

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
EDWIN V. **BARMACH**)

Appearances:

For Appellant: Michael Nasatir
Attorney at Law

For Respondent: James C. Stewart
Counsel

OPINION

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 petition of Edwin V. **Barmach** for reassessment of a jeopardy assessment of personal income tax in the amount of **\$70,481.00** for the year 1978.

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The issues for determination are the following: (i) did appellant receive unreported income from illegal bookmaking activities during the appeal period; (ii) if he did, 'did respondent properly reconstruct the amount of that income; and (iii) is respondent precluded from using **evidence obtained** in violation of appellant's constitutional rights as the basis for the subject jeopardy assessment. In order to properly consider these issues, the relevant facts concerning appellant's arrest and the jeopardy assessment are set forth below.

Pursuant to a criminal investigation unrelated to appellant, Officer Louis G. Merritt of the Los Angeles Police Department (hereinafter referred to as "the **LAPD**") recovered a betting slip listing baseball wagers and a telephone number later determined to be that of appellant. Soon thereafter, on September 8, 1978, Officer Merritt and his partner recovered from appellant's refuse collector a plastic trash bag which had been disposed of in appellant's rubbish; this search and seizure was not conducted pursuant to the issuance of a search warrant. Examination of the bag's contents revealed that it contained recorded wagers for a **two-week** period, pay and owe sheets listing bettors and code names, and records on the amounts of money won and lost on such wagers. Other items characteristic of an illegal **bookmaking** operation were also recovered.

Based largely on the above, Officer Merritt was issued a search warrant on September 11, 1978 by the Municipal Court for the Los Angeles Judicial District for the purpose of searching appellant's residence. The following day, a search of the residence was conducted and appellant was arrested and charged with conspiracy to commit bookmaking. Seized at the time of appellant's arrest were wager sheets from August 28, 1978 to the date of the arrest, betting **markers**, and detailed pay and own sheets maintained over a 16 day period. Arrested with appellant was a woman who stated that she had been living with him and knew he was involved in illegal bookmaking activities.

Upon being notified of appellant's **arrest**, respondent determined that the circumstances indicated that collection of his personal income tax for 1978 would be jeopardized by delay. Accordingly, the subject jeopardy assessment was issued on September 15, 1978. In issuing the jeopardy assessment, respondent relied upon the records seized at the time of appellant's arrest for purposes of determining appellant's income

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from bookmaking. An analysis of those records revealed that appellant accepted approximately \$651,407 in wagers over the 16-day period prior to his arrest,

On January 24, 1979, the same court which had issued the search warrant on September 11, 1978 ruled that all the evidence recovered from appellant's trash and from the subsequent search of his residence had been obtained in violation of his Fourth Amendment rights and was to be suppressed for purposes of the criminal charges pending against appellant.,

Appellant filed a petition with respondent for reassessment of the subject jeopardy assessment contending that illegally obtained evidence could not be used to form the basis of a tax assessment. Respondent thereupon requested appellant to furnish the information necessary **to enable** it to **accurately** compute his income, including income from illegal bookmaking activities. When appellant failed to respond to this request, respondent denied the petition for reassessment and this appeal followed.

The initial question presented by this appeal is whether appellant received any income from illegal bookmaking activities during the year in issue. In cases of this type, respondent must make at least an initial showing that appellant's activities were **within** the purview of Revenue and Taxation Code section **17297^{1/}** and the provisions of the Penal Code referred to therein^{2/}.

1/ In pertinent part, Revenue and Taxation Code section 17297 provides:

In computing taxable **income**, no deductions shall be allowed to any taxpayer on any of his gross income directly derived from illegal activities as defined in Chapters 9, 10 or 10.5 of Title 9 of Part 1 of the Penal Code of California; nor shall any deductions be allowed to any taxpayer on any of his gross income derived from any other activities which directly tend to promote or to further, or are directly connected or associated with, such illegal activities.

2/ Section **337a**, which prohibits bookmaking, is contained in that portion of the Penal Code referred to in section 17297 of the Revenue and Taxation Code.

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Respondent may adequately carry its burden of proof through a prima facie showing of illegal activity by the taxpayer. (Hall v. Franchise Tax Board, 244 **Cal.App.2d** 843 [53 Cal.Rptr. 597] (1966); Appeal of Richard E. and Belle Hummel, Cal. St. Bd. of Equal., **March 8, 1976**.) Upon reviewing the record on appeal, we are satisfied that respondent has established at least a prima facie case that appellant received unreported income from illegal bookmaking activities during the appeal period.

The second issue is whether respondent properly reconstructed the amount of **appellant's** income from illegal bookmaking activities. Under the California Personal Income Tax Law, taxpayers are required to specifically state the items of their 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.) Specifically, gross income includes gains derived from illegal activities. (United States v. Sullivan, 274 U.S. 259 [71 L.Ed. 1037] (1927); 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 a taxpayer's income by whatever method will, in its judgement, clearly reflect income. (Rev. & Tax. Code, § 17651, subd. (b); Int. Rev. Code of 1954, § 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. (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.)

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,

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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 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, Cal. St. Bd. of **Equal.**, Dec. 15, 1976.) 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.)

In the instant appeal, respondent relied on evidence obtained by the LAPD in reconstructing appellant's income. Specifically, respondent determined, by reference to the betting markers and pay and owe sheets seized at the time of appellant's **arrest**, that appellant had unreported income of \$651,407 from illegal **lookmak-**ing activities during the appeal period. While we believe that it was reasonable for respondent to rely upon appellant's records in order to reconstruct the amount of income he derived from illegal bookmaking activities, we cannot unqualifiably agree with the manner of respondent's reconstruction.

The record reveals that bettors placed wagers with appellant by telephone: successful bettors were evidently later paid by appellant and losing wagerers were responsible for subsequently settling their accounts. Respondent reconstructed **appellant's** income (a portion of appellant's records were analyzed by the **LAPD** which reconstructed **appellant's** income therefrom and upon which respondent relied) by simply calculating the total wagers accepted by appellant. Consequently, respondent attributed income to appellant from bets placed by successful wagerers as well as from those placed by unsuccessful ones. Respondent's reconstruction of appellant's income is incorrect to the extent that it includes amounts successfully wagered since those amounts were never received: those amounts do not constitute gross income to appellant. (Cf. Rev. and

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Tax. Code, § 17071.) Only amounts unsuccessfully wagered by appellant's clientele constitute gross income to him.

Appellant is not entitled **to deduct** from his gross income cash payouts made to individuals who placed winning wagers with him. (Rev. and Tax. Code, § 17297; **Cal. Admin. Code**, tit. 18, reg. 17297, subd. (b).) The enactment of section 17297 demonstrates a clear legislative intent not to allow a deduction for wagering losses from gross income derived from illegal bookmaking activities. (Hetzel v. Franchise Tax Board, 161 Cal. **App.2d** 224 [326 P.2d 611] (1958).)

Appellant has argued that the jeopardy assessment cannot be sustained since it was determined by reference to evidence that was obtained by law enforcement authorities in violation of his constitutional rights. In support of this contention, appellant has relied heavily upon his reading of United States v. Janis, 428 U.S. 433 [49 L.Ed.2d 1046] (1976).) After carefully reviewing appellant's argument, we conclude, as we did in Appeal of Bernie Solis, Jr. and Lucy Solis, decided June 23, 1981, 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 that present 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 "intrasovereign" context, the holding of that case and the reasoning adopted by the court are helpful for purposes of resolving the final issue **presented** by this appeal.

The Court in Janis commenced its discussion by noting that the "prime purpose" of the exclusionary

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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 561] (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 the exclusion of the evidence obtained in violation of appellant's constitutional rights would not have the effect of deterring illegal conduct on the part of criminal law enforcement agencies.

