underscore appellant's admissions.

In summary, we find that respondent's projection of appellant's income from the illegal sale of marijuana for the period in question to be reasonable when scrutinized against the record on appeal. Given that appellant has the burden of proving that the reconstruction of her income was erroneous and that she has failed to present evidence to support her claim that she only sold drugs worth \$300 during the period at issue, we must conclude that respondent properly reconstructed appellant's income for that period. Accordingly, respondent's action in this matter must be sustained.

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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 Marjorie Lillie Davis for reassessment of a jeopardy assessment of personal income tax in the amount of \$22,758 for the period January 1, 1983, to July 21, 1983, be and the same is hereby sustained.

Done at Sacramento, California, **this 9th** day of April , 1986, by the State Board of Equalization, with Board **Members** Mr. Nevins, Mr. Collis, Mr. Bennett and Mr. Harvey present.

Richard Nevins _____, Chairman
Conway H. Collis _____, Member
William M. Bennett _____, Member
Walter Harvey* _____, Member
_____, Member

*For Kenneth Cory, per Government Code section 7.9