



BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the **Matter** of the Appeal **of**)
GEORGE **DUNKOE**) No. **85J-676-PD**
)

For Appellant: Steve E. **Teich**
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 **George Dunkoe** for reassessment of a jeopardy assessment of personal income tax in the amount of \$55,605 for the period January 1, 1984, to June 15, 1984.

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 basic issue for determination is whether respondent properly reconstructed appellant's income from the sale of narcotics.

On April 25, 1984, San Francisco police **observed appellant and a woman friend entering his room, number 201, The Elm Hotel.** Appellant was carrying a bag of "balled up" balloons of a shape which the police believed were indicative of heroin. The police arrested them and confiscated 112 balloons of brown heroin from appellant.

On June 14, 1984, police received an anonymous complaint that a **"George"** was selling a large quantity of heroin **from room 201** of the Elm Hotel. Police arrested three individuals near the Elm Hotel for possession of heroin which they told the police they had purchased from **"George"** in room 201 of the hotel. When police arrived at room 201 and identified themselves, other police saw a package thrown from the air-shaft window of room 201. **Police** immediately entered appellant's room and arrested appellant and another person on the charge of **possession** of heroin for sale. Appellant told the police that the thrown package contained **"all the dope"** and granted them permission to search. The police found **180** balloons of **heroin and \$19,896 behind a loose molding, Elsewhere in** the room, they found 96 more **balloons of** heroin, 300 syringes, a **.38** calibre derringer and ammunition, automatic knives, and pieces of paper containing appellant's name. At the police station, appellant told the police that he had been selling **"dope"** on and off for a year, that he received 600 balloons a day and sold them in packages of 16 for 5.200, that **he** made \$12,000 a day, and that he employed six **runners.** Appellant also told **respondent's** representative that he had been selling from the Elm Hotel **for about a year,** that he and his friends sold about 600 balloons a day, and that not all the money in his room was his. **He** refused to identify the other owner(s) of the money.

Based on that information, and additional information provided by the San Francisco police, respondent determined that appellant had engaged in the sale of heroin and had received unreported income during the taxable period January 1 to June 15, 1984. Respondent estimated appellant's income by projecting sales of 600 balloons a day at a price of \$200 for 16 balloons (\$12.50 per balloon) for that period. In that **way, respondent** estimated that appellant sold 99,934 balloons during the **period: 99,600 balloons during the first 166 days plus**

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334 balloons on the 167th day, when he was arrested (600 balloons for that day less 276 balloons confiscated by the police). Appellant's estimated income was **\$12,249,175** and his estimated net tax liability was **\$135,688.55** for that period.

On June 15, 1984, respondent issued a jeopardy tax assessment against appellant based on that estimated income. On June 21, 1984, respondent reduced appellant's estimated income because he stated he sold heroin "on and off" and not every day. Respondent calculated the reduced income by multiplying 83 days (166 ÷ 2) times 600 balloons a day times \$12.50 per balloon **for** an estimated income of \$622,500 and an estimated net tax liability of \$66,920. Respondent issued orders to withhold to the police and to the Bank of America and collected \$19,896..

On August 9, 1984, appellant filed a petition for reassessment and requested a hearing. He later filed a tax return for 1984 reporting no taxable income but reporting nontaxable income of \$1,980 from supplemental security income and \$5,004 from social security. At the hearing, appellant denied making any statements that he **sold 600** balloons a day or that he had been selling heroin for a year. His position was that there was no evidence that he had sold heroin because there were no controlled buys or informant statements. Appellant stated that only a portion of the money in his room belonged to him and the bulk of it belonged to unidentified friends.

Sometime before January 15, 1985, a confidential informant told San Francisco police that a "George," whose described appearance resembled that of appellant, was selling heroin from room 201 of the Elm Hotel. On January 15, 1985, in a warranted search of appellant's room, police found 192 balloons of heroin, \$10,710, a Hibernia Bank savings passbook showing approximately \$25,500 in deposits **during** 1984, and various indicia of occupancy by appellant and Grace Tuttle. Police arrested appellant and Grace Tuttle on the charge **of** possessing heroin for sale.

On March 13, 1985, appellant submitted to respondent a written statement that he would be willing to accept a reconstruction of his income based upon the sales projection **method described** in the Appeal of Clarence P. Gonder, decided by this board on May 15, 1974, which assumes that the amount of contraband seized at the time of his arrest constitutes one week's **inven-**

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tory for sale. Appellant proposed that the period of his sales activity was from April 24, 1984, to June 15, 1984, on the ground that there was no evidence of any sales by him before his **arrest** in April. Appellant proposed also that only the 254^{2/} balloons found at the time of his arrest should be used **to** make the reconstruction of income and that the \$19,596^{3/} found at the time of his arrest should not be used in the projection because that money did not **belong** to **him**.

After receiving this information, respondent revised its estimate of appellant's income for **the** period. Respondent converted \$19,596 in cash found by the police to its equivalent number of balloons of heroin by dividing that number by the \$12.50 per balloon price to arrive at 1,567 balloons. To that number **of balloons**, respondent added the 254 balloons of heroin found by the **police** to arrive at **1,821** balloons **sold** per week. **From** this **amount**, respondent estimated that appellant sold 113 packages (16 balloons per package for \$200 per package to arrive at a weekly income of \$22,600, which is equivalent to a daily income of \$3,288). Multiplying that daily **income** by 166 days of the taxable period, respondent estimated appellant's income at \$535,848 and his net tax liability at **\$55,605** for the taxable period. Thus, **respondent did not accept appellant's proposals for the estimated period of his sales activity.** Appellant then filed this appeal.

In January of 1986, appellant pled guilty to three separate counts of **possession of** heroin for sale. The counts related to the April 25, 1984, June 15, 1984, and January 15, **1985**, arrests,

An initial question presented by this appeal is whether appellant received income from the illegal sales of narcotics during the period in question. Review of part of the evidence **will** suffice, Informants told police that they had made purchases of heroin [during the period], from a man-in **appellant's** hotel room who fitted appellant's description. During the period, police twice arrested appellant for possession of heroin for sale. The heroin confiscated during the June 14, 1984, arrest was accompanied by a large amount of **cash** which cannot be

2/ In fact, the police reported finding 276 balloons.

3/ The police actually turned over \$19,896 to respondent **in response to** its order to withhold.

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accounted for by appellant's receipt of nontaxable social security and supplemental security income. The obvious inference is that the cash was received from appellant's previous sales of heroin from his inventory of heroin held for sale. He eventually pled guilty to possessing that heroin for sale. Opposing these items is appellant's simple denial that he ever sold any heroin. We conclude that he received income from illegal sales of narcotics during the period in question.

The central issue presented by this appeal is whether respondent properly *reconstructed* the amount of appellant's taxable income from drug sales.

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, § 17551; 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.**, **Feb. 16, 1971.**) Mathematical exactness is not required. (Harbin v. Commissioner, 40 T.C. 373, 377 (1963).) F-more, 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 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. (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

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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. Dons, 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 this case, respondent used the projection method to finally reconstruct appellant's income. The rate of appellant's sales was based on the **heroin** and money seized from appellant by police on June 15, 1984, while relying on rules that we have recognized--that a seller of illegal drugs generally keeps no larger inventory of drugs than will be sold in a week, and that, in any seizure by the police, the amount of drugs in the seller's possession may have been depleted by sales made by him from his inventory before the seizure--to reconstruct appellant's weekly inventory. Specifically, **respondent** added the amount of sales represented by the cash which accompanied appellant's drug inventory to the remaining amount of drugs possessed by appellant to **arrive** at the amount of his weekly sales, (Appeal of Manuel Lopez Chaidez and Miriam Chaidez, Cal. St. Bd. of **Equal.**, Jan. 3, 1983,) While appellant maintains that the cash was not his, but belonged to persons he would **not** identify, we do not find that position credible. Appellant was known to have been making sales of heroin before he was arrested; sales which would have produced cash. The money was found stored with the drugs possessed by appellant, indicating that the drugs and the money were associated. Finally the amount of money was **too** large to support the proposition that appellant was a simple bailee of it **For** the benefit of chance acquaintances. Respondent **then attributed** that rate of weekly sales to the 166 days of the period from January 1, 1984, to June 16, **1984**, to arrive at appellant's total taxable income for the period.

Appellant argues that respondent has attributed sales to him at the aforementioned rate **for the whole period** because of his statements to the police and to respondent's representative that he had been making sales of heroin from his room for about a year before his

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arrest in June. Appellant's position is that his attorney was not with him at the time he made those statements and therefore respondent may not make an assessment against him which relies, in any part, on information in those statements. Appellant has not specified why such use is improper, or set forth the authorities upon which his argument relies. Presumably, he is suggesting that his statement may not be used in any way adversely to his interests because the circumstances of the police interrogation violated his rights in some manner. But the record reveals no impropriety. Even if his statements could have been suppressed in a criminal action against him, those statements may still serve as the basis for a tax assessment against him by respondent. (Appeal of Edwin V. Barmach, -Cal, St. Bd. of Equal., July 29, 1981, Op. on Petn. for Rehg., Nov. 16, 1981; Appeal of Manuel Lopez Chaidez and Miriam Chaidez, supra.)

Since we find that respondent's determination is supported by reasonable **assumptions** based on credible evidence in the record, we sustain respondent's actions.

