BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
RAYMOND HARRIS RICHARDSON, JR.)

For Appellant: Roger K. Vehrs
Attorney at Law

For Respondent: Michael E. Brownell
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 petition of Raymond Harris Richardson, Jr., for reassessment of a jeopardy assessment of personal income tax in the amount of $8,896 for the period January 1, 1980, through October 3, 1980.

Appeal of Raymond Harris Richardson, Jr.

The following issues are presented by this appeal: (i) whether appellant received unreported income from pimping during the appeal period; and [ii) if so, whether respondent properly concluded that appellant had $90,000 in taxable income from this illegal activity during the period in issue. In order to properly consider these issues, the relevant facts concerning appellant's arrest and the subject jeopardy assessment are set forth below.

On September 9, 1980, Officer Dennis R. Wilson of the Fresno Police Department (FPD) met with two confidential informants who related to him information about appellant's various alleged illegal activities. The first informant (CRI #1) advised officer Wilson that appellant was engaged in the sale of stolen property, insurance fraud, arson, and pimping, and also maintained a quantity of controlled substances at his residence. The second informant also supplied information with respect to appellant's alleged "fencing" operation, and corroborated the statements of CRI #1 about appellant's possession of controlled substances. After conferring with these informants, Officer Wilson was able to determine that appellant, also known as "Sir Love," was an ex-felon with a long criminal history, including a manslaughter conviction.

On September 11, 1980, CRI #1, in collaboration with Fresno law enforcement authorities, went to appellant's residence to discuss the purchase of a generator previously, stolen from the City of Fresno; the informant was wired with a voice transmitter and the conversation was taped. During their discussion, appellant agreed to sell CRI #1 the generator, Five days later, the informant telephoned appellant to confirm a time to purchase the stolen generator. During this taped conversation, appellant stated that the generator would cost $300. Later that day, the informant, again wired with a voice transmitter, went to appellant's residence to conclude the purchase. Upon arriving, however, appellant informed CRI #1 that the Fresno generator had already been sold; he stated that he had another generator which he would sell for $400.. The informant then stated that he would have to confer with the person for whom he was purchasing the generator. Officer Wilson, who had already supplied CRI #1 with $300 in photocopied currency, gave him another $100 to purchase the generator, and the sale was. concluded. Officer Wilson subsequently confirmed that this second generator had also been stolen.

In the three-week period following his first meeting with the aforementioned confidential informants, Officer Wilson discovered that appellant was the subject of three ongoing law enforcement investigations being conducted simultaneously by the Federal Bureau of Investigation, the California Department of Justice, as well as another independent investigation being pursued by the FPD. These investigations concerned appellant's suspected involvement in an insurance fraud scheme, loan sharking, and pimping.

Based upon the above, together with additional investigative work, Officer Wilson requested, and obtained, a search warrant for, inter alia, appellant's residence and person; the search warrant was issued on September 30, 1980. The search warrant was amended the subsequent day to include, among the items being sought, certain records allegedly compiled by appellant pertaining to his loan sharking and pimping operations. This amendment reflected certain detailed information Officer Wilson had obtained from CRI #1 and the F.B.I.

The search warrant was executed on October 2, 1980. During their search of appellant's residence, FPD officers discovered, inter alia, a massive quantity of stolen property, records maintained by appellant of his loan sharking operation, weapons, controlled substances, pink slips and purchase contracts for 26 vehicles appellant was selling to his prostitutes and loan sharkiny clients, and $20,287.55, including some of the currency used in the above described controlled purchase of the stolen generator. In addition, four women, all later identified as prostitutes working for appellant, were also found in the residence. Appellant was apprehended outside the house, and was subsequently charged with, inter alia, receiving property obtained by theft or extortion and possession of controlled substances.

Subsequent to his arrest, FPD officers conducted interviews with two of appellant's suspected prostitutes as well as with two males who had worked for appellant in various capacities; FPD officers had conducted a similar such interview on November 5, 1979, with another woman confessing to be one of appellant's prostitutes. Detailed information with respect to appellant's pimping operation was derived from these independently conducted interviews. Specifically, FPD officers discovered that: (i) appellant had as many as ten prostitutes working for him, eight of whom were "employed" prior to the beginning of. the appeal period;

(ii) the prostitutes were collectively expected to earn from a minimum of $500 daily to an estimated maximum of $1,200; (iii) appellant's operation continued until at least the date of his arrest: and (iv) the prostitutes worked a minimum of five days each week.

A review of appellant's loan sharking records and other information acquired with respect to this activity revealed that appellant charged a minimum of 40 percent interest on amounts borrowed for less than one year, and that he had a maximum principal balance of such loans in the amount of $49,956. Furthermore, appellant had a minimum of $12,755 worth of stolen property in his possession at the time of his arrest, with an established history of regularly engaging in the purchase and sale of such merchandise. Finally, the record of this appeal reveals that appellant received substantial amounts from insurance settlements on an automobile and house he allegedly had destroyed by arson; the vehicle had been stripped prior to its destruction.

In view of the circumstances described above, respondent determined that collection of appellant's personal income tax liability would be jeopardized by delay; the subject jeopardy assessment was issued on October 3, 1980. In issuing its jeopardy assessment, respondent found it necessary to estimate appellant's income. Utilizing the available evidence, respondent determined that appellant's taxable income from pimping was $90,000; income from other illegal activities was ignored.

On November 21, 1980, appellant filed a petition for reassessment. Respondent thereupon requested that he furnish the information necessary to enable it to accurately compute his income, including income from illegal activities: appellant did not submit any information. The record of this appeal reveals that appellant has not filed a California personal income tax return for the year in issue; it does not reveal the outcome of the criminal charges filed against appellant.

The initial question presented by this appeal is whether appellant received any income from illegal pimping activities. After careful review of the detailed evidence contained in the record of this appeal with respect to appellant's pimping operation, we find his contention that he was not engaged in "any pimping operation whatsoever" to be less than persuasive. The FPD arrest report, Officer Wilson's affidavit in support of

the above mentioned search warrant, and the independent and corroborating declarations of three of appellant's prostitutes and two of his male employees establish at least a prima facie case that appellant received unreported income from pimping during the appeal period.

The second issue is whether respondent properly reconstructed the amount of appellant's income from pimping. 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); former Cal. Admin. Code, tit. 18, reg. 17561, subd. (a)(4), repealed July 25, 1981.) 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, § 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.)

In the instant appeal, respondent used the projection method in reconstructing appellant's income from pimping. Like any method of reconstructing income, the projection method is somewhat speculative. For example, it may rest on a hypothesis that the amount of income during a base period is representative of the level of income throughout the entire projection period. (Cf. Pizzarello v. United States, 408 F.2d 579 (2d Cir.), cert. den., 396 U.S. 986 [24 L.Ed.2d 450] (1969).)

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, 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 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, 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.)

The data relied upon by respondent in reconstructing appellant's income from pimping was derived from the. results of the FPD investigation which culminated in appellant's October 2, 1980, arrest, together with information disclosed by certain of appellant's prostitutes and other employees in the course of the aforementioned interviews. Specifically, respondent determined that: (i) appellant had been engaged in the "business" of pimping from at least January 1, 1980, through the date of his arrest; (ii) a minimum of five prostitutes worked for appellant during the projection period:: (iii) appellant earned a minimum of $500 daily from his prostitutes.; and (iv) the prostitutes worked five days each week resulting in monthly income to appellant of $10,000, or $90,000 over the period January through September 1980. Finally, appellant was allowed no deductions for the cost, if any, of engaging in this "business" in view of his failure to provide any substantiation.1/

1/ Even with proper substantiation, appellant would not be permitted any deductions arising from engaging in the business of pimping. Revenue and Taxation Code section 17297.5, effective September 14, 1982, provides, in pertinent part, as follows:

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The elements of respondent's reconstruction formula are based upon the independent and corroborating statements of three of appellant's prostitutes and two of his male employees, all of whom were intimately familiar with the details of the pimping operation. We believe that the statements of these individuals are credible and that they support the reasonableness of respondent's reconstruction formula. Indeed, to the extent that respondent's formula relies on the most conservative of the statements of his "employees," and because it ignores income earned by appellant from his host of other illegal operations, we believe that respondent's computation considerably understates appellant's actual income. Finally, we note that there exists

1/ (Continued)

> (a) In computing taxable income, no deductions (including 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 (commencing with Section 11350) of Division 10 of the Health and Safety Code; nor shall any deductions 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.
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> (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.

Pimping constitutes an illegal activity as defined by Title 9 of Part 1 of the Penal Code. (Penal Code, § 266h.)

established authority for reliance upon data acquired from informants to reconstruct a taxpayer's income from illegal activities, provided that there do not exist "substantial doubts" as to the informant's reliability. (Cf. Nolan v. United States, 49 Am.Fed.Tax R.2d 941 (1982); see also Appeal of Clarence Lewis Randle, Jr., Cal. St. Bd. of Equal., Dec. 7, 1982.) The record of this appeal provides no basis for finding that any of the informants were unreliable.

Again, we emphasize that when a taxpayer fails to comply with the law in supplying the information required 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; 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 appellant's failure to provide any evidence challenging respondent's reconstruction of his income, we must conclude that respondent reasonably reconstructed the amount of such income. We do note, however, that respondent incorrectly overstated appellant's tax liability by seven dollars. Respondent computed appellant's tax at $8,916, then subtracted his personal exemption of $27 to arrive at a tax liability of $8,896; the correct amount of tax liability after allowance for the personal exemption credit is $8,889. Despite this minor error, however, we believe the jeopardy assessment should be sustained in its entirety. The subject jeopardy assessment is based upon all taxable income to appellant during the period in issue, not merely the income reflected in respondent's reconstruction thereof. (Appeal of Philip Marshak, Cal. St. Bd. of Equal., March 31, 1982.) The voluminous record of this appeal is replete with detailed evidence concerning appellant's income from illegal activities other than pimping; that income was ignored by respondent in computing appellant's tax liability for the period in issue. The income so derived is obviously more than sufficient to result in the incurrence of an additional tax liability of seven dollars.

Appeal of Raymond Harris Richardson, Jr.

ORDER

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 Raymond Harris Richardson, Jr., for reassessment of a jeopardy assessment of personal income tax in the amount of $8,896 for the period January 1, 1980, through October 3, 1980, be and the same is hereby sustained.

Done at Sacramento, California, this 4th day of May , 1983, by the State Board of Equalization, with Board Members Mr. Bennett, Mr. Collis, Mr. Dronenburg and Mr. Nevins present.

William M. Bennett , Chairman

Conway H. Collis , Member

Ernest J. Dronenburg, Jr. , Member

Richard Nevins , Member

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