BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
BERNIE **SOLIS**, JR. AND LUCY **SOLIS**)

For Appellants: Donald E. Rinaldi
Attorney at Law

For Respondent: Mark **McEvilly**
Counsel

O P I N I O N

This appeal is made pursuant to section **18646** of the Revenue and Taxation Code from the action of the Franchise Tax Board in denying the petitions of Bernie **Solis**, Jr. and Lucy **Solis** for reassessment of a jeopardy assessment of personal income tax against each of them in the amount of **$8,918.00 for** the period January 1, 1978, through July 23, 1978.

The issues for determination are the following: (i) did Bernie Solis, Jr. and Lucy Solis (hereinafter referred to as "appellant-husband" and "appellant-wife," respectively, and collectively referred to as "appellants") receive unreported income from illegal sales of narcotics during the appeal period; (ii) if they did, did respondent properly reconstruct the amount of that income; and (iii) is respondent precluded from using evidence unconstitutionally obtained by law enforcement authorities as the basis for the subject jeopardy assessments. In order to properly consider these issues, the relevant facts concerning appellants' multiple arrests and the jeopardy assessments are set forth below.

On February 1, 1978, Deputy Richard Sloan of the Narcotics Bureau of the Los Angeles Sheriff's Department received information to the effect that appellant-husband was engaged in the sale of phencyclidine, commonly referred to as "PCP" or "angel dust."' The following day, Deputy Sloan began to conduct surveillance of appellants' residence. During the course of this surveillance, Deputy Sloan observed that there was heavy vehicular and pedestrian traffic to and from appellants' residence. He also noted that the individuals entering the home would always 'exit within ten minutes. Less frequently appellant-husband would exit the residence, complete an apparent sales transaction, and return to the house. During the course of the surveillance period, which continued for more than five months, the Narcotics Bureau received five anonymous telephone calls complaining of appellants' apparent sales of narcotics. Deputy Sloan also learned that appellants, both employed prior to February 1, 1978, had voluntarily left their jobs. Additionally, it was observed that appellants made extensive and costly improvements to their residence,

On July 1, 1978, Deputy Sloan advised officers patrolling the area of appellants' residence that appellants were suspected of selling narcotics. From July 13 to July 23, 1978, three persons, in separate incidents, were arrested for possession of phencyclidine immediately after leaving appellants' residence. Two of the three individuals admitted to having just purchased the drug from appellants. One stated that he had paid $125 for the 29 grams (approximately one ounce) of PCP found in his possession and further stated that appellant-wife participated in the drug sales; the other acknowledged having paid twenty dollars for two foil bindles of mint leaves treated with PCP.

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On July 23, 1978, appellant-husband was placed under arrest for possession of a controlled substance after officers discovered a white powder resembling cocaine in the vehicle in which he was driving. At the time of his arrest, appellant-husband requested the arresting deputies to return his truck to his home and to give the keys to his wife. upon seeing the officers approaching her residence, appellant-wife ran into the house leaving the front door ajar. As he reached the door, one deputy noticed the distinct odor of ether and mint emanating from inside. Ether is used both in the manufacture of PCP and in the application of PCP dust to mint leaves. Instead of responding to the deputy's request that she accept delivery of the vehicle, appellant-wife, in view of the deputy, ran from the kitchen towards a bathroom carrying a bottle containing a solid substance. Fearing that appellant-wife was attempting to conceal or destroy evidence, the deputy entered the residence. He entered the bathroom and found the bottle which he had just seen appellant-wife carrying. The smell of ether was noticeable both in the bottle and toilet, and mint leaves, or particles thereof, were still in evidence.

After detaining appellant-wife, law enforcement officers conducted a search of appellants' residence. During the course of their search, the officers found numerous items characteristic of a drug selling operation. Additionally, a box containing $11,064 was found in a bedroom. During the approximate one hour the deputies were in the residence, they responded to approximately twenty telephone calls from persons indicating they wanted to "score" (purchase) an "oz" (ounce) of PCP from "Bernie."

Five days after their first arrest, appellants were again arrested on the same charges;. $1,270.56 located in appellants' residence and on appellant-husband's person was recovered as evidence. Again, on September 11, 1978, appellant-husband was arrested for possession of a controlled substance for sale. Additionally, he was charged with assault with a deadly weapon on a peace officer and attempted bribery; $700.09 was seized by the arresting officers as evidence. A motion to suppress all evidence relating to appellants' arrests for conspiracy to sell, and possession of, a controlled substance, was granted by the Los Angeles Superior Court on September 21, 1979.

Respondent was notified of appellants' first arrest on July 24, 1978, and determined that the circumstances indicated that collection of their personal income tax for the period in issue would be jeopardized by delay. Accordingly, jeopardy assessments in the amounts of $8,918 were issued the same day, terminating appellants' taxable years as of July 23, 1978. In issuing the jeopardy assessments, respondent found it necessary to estimate appellants' income for the appeal period. Utilizing the available evidence, respondent determined that appellants' total taxable income from drug sales during the period from February 2, 1978 to July 23, 1978 was $178,500, or $89,250 for each appellant.

Pursuant to section 18817 of the Revenue and Taxation Code, respondent obtained from the Los Angeles Sheriff's Department the amounts seized following each of the above described arrests. Appellants, claiming that the assessments were "arbitrary and capricious," filed petitions for reassessment on September 19, 1978. Respondent thereupon requested them to furnish the information necessary to enable it to accurately compute their income, including income from the sale of narcotics. Appellants replied to this request by stating that they were unwilling to provide any information which would tend to incriminate them in any way. On April 27, 1979, appellants filed a return for the year 1978; no income from narcotics sales was reported. When appellants failed to respond to respondent's subsequent letters requesting information with regard to their alleged sales of controlled substances, their petitions for reassessment were denied and this appeal followed.

The initial question presented by this appeal is whether appellants received any income from illegal drug sales during the period in issue. The Sheriff's Department arrest and 'complaint reports which contain references to, appellants' actions and statements, corroborating observations by sheriff's deputies, and statements from two of appellants ' drug purchasers, establish at least a prima facie case that appellants received unreported income from the illegal. sale of narcotics during the appeal period.

The second issue is whether respondent properly reconstructed the amount of appellants' 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; Int. Rev. Code of 1954, § 61.) Gain from the illegal sale of narcotics -constitutes gross income. (Farina v. McMahon, 2 Am.Fed. Tax.R.2d 5918 (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); Cal. Admin. Code, tit. 18, reg. 17561, subd. (a)(4).) In the absence of such records, the taxing agency is authorized to compute his 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. (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. (Harold E. Harbin, 40 T.C. 373, 377 (1963).) Furthermore, a reasonable reconstruction of income is presumed correct, and the taxpayer bears the 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 the instant appeal, respondent used the projection method to reconstruct appellants' income from the illegal sale of phencyclidine. 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., ¶ 64,275 P-H Memo T.C. (1964), affd. sub nom., Fiorella v. Commissioner, 361 F.2d 326 (5th Cir. 1966); Appeal of Burr MacFarland Lyons, Cal. St. Bd. of Equal., Dec. 15, 1976.) It has also been recognized, however, 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 insure that use of the projection method 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 (5th Cir. 1973); Shapiro v. Secretary of State, 499 F.2d 527 (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, 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).) 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., March 8, 1976.)

Respondent used information obtained by the County of Los Angeles Sheriff's Department in reconstructing appellants' income, Specifically, respondent determined that: (i) appellants had been in the "business" of. selling phencyclidine from at least February 2 to July 23, 1978; (ii) the average amount of each drug sale concluded was $70; (iii) an average minimum of 25 such sales were concluded each day over the 1'70 day period; and (iv) appellants' standard cost of "goods" sold was 40 percent of their selling price.

We believe that the evidence obtained from the sheriff's investigation which led to, and culminated with, appellants' July 23, 1978 arrest, as detailed in the arrest and complaint reports and as summarized above, supports the reasonableness of the first three above mentioned assumptions. Respondent's fourth and last assumptionconcerning the cost to appellants of the drugs sold was apparently based on information provided by the Narcotics Bureau of the Los Angeles County Sheriff's Department. While appellants complain that respondent has demonstrated a "strange lack of knowledge of the value" of PCP, they have failed to provide any evidence regarding their basis in the phencyclidine they subsequently sold.

Again we emphasize that when a taxpayer fails to comply with the law in supplying the required information to accurately compute income, and respondent finds it necessary to reconstruct the taxpayer's income, some reasonable basis must be used. Respondent must resort to various sources of information to determine such income and the resulting'tax liability. In such circumstances, a reasonable reconstruction of income'will be presumed correct., and the taxpayer has the burden of proving it

erroneous. (Breland v. United States, supra; Appeal of Marcel C. Robles, supra.) Mere assertions by the taxpayer are not enough to overcome that presumption. (Pinder v. United States, 330 F.2d 119 (5th Cir. 1964).) Given appellants' failure to provide any evidence challenging respondent's reconstruction of their income from drug sales, we must conclude that respondent reasonably reconstructed the amount of such income.

The final issue presented by this appeal concerns appellants' contention that the jeopardy assessments should not be sustained since they were determined by reference to evidence obtained as the result of an illegal search and seizure. In support of this argument, appellants have relied principally upon United States v. Janis, 428 U.S. 433 [49 L.Ed.2d 1046] (1976). After carefully reviewing appellants' arguments, we conclude, as we did in Appeal of Paul Joseph-Kelner, decided by this board September 30, 1980, that respondent may take into consideration evidence unlawfully obtained by law enforcement authorities in order to determine tax liability.

In Janis, the United States Supreme Court was confronted with a factual situation distinguishable from the one in the instant appeal. In that case, the Court was called upon to decide whether evidence obtained by a state law enforcement officer in good-faith reliance on a warrant that later proved to be defective should be inadmissible in a federal civil tax proceeding. The issue in Janis, consequently, dealt with the admissibility of unconstitutionally obtained evidence in an "intersovereign" context, i.e., one in which the officer having committed the unconstitutional search and seizure was of a sovereign that had no responsibility or duty to the sovereign seeking to use the evidence. While the Court was careful to note that it need not consider the applicability of the exclusionary rule in an "intra-sovereign" context, the holding of that case and the reasoning adopted by the Court are helpful for purposes of resolving the issue raised by appellants.

The Court in Janis commenced its discussion by noting that the "prime purpose" of the exclusionary rule, if not the only one, "is to deter future unlawful police conduct." (United States v. Calandra, 414 U.S. 338, 347 [38 L.Ed.2d 5611 (1974).) It also observed that, in those cases in which it had opted for exclusion in the anticipation that law enforcement officers would be deterred from violating Fourth Amendment rights, it had

acted in the absence of any convincing empirical evidence on the effects of the exclusionary rule and relied, instead, "on its own assumptions of 'human nature and the inter-relationship of the various components of the law enforcement system." (United States v. Janis, supra, 428 U.S 433, 459.) Holding that the exclusionary rule should not be extended to preclude the use of evidence unlawfully obtained by police officers in cases in which its deterrent purpose would not be served, the Court refused to extend the rule to prohibit the use of such evidence when it was obtained by state authorities and was sought to be used in a federal civil proceeding. This holding was based on the Court's conclusion that "exclusion from federal civil proceedings of evidence unlawfully seized by a state criminal enforcement officer has not been shown to have a sufficient likelihood of deterring the conduct of state police . .." (Janis, supra, at p. 454.) Finally, the Court observed that it had never applied the exclusionary rule to exclude evidence from a civil proceeding, federal or state.

The attenuation present in Janis between the conduct of state law enforcement authorities and a federal civil proceeding is similarly present in the instant appeal. The subject matter of this appeal falls outside the zone of primary interest of local law enforcement authorities; their primary concern is criminal law enforcement, not tax liability. As did the Court in Janis, we conclude that to exclude the evidence unlawfully seized by the Los Angeles Sheriff's Department would not have the effect of deterring illegal conduct on the part of criminal law enforcement agencies.

Appellants' reliance upon People v. Belleci, 24 Cal.3d 879 [157 Cal.Rptr. 503] (1979) is equally misplaced. That case dealt with the issue of whether illegally obtained evidence should be admitted in a probation hearing conducted under the Penal Code. It has no relevance to the issue of whether such evidence should be excluded in a civil tax matter.

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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 petitions of Bernie Solis, Jr. and Lucy Solis for reassessment of a personal income tax jeopardy assessment against each of them in the amount of $8,918.00 for the period January 1, 1978, through July 23, 1978, be and the same is hereby sustained.

Done at Sacramento, California, this 23rd day of June , 1981, by the State Board of Equalization, with Board Members Mr. Dronenburg, Mr. Reilly, Mr. Bennett and Mr. Nevins present.

Ernest J. Dronenburg, Jr., Chairman

George R. Reilly, Member

William M. Bennett, Member

Richard Nevins, Member

_____, Member