BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of )
) No. 83J-557-PD
RAUL E. SARRAUTE )

For Appellant: Raul E. Sarraute, in pro. per.

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 Raul E. Sarraute for reassessment of a jeopardy assessment Of personal income tax in the amount of $28,074 for the period January 7, 1981, to August 11, 1981.

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

Appeal of Raul E. Sarraute

In July 1931, Officer Horico Marco of the Los Angeles Police Department, working undercover in a drug investigation, was introduced to Raul Emilio Sarraute (appellant), who told Marco that he would be willing to sell him cocaine. On August 5, 1981, Marco contacted appellant and opened negotiations for two kilos of cocaine. Appellant agreed to meet Marco at a certain restaurant later that day.

At the appointed time, appellant appeared in a car and circled the area, Appellant stopped at a gas station near the restaurant, appeared to look under the hood of his car, and then drove away. Marco soon called appellant at his house, and appellant stated that he had not met with Marco because he had observed undercover police narcotic units parked in the restaurant area. Appellant and Marco arranged a second meeting, At that meeting, appellant told Marco that he could supply-him with as much as 10 kilos of cocaine per week for $65,000 per kilo. Marco asked appellant for a sample of the cocaine. Appellant directed Marco to drive to the vicinity of Hobart and Sunset streets, where appellant entered a building. When appellant reappeared, he directed Marco to drive to the vicinity of Hobart and Hollywood Boulevard. There, appellant produced a one-ounce bag of cocaine, and Marco took away a 4.5 gram sample for testing. When appellant called Marco later that same day, Marco told appellant he wanted to buy two kilos of cocaine. Appellant told Marco that the price of that amount would be $135,000 and that Marco should call him when Marco had the money.

On August 6, 1981, Marco called appellant, who agreed to meet Marco at Hobart and Sunset streets to sell him two kilos of cocaine.' About three hours later, appellant called Marco and told him he needed more time to get the cocaine ready and set a later time for the meeting. When Marco arrived at Hobart and Sunset at the appointed time, appellant examined and counted the $135,000 which Marco had brought. Appellant said that the exchange would take place at a Howard Johnson Motel. But Marco insisted that the sale take place where they were, at Hobart and Sunset. Appellant then placed a telephone call to someone named "Yolanda" and instructed her to bring the cocaine to Hobart and Sunset. Shortly thereafter, Esperanza Yolanda Zepeda arrived in a car. Appellant told Marco that he should get the cocaine from her. When Marco entered Zepeda's car, she handed him a plastic shopping bag containing 2,090 grams (4.6 pounds) of cocaine. The police arrested appellant and Zepeda.

In a later search of appellant's house, the police found cocaine packages of varying quantities in various Locations throughout the house totaling 3,133 grams (6.9 pounds). The police also found $15,500 in cash, a .357 magnum revolver in the master bedroom, a .45 calibre semi-automatic carbine in the attic, and ammunition.

On August 26,. 1981, appellant's $20,000 bail was posted. On January 21, 1983, appellant. pled guilty to the sale of cocaine.

Based upon appellant's possession of 12 pounds of cocaine, valued at a cost of $40,000 a pound, and $19,000 in cash, plus $7,000 in estimated living expenses, during the taxable period, respondent determined that appellant had received $506,000 in income during the taxable period beginning January I, 1981, and ending August 10, 1981. Respondent immediately issue-d a jeopardy assessment of income tax against appellant for that period and issued an order to withhold to the Los Angeles police. The next day, respondent revised its estimate of appellant's income downward to $266,000, because it revalued the cost of the cocaine downward to $20,000 a pound, and it revised its jeopardy assessment accordingly. Respondent collected $15,500 from the police as a result of its order to withhold, The balance of the assessment is outstanding.

After the filing of this appeal, respondent determined the amount of cash seized was $15,500 rather than the $19,000 originally used in its estimate. Consequently, respondent agrees that the estimate of appellant's taxable income should be reduced to $262,500 and his net tax liability to $26,305.

Appellant filed a petition for reassessment and, at the request of respondent, filed a financial questionnaire, a statement of financial condition, and a record of his savings account. Appellant reported that he owned a house valued at $80,000-$85,000, had two savings accounts, and owned a car and a truck valued collectively at $3,100. Appellant also stated that he had been employed at Heiko Tool Co. until the time of his arrest and earned approximately $15,000 for the period January 1, 1981, to August LO, 1981. Appellant's reported expenditures for the same period were $3,170 a month. Appellant also reported that he supported his wife and S-year-old daughter and that none of the money. seized from his residence belonged to him. Appellant

reported no income from the sale of cocaine and did not file a 1981 tax return. Appellant reported a balance of $300 In his savings account at the end of 1980.

Respondent alternatively calculated appellant's income by using the value of the cocaine seized at the time of his arrest as an indication of the previous sales of cocaine during the period ($240,000). To this amount, respondent added $15,000 in salary appellant claimed he earned and the $15,500 of cash seized at the time of his arrest to obtain a total income of $270,500. However, as this amount exceeded the original assessment and was not in appellant's favor, no further assessment was issued.

A hearing on appellant's petition for reassessment was held on November 18, 1982. Appellant stated that although he was technically guilty of selling two kilos of cocaine to Officer Marco, he had been coerced into participating in the sale by an Alberto Ramirez, who, at the time of the transaction, was holding appellant's wife and child as hostage. Not knowing that Ramirez was dealing in drugs, appellant allowed him on several occasions to stay at appellant's home as a favor to one of appellant's friends, George Fuenzalida, since Ramirez and Fuenzalida were partners in a fertilizer import business. Thereafter, Fuenzalida betrayed Ramirez and disappeared with several pounds of cocaine,. Ramirez held appellant responsible for the loss since appellant had originally introduced Ramirez to Fuenzalida. Ramirez then forced appellant to make the delivery of cocaine which was to have been delivered by Fuenzalida. Appellant told a similar story, although differing in several details, to the probation officer. Neither Ramirez nor Fuenzalida can be located.

After consideration of all of the evidence, respondent affirmed the assessment against appellant for the period on appeal. Appellant disagreed with the decision, and this timely appeal followed.

The initial question presented by this appeai is' whether appellant earned any income from the illegal sale of narcotics during the period at issue. Of particular relevance is appellant's guilty plea to the sale of cocaine to Marco. This fact alone makes a prima facie case for the existence of such income.. (Cf. Appeal of Glen Alexander, Cal. St. Bd. of Equal,, Feb. 4, 1986.)

The second question 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-E) ¶ 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, § 17561 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 (5th 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).) 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 Cir. 1963); Appeal of Marcel C. Robles, Cal. St, Bd. of Equal., June 28, 7979.)

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-R) (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 af proving that the reconstruction is erroneaus (Breland v. United States, supra), the taxpayer is put in the position of having to prove a negative, i.e., that he did nut 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 (2d Cir. 1970).)

We have previously approved of respondent's reconstruction of income from illegal sales of narcotics based on the amount of cash. and narcotics in the taxpayer's possession at the time he was arrested by the police plus the amount of the taxpayer's estimated living expenses during the period covered by the assessment. (Appeal of Ronald Lee Rover, Cal. St. Bd. of Equal., July 26, 1978.) As required in the use of that method, respondent established appellant's net wortn or cash on hand at the beginning of the period, as reflected by the savings account balance at the end of 1980 as well as all the other required elements.

The total of appellant's living expenses during the period'plus the cash and the value of the cocaine held by him at the time of his arrest is far more than his net worth at the beginning of the period, and, thus, represents a reasonable estimate of his income during the period.

In opposition, appellant simply takes the nonresponsive position that he never made any previous sales of narcotics and that the amounts of cocaine that he sold to the police and that were found in his house were owned by Ramirez, who was forcing appellant to sell those amounts for Ramirez' account. Accordingly, appe l-lant argues, a reconstruction by respondent of past sales of cocaine by appellant is in error because he made no previous sales and that the income from the sale- to *the* police should be attributed to Ramirez.

We reject appellant's position as inherently impossible. In particular, we note that appellant offered to sell Marco 10 kilos of cocaine a week when he possessed only about 5 kilos. That implies that appel-lant expected to be able to obtain much more cocaine on a weekly basis than he had in his inventory. Such an expectation further implies that appellant had estab-lished a dependable source of large amounts of cocaine for resale by him. This controverts appellant's

contention that he was simply a bailee of Ramirez' goods.

Accordingly, subject to respondent's concession, we must sustain respondent's action.

Appeal of Raul E. Sarraute

## 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 Raul E. Sarraute for reassessment of a jeopardy assessment of personal income tax in the amount of $28,074 for the period January 1, 1981, to August 11, 1981, be and the same is hereby modified in accordance with respondent's concession. In all other respects, the action of the Franchise Tax Board is sustained.

Done at Sacramento, California, this 19th day of November, 1986, by the State Board of Equalization, with Board Members Mr. Nevins, Mr. Collis, Mr. Bennett, Mr. Dronenburg and Mr. Harvey present.

Richard Nevins, Chairman

Conway H. Collis, Member

William M. Bennett, Member

Ernest J. Dronenburg, Jr;, Member

Walter Harvey*, Member

*For Kenneth Cory, per Government Code section 7.9