BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
BRUCE JAMES WILKINS)

For Appellant: Henry D. Nunez
Attorney at Law

For Respondent: John R. Akin
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 Bruce James Wilkins for reassessment of a jeopardy assessment of personal income tax in the amount of $2,881 for the period January 1, 1978, through April 11, 1978.

The issues presented for determination are the following: (i) whether appellant received unreported income from illegal bookmaking activities during the appeal period; (ii) if so, did respondent properly reconstruct the amount of that income; and (iii) whether respondent's receipt of funds held by law enforcement authorities was improper. In order to properly consider these issues, the relevant facts concerning appellant's arrrest and the subject jeopardy assessment are set forth below.

On or about October 10, 1977, the Fresno County Sheriff's Office (FCSO) received information, from a confidential informant to the effect that appellant and one Robert Monopoli were engaged in a bookmaking opration, the profits from which were shared equally. Based upon this information, FCSG authorities initiated an investigation of the alleged illegal operation, including surveillance of the location where it was being conducted. During the course of their investigation, law enforcement authorities discovered that the operation's clients placed their wagers by telephone and settled their accounts weekly; wagers were accepted on a credit basis.

On November 4, 1977, FCSO officers discovered that appellant and Monopoli had moved their bookmaking operation to a new location. Reliable law enforcement information in the record of this appeal reveals that such transfers of location are a common occurrence with those engaged in illegal bookmaking, and are designed to help avoid detection by the police. Surveillance of the new location continued until December 18, 1977, at which time the operation was temporarily suspended. The apparent reason for halting the activity was the hearing of federal criminal charges brought against appellant, Monopoli, and others, arising out of the operation of a similar illegal venture in 1974 and 1975. The record of this appeal reveals that appellant was convicted at this trial of ". . . conducting, financing, managing, supervising, directing or owning an illegal gambling business;" judgment was entered on February 27, 1978. On the same day that the judgment was entered on t'he federal charges, FCSO officers received information to the effect that appellant and Monopoli had recently resumed their bookmaking operation, again from a different location. The authorities discovered that location on March 2, 1978, and again commenced their surveillance.

Simultaneous with the FCSO investigation, the Federal Bureau of Investigation was also involved in investigating the suspected bookmaking operation. On March 2, 1978, the owner of the residence from which the illegal activity was being conducted was contacted by federal agents. The owner disclosed that he had leased the property to one Lloyd Phillips in August of 1977, and that he had observed appellant and others suspected of involvement in the illegal venture at the leased residence for the previous three or four weeks. Finally, he noted that he had observed appellant exit the residence with a quantity of papers, deposit them in the trash, and then destroy them by fire.

Surveillance of this location continued through March 8, 1978. In the intervening period, the autnorities apparently learned that the betting records were destroyed daily, whereas the "pay and owe" sheets, disclosing the net amounts due from or to the wagerers, were destroyed weekly, after the accounts had been settled. Despite the efforts taken to destroy these records, the surveilling officers managed to recover some partially burned records. The pay and owe sheets clearly disclosed the net income realized from each wagerer.

Based largely on the above, a search warrant was issued on March 8, 1978, by the Municipal Court of Fresno for the purpose of searching the residence from which the suspected bookmaking operation was being conducted; the search warrant was executed the same day. During the course of their search, the officers found a quantity of bookmaking paraphernalia and detailed pay and owe records reflecting net income of $34,373 for a one-week period. In addition, $4,022 was found on appellant's person. Upon conclusion of the search, appellant was arrested on charges of bookmaking.

Upon being notified of appellant's arrest, respondent determined that the circumstances indicated that collection of his personal income tax for the appeal period would be jeopardized by delay. Accordingly, the subject jeopardy assessment was issued on April 11, 1978. In issuing the jeopardy assessment, respondent relied upon the records seized at the time of appellant's arrest for purposes of reconstructing his income from bookmaking. As previously noted, those records revealed that, during a one-week period, the bookmaking operation realized net income of $34,373 from wagers accepted.

Appellant filed a petition with respondent for reassessment of the subject jeopardy assessment contending that the assessment had no basis in fact. 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.

With respect to the bookmaking charges filed against appellant, the record of this appeal reveals that, on June 28, 1979, the Fresno Superior Court accepted a plea of nolo contendere to one count of accepting a bet. Pursuant to Revenue and Taxation Code section 18817, respondent obtained the funds necessary to satisiy the subject jeopardy assessment from the FCSO.

The initial question presented by this appeal is whether appellant received any income from illegal bookmaking activities during the period 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/ Respondent may adequately carry its burden of proof through a prima facie showing of illegal activity by the taxpayer. (Hall v. Franchise Tax Board,

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.

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), repealed July 25, 1981, Reg. 81, No. 26.) 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. (Breiand 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 appellant's income from illegal bookmaking. 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.)

In the instant appeal, respondent relied on evidence obtained by the aforementioned law enforcement investigations in reconstructing appellant's income. Specifically, respondent determined,, by reference to the pay and owe sheets seized at the time of appellant's arrest, that appellant had unreported income of at least $34,373 from illegal bookmaking activities during the appeal period. Upon careful review of the record on appeal, we believe that respondent's reconstruction of appellant's income is reasonable.

The record of this appeal reveals that the subject bookmaking operation was active for at least four weeks during 1978. As noted above, the lessor of the last location from which the operation was run related to federal agents that he had observed appellant burning records for three or four weeks prior to March 2, 1978, approximately one week prior to the March 8, 1978, arrest. Furthermore, we believe that it was reasonable for respondent to rely upon the operation's own records to project its income over the period it was

active. So, computed the boo-making operation's income would total at least $137,492 ($34,373[3/] x four weeks). Of this amount appellant's 50 percent share would be $68,746, double the amount of unreported income attributed to him by respondent. Again, we note that even this reconstruction is conservative because it utilizes as the base period income figure the net, rather than gross, income realized by the bookmaking operation.

Appellant has argued that the fact that the Fresno County District Attorney acquiesced to his nolo contendere plea to a single count of accepting a bet is indicative of a low level of activity, and undermines respondent's reconstruction to the extent that the latter presumes continuous involvement in illegal bookmaking. The record of this appeal reveals, however, that the District Attorney acquiesced to appellant's plea only because police surveillance after his March 8, 1978, arrest failed to disclose any involvement in illegal bookmaking. Consequently, we find the District Attorney's acquiescence to appellant's nolo contendere plea to be irrelevant as to his level of involvement in the

3/ The operation's records were maintained in such a manner that they clearly indicated the net amount due from or to each individual wagerer. In addition, the record of this appeal reveals that the wagerers settled their accounts with the bookmaking operation every Tuesday. Appellant was arrested on March 8, 1978, a Wednesday, apparently after the subject $34,373 had actually been received. Consequently, in view of Revenue and Taxation Code section 17297, respondent's determination that the operation realized income of only $34,373 in any one-week period appears conservative to the extent that it focused on net, rather than gross, income. Pursuant to section 17297, appellant would not have been entitled to deduct from his gross income any portion of the cash payouts made to individuals who placed winning wagers. (See also Cal. Admin. Code, tit. 18, reg. 17297, subd. (b), repealed Jan. 22, 1982, Reg. 81, No. 52.) 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).)

subject illegal activity during the period prior to his arrest. Equally irrelevant is appellant's explanation as to the source of the $4,022 found on his person on the date of his arrest. Appellant claims that these funds constituted part of a $4,500 loan advanced to him in February, and has provided a handwritten note from one Glenn Bedgood to substantiate this assertion. Respondent's reconstruction was based upon appellant's participation in the illegal bookmaking operation, not the cash on his person at the time of his arrest. Consequently, the source of the $4,022 is irrelevant.

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 taxayer'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. (Pfnder 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.

The third issue presented by this appeal concerns appellant's contention that respondent's receipt of the funds needed to satisfy the subject jeopardy assessment from the FCSO was improper. The identical contention was addressed and rejected in the Appeals of Manuel Lopez Chaidez and Miriam Chaidez, decided by this Board on January 3, 1983. There is no reason to reach a different conclusion in this appeal. (See also, Horack v. Franchise Tax Board, 18 Cal.App.3d 363 [95 Cal.Rptr. 717] (1971).)

For the reasons set forth above, respondent's action in this matter will be sustained.

Appeal of Bruce James Wilkins

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 Bruce James Wilkins for reassessment of a jeopardy assessment of personal income tax in the amount of $2,881 for the period January 1, 1978, through April 11, 1978, be and the same is hereby sustained.

Done at Sacramento, California, this 4th day Of May , '983, 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

, Member