

Appeal of Richard Tyree

The issues presented by this appeal are whether appellant received income from the illegal sale of controlled substances and whether respondent has properly reconstructed appellant's income from such drug sales to support the resulting jeopardy assessment.

On November 25, 1980, Officer Robert J. Brodник of the San Francisco Police Department (SFPD) received information from a confidential reliable informant (CRI) that appellant was selling methamphetamine from his room at 144 Eddy Street in San Francisco. The CRI told Officer Brodnik that he had just purchased \$80 worth of methamphetamine from appellant. At that time appellant was subject to a 24-hour search as a condition to his probation on previous drug charges. Officer Brodnik and two other SFPD officers went to appellant's known address at 875 Post Street in San Francisco to conduct a search and to advise him that they also intended to conduct a search of the Eddy Street premises. The officers were admitted to the Post Street address by appellant. A search was conducted and the officers found \$1,550 in cash, needles and syringes, and a telephone bill for the telephone located at 144 Eddy Street. Appellant and his companion, Billie J. Donaldson, were arrested at that time. The officers proceeded to the Eddy Street address where they found personal papers belonging to appellant and eleven plastic bindles of a white powder later determined to be methamphetamine. On December 23, 1980, the criminal charges against appellant were dismissed on the basis that appellant had been subject to an illegal arrest and seizure of evidence.

Prior to his November, 1980, arrest, appellant had been arrested for possession and possession for sale of controlled substances on 21 occasions since 1970. During 1979 appellant was arrested on four occasions for possession of controlled substances for sale. On May 30, 1979, the SFPD seized a quantity of methamphetamine and \$5,000 in cash. On September 14, 1979, the SFPD arrested appellant after the issuance of a search warrant and seized several bindles of methamphetamine for which appellant was convicted of possession of a controlled substance for sale and sentenced to county jail for nine months. Appellant was released from county jail in August, 1980.

According to information received by the SFPD from several CRI's, appellant sold one to three ounces of methamphetamine on a daily basis during the period between September 1, 1980, and his arrest on November 25,

Appeal of Richard Tyree

1980. At that time, according to the SFPD, the street price of methamphetamine was approximately \$1,100 to \$1,500 per ounce.

On December 2, 1980, respondent determined that **the** collection of tax might be jeopardized by delay and issued a jeopardy assessment. On the same date, an Order to Withhold was issued to the SFPD and the \$1,550 seized at the time of appellant's November 25, 1980, arrest was secured by respondent.

Appellant filed a timely petition for reassessment on December 18, 1980. Respondent thereupon requested that appellant make a full and complete disclosure of his income for the years 1975 through 1980, including all information relating to his sales of methamphetamine. Appellant replied through his attorney with a request that his funds be returned. Respondent again requested appellant to file a financial disclosure. On March 24, 1981, appellant's attorney submitted a letter with a partially completed financial questionnaire which indicated that appellant had no income during the years 1978, 1979 and 1980, and that the funds seized belonged to appellant's friend Michelle Eberhart.

On May 7, 1981, respondent again requested that appellant make a full disclosure of his income from the sale of controlled substances. Respondent also requested an affidavit from Michelle Eberhart regarding her interest, if any, in the funds seized. Appellant has never responded to this request. On November 6, 1981, respondent denied appellant's petition for reassessment of the jeopardy assessment. Appellant then filed a timely appeal.

Appellant contends that he earned no income from any source in 1980. He submits that neither the amount nor the circumstances of the seizure of drugs and money at the time of his arrest on November 25, 1980, support the conclusion that he was selling **methamphetamine** and that the **CRI's** relied on by respondent and the police to support the conclusion that appellant was selling drugs are unreliable because they are presumably drug users.

Respondent submits that the facts **clearly** show that appellant was selling methamphetamine during the period in question and the income from the sales was at least adequate for this board to sustain the jeopardy assessment against appellant.

Appeal of Richard Tyree

The initial question presented by this appeal is whether appellant received any income from the illegal sale of methamphetamine during the period in issue. The reports submitted by Officer Brodnik detailing appellant's activities and history of arrests, the results of the search of his two rooms, and the statements of the **CRI's**, establish at least a prima facie case that appellant received unreported income from the sale of **methamphetamine** during the appeal period. Since appellant has offered no evidence to refute this prima facie showing, we must conclude that he did receive unreported income from the sale of illegal drugs during the appeal period.

The second issue is whether respondent properly reconstructed the amount of appellant's taxable 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.**) Gross income is defined to include "all income from whatever source derived," unless otherwise provided in the law. (Rev. & Tax. Code, **§ 17071.**) It is well established that any 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)**; former Cal. Admin. Code, tit. 18, reg. 17561, subd. **(a)(4)**, repealer filed June 25, 1981.) 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.)

We acknowledge the fact that there are inherent difficulties in obtaining evidence in cases involving illegal activities. Both the courts and this board, however, have recognized that the use of some assumptions must be allowed in cases of this sort. (See, e.g.,

Appeal of Richard Tyree

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** that a dilemma confronts the taxpayer whose income has been reconstructed. The taxpayer bears the burden of proving that the reconstruction is erroneous and therefore 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 the taxing authority's reconstruction 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); Snapiro 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 MacFarland Lyons, supra.) In summary, 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 MacFarland Lyons, supra; Appeal of Leon Rose, Cal. St. Bd. of Equal., March 8, 1976.)

The data relied upon by respondent in the instant case in reconstructing appellant's income was derived from information contained in related arrest reports, the affidavit for a search warrant for the arrest on September 14, 1979, and San Francisco police officers' reports and the statements of CRI's made to San Francisco police prior to the 1980 arrest. On this basis, respondent determined that appellant: (i) had been selling methamphetamine almost continuously from early 1979 to November 25, 1980, except for his nine-month stay in the San Francisco County Jail; (ii) sold methamphetamine for \$1,000 an ounce; (iii) sold an average of one ounce a day; (iv) realized a gross income of \$85,000 from such sales during the appeal period.

In this case respondent determined that appellant had received income from drug sales, and, since he had apparently kept no record of such sales, it attempted to reconstruct his income in the following manner. Respondent first determined that appellant had

3

Appeal of Richard Tyree

been selling methamphetamine on a daily basis between September 1, 1980, and November 24, 1980, a total of 85 days. Respondent next assumed that appellant **sold** an average of one ounce each day for an average **selling** price of \$1,000 per ounce. From this respondent concluded that appellant had earned \$85,000 in gross receipts from drug sales. Respondent allowed a 50 percent cost of goods sold deduction resulting in a taxable income of **\$42,500.***

The record reveals that the San Francisco Police had received information from at least two **CRI's** regarding appellant's continuing sales of methamphetamine following his release from jail in August, 1980. Based on the information from the **CRI's**, the police estimated that appellant was selling from one to three ounces of methamphetamine on a daily basis. The **CRI's** based their information on their own purchases of methamphetamine from appellant, their observations of sales to other persons and appellant's statements to the **CRI's**. On the day of appellant's arrest, a **CRI** told the SFPD that he had purchased \$80 worth of methamphetamine from appellant.

The assumption that appellant sold methamphetamine for \$1,000 an ounce is supported by the record. The San Francisco police informed respondent that the street price in 1980 of methamphetamine was **approximately** \$1,100 to **\$1,500** an ounce. The estimate by the California Bureau of Narcotic Enforcement for retail sales of methamphetamine during 1980 was \$500 to \$1,000 an ounce. The \$1,000 per ounce figure is the approximate average of these figures and is, therefore, reasonable.

* Prior to 1982, as a result of this board's decision in the Appeal of Felix L. Rocha, decided February 3, 1977, respondent 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 prohibited by statute. Effective September 14, 1982, Revenue and Taxation Code section 17297.5 provides that no deduction shall be allowed in cases where the income is derived from the sale of a controlled substance such as methamphetamine. Section 17297.5 is specifically made applicable with respect to taxable years which have not been closed by a statute of limitations, res judicata, or otherwise.

Appeal of Richard Tyree

The amount of methamphetamine appellant was selling per day was based on statements made by several **CRI's**. Prior to appellant's 1979 arrest, a **CRI** informed the San Francisco Police that he had observed approximately 30 persons entering and leaving appellant's room on a daily basis. It is reasonable to assume that each person purchased at least one bindle of methamphetamine per visit. When appellant was arrested, the eleven bindles of methamphetamine seized at the time of his arrest weighed a total of 7 grams or **.245** ounce. One bindle of methamphetamine would, therefore, weigh approximately **.022** ounce. If appellant sold approximately 30 bindles of methamphetamine per day, the total amount sold would be **.668** ounce, or approximately two-thirds ounce. According to information received from several **CRI's** by the SFPD, at the time of his arrest, appellant was selling one to three ounces of methamphetamine per day. This information is further corroborated by the large amount of money appellant had at the time of his arrest and the fact that a **CRI** had purchased \$80 worth of **methamphetamine** from appellant on the day of the arrest. Thus, it is reasonable to assume that appellant was selling at least two-thirds ounce per day.

To sum up, the evidence before us creates a reasonable inference that appellant earned approximately \$56,780 selling methamphetamine during the 85 day appeal period. This figure is computed by assuming that appellant sold approximately two-thirds ounce per day and an ounce sold for approximately \$1,000. Thus modified, the reconstruction of appellant's income has a foundation in fact and is not arbitrary or unreasonable. (Appeal of David Leon Rose, supra; Appeal of Burr MacFarland Lyons, supra.)

The conclusion that the reconstruction is reasonable does not end our inquiry. Appellant may still prevail if he can prove, by a preponderance of the evidence, that the modified assessment is erroneous. (Appeal of Peter O. and Sharon J. Stohrer, Cal. St. Bd. of Equal., Dec. 15, 1976) In an attempt to meet this burden, appellant **claims** that the \$1,500 found in his room at the time of his arrest belonged to his companion, Ms. Eberhart. Appellant's allegation is not supported by any evidence, including an affidavit attesting to this fact by Ms. Eberhart which was requested by respondent. Such an allegation is unconvincing when weighed against the other evidence of his involvement in drug sales. Appellant's contention that the **CRI's** relied on by respondent are unreliable because they are presumably drug users is

Appeal of Richard Tyree

without merit. Appellant's allegation presupposes that he is aware of the identity of the various CRI's, whereas the record does not indicate that their identity was ever revealed. The accuracy of the information supplied by the CRI's is established by the fact they furnished accurate information to the SFPD at the time of his 1979 and 1980 arrests. (See Appeal of Eduardo L. and Leticia Raygoza, Cal. St. Bd. of Equal., July 29, 1981, wherein the reliability of a confidential informant was established based on hi's past record of supplying information resulting in arrests, convictions and the seizure of narcotics.) The record of this appeal provides no basis to support a finding that the CRI's were unreliable. Accordingly, we conclude that appellant has failed to establish that the modified assessment is erroneous.

Finally, there is one additional issue which must be addressed. In computing appellant's taxable income, appellant allowed a 50 percent cost of goods sold deduction. As previously noted, a deduction for the cost of goods sold is now prohibited by the enactment of section 17297.5. As such, we have not allowed any cost of goods sold deduction in computing appellant's taxable income.

Based upon the above, we conclude that appellant received a total of \$56,780 in unreported taxable income from the illegal sale of methamphetamine during the appeal period. Because there is no deduction for cost of goods sold, this is in excess of the amount originally computed by respondent and is sufficient to sustain the subject jeopardy assessment in its entirety.

Appeal of Richard Tyree

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 on the petition of Richard Tyree for reassessment of a jeopardy assessment of personal income tax in the amount of \$3,664 for the period September 1, 1980, to November 24, 1980, be and the same is hereby sustained.

Done at Sacramento, California, this 17th day of August, 1983, by the State Board of Equalization, with Board Members Mr. Bennett, Mr. Collis, Mr. Dronenburg, Mr. Nevins and Mr. Harvey present.

William M. Bennett, Chairman
Conway H. Collis, Member
Ernest J. Dronenburg, Jr., Member
Richard Nevins, Member
Walter Harvey*, Member

*For Kenneth Cory, per Government Code section 7.9