



Appeals of Manuel Lopez Chaidez  
and Miriam Chaidez

The issues for determination are the following: (i) did Manuel Lopez, Chaidez and Miriam Chaidez (hereinafter referred to as "appellant-husband" and "appellant-wife," respectively, and collectively referred to as "appellants") receive unreported income from the illegal sale of narcotics during the appeal period; (ii) if so, did respondent properly reconstruct the amount of that income; (iii) is respondent precluded from using evidence illegally obtained by law enforcement authorities as a basis for the subject jeopardy assessments; and (iv) whether respondent's receipt of funds held by the Los Angeles Police Department ("LAPD") was in violation of Penal Code section 1536. In order to properly consider these issues, the relevant facts concerning appellants' arrest and the subject jeopardy assessments are set forth below.

On May 9, 1979, Detective Ruben Ybarra of the Narcotics Division of the LAPD Bureau of Special Investigations met with one Manuel Cruz who said that he had a "connection" who could provide large quantities of heroin for sale. Cruz also provided Detective Ybarra with a sample of the heroin available. On the subsequent day, Detective Ybarra, together with another undercover LAPD investigator, Officer Galvan, met Cruz and accompanied him to the residence of one Victor Saucedo (identified in Detective Ybarra's arrest report as appellant-husband's brother-in-law); Cruz entered the house alone and, after, returning approximately ten minutes later, informed the officers that his heroin connection would meet them later that afternoon at a designated bar.

At approximately 4:30 that afternoon, Saucedo arrived at the bar and was introduced to the waiting officers. Detective Ybarra discussed the purchase of ten ounces of heroin with Cruz and Saucedo, and agreed to a purchase price of \$1,150 an ounce. At this point, Saucedo stated that he would call appellant-husband, the actual heroin supplier. Saucedo returned a few minutes later and stated that appellant-wife, his sister, had told him that her husband was intoxicated and unable to talk; Saucedo told Detective Ybarra that he would call again.

While waiting to successfully communicate with appellant-husband, Saucedo engaged in a conversation with the undercover officers. During the course of this conversation, Saucedo stated that appellant-husband purchased large quantities of heroin in amounts of one pound to one kilogram every two or three days, and that if he could not obtain all of the heroin Ybarra wanted on that day, he would do so in a day or two.

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After several additional unsuccessful attempts to contact appellant-husband by telephone, **Saucedo** stated: "Let's go to his house and I'll get him up." The four then drove to appellant's residence in Detective Ybarra's automobile. Upon arriving, **Saucedo** entered the residence, and after approximately ten minutes exited and stated: "He's got over ten or twenty ounces of heroin inside but he says he won't do business until tomorrow. He's still pretty loaded." **Saucedo** subsequently restated the purchase price was \$1,150 an ounce and acknowledged that appellant-husband realized a profit of \$600 per ounce. Based on the foregoing, Detective Ybarra requested, and obtained, a search warrant for appellants' residence.

On May 11, 1979, Detective Ybarra and Officer **Galvan** met Cruz and drove to Saucedo's residence. Upon arriving, Ybarra and Cruz entered the house while Officer **Galvan** remained in the vehicle. **Saucedo** removed two plastic bags from between the mattresses of a bed and announced: "Each contains five ounces;" he then asked Detective Ybarra for payment. Ybarra stated that the funds were in the car, went to the front door, and motioned for Officer **Galvan** to enter. He then returned to the bedroom and conducted a chemical test to confirm that the plastic bags contained heroin. At this point, Detective Ybarra gave a pre-arranged signal to covering officers who entered the residence and placed Cruz and **Saucedo** under arrest.

At approximately the same time as the above arrest, other officers at appellants' residence served appellant-wife the search warrant obtained by Detective Ybarra and proceeded to search the house. Among other items, the investigators discovered \$16,635 in currency, three bank books issued to appellants (one from a Mexican bank), and four ounces of heroin in a can buried on the property. Upon conclusion of the search, appellant-wife was arrested and charged with possession of heroin for sale. Shortly thereafter, appellant-husband was arrested a short distance from his home and charged on the same count as his spouse; \$500 was found on his person at the time of the booking search.

Respondent was notified of appellants' arrest later in the day on May 11, 1979, and determined that the circumstances indicated that the collection of their personal income tax for the period in issue would be jeopardized by delay. Accordingly, jeopardy assessments in the amounts of \$22,334 were issued the same day, terminating appellants' taxable years as of May 11, 1979. 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 heroin sales during the period from January 1, 1979 through May 11, 1979 was \$422,400, or \$211,200 for each appellant.

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Pursuant to section 18817 of the Revenue and Taxation Code, respondent obtained **from the LAPD** the \$17,135 seized at **the** time of the above described arrests; a total of **\$4,036.26** was also obtained from two of appellants' known bank accounts. Appellants, claiming that the assessments were arbitrary and capricious, filed petitions for reassessment on June 28, 1979. Respondent **thereupon** requested that they furnish the information necessary to enable it to accurately compute their income, including income from the sale of controlled substances. When appellants replied to this request by stating that they were unwilling to provide any information which would tend to incriminate them in any way, their petitions for reassessment **were** denied.

In addition to filing their petitions for reassessment on June '28, 1979, appellants also served upon respondent a subpoena **duces tecum** to appear in the Municipal Court of the Compton Judicial District with the \$17,135 obtained from the LAPD. On January 18, 1980, respondent's efforts to quash this subpoena failed, and the **court** ordered **that the** money be returned to appellants. That order was reversed, however, on March 25, 1980, by the Superior Court **of the Compton** Judicial District. On the subsequent day, a judicial determination was made that the search warrant issued on May 11, 1979 was invalid on the basis that the affidavit in support thereof was insufficient to support the issuance of the search warrant. Accordingly, the evidence recovered pursuant to that warrant was suppressed for purposes of the criminal charges pending against appellants.

The **initial** question presented by this appeal is whether appellants received any income from the illegal sale of **controlled substances** during the period in issue. Detective Ybarra's **arrest** report **and his** affidavit for the aforementioned search warrant, which contain references to appellants' actions and activities, **corroborating** observations by LAPD investigators, and the statements of Cruz and **Saucedo**, together with appellants' extensive previous history of dealing in heroin, establish at least a prima facie case that appellant; received unreported income from the sale of heroin 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 derivei!," 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. McMahan, 2 Am.Fed.Tax R.2d 5918 (1958).)

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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); 'Former Cal. Admin. Code, tit. 18, reg. 17561, subd. (a) (4), repealer filed 6-25-81; Register 81, No. 26.) 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 heroin. 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.)

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The evidence relied upon by respondent in reconstructing appellants' income was derived from the results of the LAPD investigation, and is largely based upon the statements of Victor Saucedo. Specifically, respondent determined that appellants: **(i)** had been in the "business" of **selling** heroin from at least January 1, 1979, through May 11, 1979; **(ii)** sold heroin for \$1,150 an ounce; **(iii)** sold at least one pound of heroin each three days over the appeal period; **(iv)** **realized** gross income of at least \$809,600 from heroin sales; and **(v)** had a standard cost of heroin sold of \$550 an ounce..

We believe that Saucedo's **statements** to undercover LAPD investigators regarding appellants' heroin operation are credible **and** that, together with the other evidence obtained from the LAPD investigation which led to, and culminated with, appellants' May 11, 1979, arrest, as detailed in Detective Ybarra's affidavit for a search warrant and the arrest report and as summarized above, they support the **reasonableness** of each of the **above** elements of respondent's **reconstruction** formula. Moreover, we note that each of those elements is buttressed by evidence independent of Saucedo's statements.

Respondent's determination that appellants were engaged in the sale of heroin from at least January 1, 1979, is supported by their previous and extensive history of selling heroin. Information obtained by respondent reveals that appellants were **arrested** and charged with possession of heroin for sale a combined total, of four times in the **30-month** period previous to their May 11, 1979, arrest. Such a repeated history is indicative of continuous involvement in the sale of heroin. The second element of the **reconstruction** formula pertains to appellants' selling price. Data supplied by the Department of Justice reveals that the "street price" of heroin in Los Angeles County during the period in issue ranged from \$1,000 to \$1,600 an ounce **and** supports respondent's determination that **appellants'** selling price was \$1,150 an ounce. The fact that 14 ounces of heroin and funds sufficient for the purchase of an additional 31 ounces were seized at the time of appellants' arrest supports the conclusion that appellants **were** purchasing at least one pound of heroin every three days. Finally, the determination that appellants' cost of "goods" sold was equal to \$550 an ounce, **or** approximately 50 **percent** of their selling price, is supported by reliable law enforcement data previously utilized by this

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board in cases of this **type.1/** (Appeal of Eduardo L. 'and Leticia Raygoza, Cal. St. Bd. of Equal., July 29, 1981.)

Again we emphasize that when a taxpayer fails to comply with **the**' law in supplying the required information to accurately compute his 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;

1/ While in previous such cases respondent has allowed taxpayers **engaged** in the illegal **sale of** controlled substances to deduct the cost of "goods" sold from gross sales to arrive at their taxable income, this deduction is now statutorily prohibited. Revenue **and** Taxation Code section 17297.5, effective September 14, 1982, provides in pertinent part, as follows:

(a) In computing taxable income, no deductions (**includ- ing** deductions for cost of goods sold) shall be allowed to any taxpayer. on any of his or 'her gross' income directly derived from illegal activities as defined in Chapter 4 (commencing with Section 211) of Title. 8 of, Chapter 8 (commencing with Section 314) 'of Title 9 of, or Chapter 2 (commencing with Section **459**), Chapter 4 (**commencing** with Section **484**), or Chapter 5 (commencing with Section 503) of Title 13 of, Part 1 of the Penal Code, or as defined **in** Chapter **6** (**corn- mencing** with Section 11350) of Division 10 of the Health and Safety Code; nor shall any dedurtions be allowed to any taxpayer on any of his or her gross income derived from any other activities which directly tend to promote. or to further, or **are** directly 'connected or associated with; those illegal activities.

\* \* \*

(c) This section shall be applied with respect to taxable years which have not been closed by a statute of limitations, res judicata, **or** otherwise.

The sale of controlled substances, including heroin, constitutes an illegal activity as defined by chapter **6** of division 10 of the Health and Safety Code. (Health & Saf. Code, § 11350 et seq.) Accordingly, no deduction for appellants' cost of "goods" sold is allowable.

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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 third issue presented by this appeal concerns **appellants'** contention that the jeopardy assessments should not be sustained since they were determined, in part, by reference to evidence obtained as the result of an illegal search. The identical contention was addressed and rejected in the Appeal of Edwin V. Barmach, Cal. St. Bd. of Equal., July 29, '1981, Op. on Pet. for Reh., Nov. 16, 1981. There is no reason to reach a different conclusion in this appeal. (See also, Appeal of Bernie Solis, Jr. and Lucy Solis, Cal. St. Bd. of Equal., **June 23**, 1981.)

The final contention raised by appellants is that respondent's receipt of the \$17,135 seized by the LAPD at the time of their arrest was in violation of Penal Code section 1536, and that the funds held were within the jurisdiction of the Municipal Court which has jurisdiction over the criminal charges pending against appellants. Accordingly, they assert, those funds should be returned. After careful **consideration of** the argument advanced by appellants, we conclude that it is without merit.

Initially, we note that **appellants' reliance upon Penal Code section 1536** is misplaced. Section 1536 is specific in this regard: the court issuing a search warrant is granted limited jurisdiction over property seized, only if such property is described in, and seized pursuant to, the search warrant. The **subject funds were not** within the purview of the search warrant.

The case of Horack v. Franchise Tax Board, 18 Cal.App.3d 363 [95 Cal.Rptr. 717] (1971), is controlling under these circumstances. In Horack, the police illegally seized funds belonging to the taxpayer. The court held that the fact that the funds were illegally seized did not insulate them from the lawful tax levy. As long as the funds were in the hands of the police, the levy of respondent reached those funds;

Based upon the above, and in view of the provisions of Revenue and Taxation Code section 17297.5, we conclude that each **appellant** received a total of \$404,800 in unreported taxable income from the illegal sale of heroin during the **appeal period**. This is substantially in excess of the amount computed by respondent, and is sufficient to sustain the subject jeopardy assessments in their entirety.



