86-SBE-205

BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
) No. 82J-724-KP
ROBERT A. VON MERTA, JR.)

Appearances:

For Appellant: Fred Alan Jones
Attorney at Law

For Respondent: Philip M. Farley
Counsel

OPINION

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 Robert A. Von Merta, Jr., for reassessment of a jeopardy assessment of personal income tax in the amount of $1,530 for the period January 1, 1980, to May 27, 1988.

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 Robert A. Von Merta, Jr,.

The issue presented by this appeal is whether respondent properly reconstructed appellant's income for the period at issue.

On May 14, 1980, a detective of the San Francisco Police Department was contacted by two separate informants. Each informant individually stated that appellant was selling cocaine from his residence. Each informant also stated that he had known appellant and had purchased cocaine from him for a number of years. Further, each informant admitted to purchasing one-half gram of cocaine a week at a cost of $525 per half gram for some time. One of the informants cooperated with the police and conducted a controlled buy of narcotics from appellant. Subsequently, a search warrant for appellant's residence was executed, which resulted in the confiscation of cocaine valued at $5,000, a scale, two pistols and 1,000 rounds of ammunition., *cutting* agent, bindles for packaging cocaine, and $3,400 in cash.. Appellant eventually pled guilty to one count of possession of a controlled substance.

Respondent was informed of the above-described information and events, and determined that appellant's cocaine sales had resulted in taxable income for 1979 and the period. January 1, 1980, to May 27, 1980. Respondent used the projection method of income reconstruction and issued a jeopardy assessment based. on its findings. Appellant petitioned for reassessment of respondent's determination and provided respondent a detailed accounting of his financial situation for a number of years prior to 1980 as well as an admission that he had been selling cocaine for the six weeks prior to his arrest in 1980 on a very limited basis. As a result of this additional information, respondent withdrew its 1979 assessment and modified its assessment for January 1, 1980, to May 27, 1980. The, revised assessment, *however,* reflected higher income than appellant admitted to in his petition for reassessment. This appeal followed.

Under the California Personal Income Tax Law, a taxpayer is required to state the items of his gross income during the taxable year. (Rev. & Tax, Code, § 18401.) Except as otherwise provided by law, gross income is defined to include "all income from whatever source derived" (Rev. & Tax. Code, § 17071), and it is well established that any gain from the 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, and 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 rafiect income. (Rev. & Tax. Code, § 17561; I.R.C. § 446.) Where a taxpayer fails to maintain the proper records, an approximation of net income is justified even if the calculation is not exact. (Appeal of Siroos Ghazali, Cal, St. Ed. of Equal., Apr. 9, 1985.) Furthermore, the existence of unreported income may be demonstrated by any practical method of proof that is available and it is the taxpayer's burden of proving that a reasonable reconstruction of income is erroneous. (Appeal of Marcel C. Robles, Cal. St. Bd. of Equal,, June 28, 1979.)

Respondent doesnot, however, have unrestricted authority to reconstruct a taxpayer's income. (Appeal of Siroos Ghazali, supra.) As stated in Appeal of Siroos Ghazali, supra:

> [I]n 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. [Citations.] 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. [Citations.] If the reconstruction is found to be based on assumptions lacking corroboration in the record, the assessment is deemed arbitrary and unreasonable. [Citations.] In such instance, the reviewing authority may redetermine the taxpayer's income on the facts adduced from the record. [Citations.]

Respondent's reconstruction is based upon the following assumptions: (1) appellant was in the business of selling cocaine; (2) appellant sold one ounce of cocaine a week at $1,050 an ounce; and (3) appellant had been in the business of selling cocaine since at least the beginning of 1980.

In the present case, there is no issue as to appellant's involvement in the sale of drugs, for his admissions and plea confirm that he sold narcotics.

Appellant contends, however, that the informant's' statements, which are the basis of the other two assumptions used by respondent, are unreliable hearsay. Appellant further objects to the fact that the informants are not identified by name and that he has been unable to cross-examine them and attack their credibility,

We begin by noting that the technical rules of evidence do not preclude our consideration of the entire record for purposes of deciding appeals, including hearsay evidence, as long as the evidence is the sort of evidence on which responsible persons are accustomed to rely in the conduct of serious affairs. (Appeal of Marcel C. Robles, supra.) Hearsay evidence from an untested confidential informant will be considered reliable if the information that he supplies. proves to be accurate and ultimately results in the seizure cf narcotics and arrest and conviction of the appellant. (Appeal of Siroos Ghazali, supra.)

As'the information provided by these unknown individuals was proven at least partially accurate by appellant's arrest and plea, and in light of the police discoveries during the search of appellant's residence, we find it reasonable to grant credence to the remainder of the informants' stories.. Furthermore, appellant was arrested with cocaine worth $5,000 in his possession. 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 Alan E. French, Cal. St. Ed. of Equal, Mar. 4, 1986; Appeal of Clarence F. Gonder, Cal. St. Bd. of Equal., May 15, 1974.) We have previously found that an inventory turnover rate- of once a week is a reasonable approximation. (See, e.g. , Appeal of Alan E. French, supra; Appeal of Gregory Flores, Sr., Cal. St. Bd. of Equal., Aug. 1, 1984.) Therefore, even if respondent did not use the information provided by the informants, appellant could have been found to have been selling almost five times the amount of weekly sales attributed to him in the assessment. If respondent' coupled the large amount of cocaine discovered during the police search with appellant's own admission that he had been selling for about six weeks, it would have been justified in projecting a yearly income from narcotics sales for 1980 slightly higher than it actually di.d. As appellant's own actions indicate an involvement in drug sales greater than that described by the informants, we find that respondent's reliance on the statements provided by the informants to derive its estimation of income was reasonable.

Appellant also attacks the fact that he has not been given an opportunity to cross-examine the confidential informants. Yet, appellant undercuts his own argument by later stating that he knows who the informants are. This latter "admission" comes as part of the explanation of appellant's alleged "minor" involvement in drug sales. Appellant alleges that he was only holding onto the cocaine discovered in his residence as collateral for a $3,000 loan he made to the two individuals he believes to be the informants., Appellant argues that the two individuals turned him into the police to avoid having to repay the loan. The only reason appellant sold any of the cocaine prior to his arrest was in an attempt to recoup some of the loan money.

We note, however, that appellant has failed to provide us with a written agreement or statement or testimony from either of the two individuals to whom appellant allegedly loaned the funds to confirm any portion of his story. If, as appellant suspects, the two "borrowers"- were the confidential informants, appellant could have subpoenaed them as hostile witnesses. Yet, he apparently made no effort to secure their testimony. Furthermore, the discoveries made during his arrest do not correspond with his explanation. Appellant claims to have received cocaine worth only $3,000 as collateral for the "loan," yet when he was arrested, appellant was found to possess cocaine worth $5,000; and that cache of cocaine was allegedly the amount of *collateral" remaining after appellant made somewhere between $800 and $4,000 in cocaine sales. No matter which sales figure is chosen, appellant was arrested with more cocaine in his possession that he allegedly held as "loan collateral." It is evident that appellant's involvement in the cocaine trade was far greater than he has admitted.

In summary, we find that the record on appeal supports respondent's reconstruction of appellant's income for the period at issue. While appellant has presented us with an intricately woven story to support his contention that he was minimally involved in the cocaine trade, it is a story that is unsubstantiated and clearly contradicted by the presented facts. Given that appellant has the burden of proving that a reasonable reconstruction of his income was erroneous and that he has failed to present sufficient'evidence to support his claim, we must conclude that respondent properly reconstructed appellant's income for the period in question, (Anneal of Marjorie Liiiie Davis, Cal. St. Bd. of Equal,,

Apr. 9, 1986.) 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 Robert A, Von Merta, Jr., for reassessment of a jeopardy assessment of persocai income tax in the amount of $1,530 for the period January, 1, 1980, to May 27, 1980, be and the same is hereby sustained.

Done at Sacramento, California, this 3rd day of December , 1986, by tte State Board of Equalization, with Board Members Mr. Nevins, Mr. Collis, Mr. Bennett, Mr. Dronenburg and Mr. Harvey present.

Richard Nevins, Chairman

Conwav H. Collis, Member

William M. Bennett, Member

Ernest J. Dronenbury, Jr., Member

Walter Harvey*, Member

*For Kenneth Cory, per Government Code section 7.9