BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeals of)
)
SIROOS GHAZALI)

For Appellant: Howard E. Beckler
Attorney at Law

For Respondent: Bruce R. Langston
Counsel

O P I N ION

These appeals are made pursuant to section 18646 of the Revenue and Taxation Code from the action of the Franchise Tax Board in denying the petitions of Siroos Ghazali for reassessment of jeopardy assessments of personal income tax in the amounts of $31,141.95, including penalty, for 1980, and $30,747 for 1981, and for reassessment of supplemental jeopardy assessments of personal income tax in the amounts of $33,633.60, including penalty, for 1980, and $32,032 for 1981.

Appeals of Siroos Ghazali

The issues presented by these appeals are whether appellant received unreported income from the illegal sales of heroin during the years 1980 and 1981, and, if so, whether respondent properly reconstructed the amount of that income.

Appellant is a student who came to this country from Iran. During the period in question, he lived with his wife and sister in the West Hollywood area of the County of Los Angeles. For the year 1980, appellant was self-employed as the sole proprietor of an ice cream parlor located in Westwood.

In mid-July 1981, Deputy John W. Sullivan of the Los Angeles County Sheriff's Department, Narcotics Bureau, was advised by a confidential informant that someone known as "John" was selling heroin from a condominium residence at 1230 North Horn Avenue, Number 400, West Hollywood. Thereafter, using government funds and under the surveillance of four deputy sheriffs, the confidential informant participated in a controlled purchase of a paper bindle of heroin from a thin, dark-haired male at the North Horn Avenue residence.

Based upon this undercover investigation and his opinion that the residence was being used for the trafficking of controlled substances, Deputy Sullivan obtained a court-issued warrant to search the premises and person of "John" who was described, in part, as a male Iranian. On July 22, 1981, Deputy Sullivan executed the search warrant in the company of four other deputies. After identifying themselves and demanding entry, the deputies heard loud voices and noises coming from inside the condominium unit. Believing that evidence was being destroyed, the deputy sheriffs forcibly entered the residence and detained the five occupants, including appellant, his wife, and his sister. A search of the premises uncovered 6 grams of heroin, 9 grams of opium, $150 of cash, hypodermic needles and syringes, weighing devices, and various drug paraphernalia. After he admitted that the narcotics were his, appellant was arrested and apparently charged with possession of controlled substances for sale in violation of section 11352 of the California Health and Safety Code, a felony. Appellant's wife was arrested for being under the influence of an opiate.

Six months later in January 1982, another confidential informant advised Deputy Sullivan that appellant was selling heroin from his residence on North

Horn Avenue. After employing the confidential informant in another undercover purchase of'heroin from appellant's residence, Deputy Sullivan obtained a second search warrant. On January 21, 1982, the Sheriff's Department served the warrant by forcibly entering appellant's residence after hearing noises indicating the possible destruction of evidence. Upon entry; deputies detained appellant after he was seen running through the condominium with a wallet in his hand. A search of the wallet revealed 1.5 grams of heroin. A search of the premises uncovered 1/4 gram of heroin, a gram weigh scale, drug paraphernalia, and two keys to a bank safe deposit box.

Upon conducting a search of the safe deposit box pursuant to a warrant, deputies found inside 8 grams of heroin, a firearm with 49 rounds of ammunition, gold coins, and a $10,000 time certificate of deposit and two savings passbooks in appellant's name. Appellant was arrested and charged with possession of heroin for sale.

In a consolidated criminal case, appellant later pleaded guilty to possession of a controlled substance in connection with the first arrest and guilty to possession for sale of a controlled substance in connection with the second arrest. Following his plea, appellant was sentenced to serve one year in the county jail.

On or about January 22, 1982, the Sheriff's Department notified respondent of appellant's arrests and declared that appellant had been selling a half ounce of heroin at $200 per quarter gram for the past two years. From this information, respondent estimated that in each of those two years appellant had received $292,214 in taxable income. In its calculations, respondent allowed a SO-percent cost of goods sold deduction. Respondent determined that collection of the resultant tax would be jeopardized by delay and issued jeopardy assessments for the years 1980 and 1981.

On January 29, 1982, respondent revised its estimate of appellant's taxable income to $291,200 for each of the two years in question. Moreover, after examining appellant's 1980 tax return wherein he reported that he had no taxable income, respondent determined that there was a tax deficiency due to appellant's negligence or intentional disregard of the income tax rules and regulations. Accordingly, respondent assessed appellant with a penalty under section 18684 of the Revenue and Taxation Code.

Shortly thereafter, appellant petitioned the Franchise Tax Board for reassessment of the revised jeopardy assessments. In July 1982, respondent denied the petition and affirmed the assessments. Appellant thereupon filed timely appeals with this board. During the pendency of those appeals, respondent determined that, under former Revenue and Taxation Code section 17297.5, which became effective on September 14, 1982, appellant was no longer entitled to the cost of goods sold deduction. Accordingly, on August 12, 1983, respondent issued a supplemental set of jeopardy assessments charging appellant with an additional- $291,200 in taxable income for each year already under appeal. The additional taxable income represented the deductions which respondent had previously allowed in its original assessments. In addition, respondent imposed a five-percent penalty for failure to file a timely return for 1980. Following the denial of a reassessment petition, appellant appealed these supplemental jeopardy assessments. Thus, except for the two penalties, the total tax liability at issue in these appeals is based upon appellant's gross income from heroin sales in 1980 and 1981 as reconstructed by respondent without regard to any deductions for cost of goods sold.

The first question presented by these appeals is whether appellant received any income from the illegal sale of heroin in the years 1980 and 1981, It is appellant's contention that he did not engage in the selling of the controlled substance during this time period. Appellant declares that his wife was a heroin user and that the heroin which the sheriff's deputies found in his possession on the dates of his two arrests was obtained for her personal use.

The record in these appeals, however, does not support appellant's position. The affidavits prepared by Deputy Sullivan in application for the search warrants describe the supervised purchases of heroin from a residence which appellant has conceded that he purchased in October 1980. The first confidential informant related that from this residence appellant had supplied him with heroin for some period in the 18 months prior to July 1981 when he contacted Deputy Sullivan. The second confidential informant disclosed that, at first, appellant had given him heroin for free but began to charge him for the narcotic after he became addicted to it. This informer added that he had been contacted by the families of other persons who purchased heroin from appellant and whose lives were being destroyed by addiction to the

controlled substance. The ensuing searches of appellant's condominium and the examination of his bank safe deposit box uncovered several grams of heroin, weighing devices, and sundry narcotics paraphernalia. Thus, the arrest reports, the search warrant affidavits, the results of the searches of appellant's home and bank box, and the statements of the tipsters establish at least a prima facie case that appellant received unreported income from the sale of heroin during the appeal period.

Moreover, admissions made by appellant fail to lend support for his position that the heroin seized was intended for his wife's ingestion. When confronted with the heroin and opium seized at the time of his first arrest, appellant stated to the sheriff's deputies that the controlled substances were for his personal use, not his wife's. Subsequently, at the trial setting of his criminal cases, appellant pleaded guilty, not only to possession, but to possession of a controlled substance for sale. Appellant's conviction for felonious possession for sale serves as additional prima facie evidence that appellant received taxable income from the sales of heroin during the years in question. (See Appeal of John C. and Elizabeth R. Fulton, Cal. St. Bd. of Equal., April 5, 1983; Appeal of Eli A. and Virginia W. Allec, Cal. St. Bd. of Equal., Jan. 7, 1975.)

Appellant makes the argument that there is insufficient proof to sustain a finding that he was selling heroin since respondent relied upon hearsay evidence from undisclosed sources contained in police reports. This identical contention was addressed by this board in the Appeal of Carl E. Adams, decided on March 1, 1983, where we noted that this board may consider any relevant evidence, including hearsay evidence, provided that "it is the sort of evidence on which responsible persons are accustomed to rely in the conduct of serious affairs." (Cal Admin. Code, tit. 18, reg. 5035, subd. (c).) While the reports of the Sheriff's Department in the instant appeals are hearsay, such documents are credible evidence (Appeals of Manuel Lopez Chaidez and Miriam Chaidez, Cal. St. Bd. of Equal., Jan. 3, 1983) and admissible in a proceeding before this board (Appeal of David Leon Rose, Cal. St. Bd. of Equal., March 8, 1976). Because appellant has failed to refute respondent's prima facie showing of his drug sales activities, we must conclude that appellant received unreported income from the illegal sale of heroin during the years 1980 and 1981.

The next issue for our consideration is whether respondent properly reconstructed the amount of said taxable income. 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 derived," 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. McMahon, 2 Am.Fed.Tax R.2d 5918 (1958); Daniel T. Galluzzo, ¶ 81,733 P-E Memo. T.C. (1981);)

It is well settled that both federal and state income tax regulations require each taxpayer to maintain such accounting records as will enable him to file an accurate tax return. (Treas. Reg. § 1.446-1(a)(4); former Cal. Admin. Code, tit. 18, reg. 17561, subd. (a)(4), repealer filed June 25, 1981 (Register 81, No. 26).) In the absence of reliable books or records, the taxing agency is given great latitude to determine a taxpayer's taxable income by whatever method will, in its opinion, clearly reflect income. (Rev. & Tax. Code, § 17561, subd. (b); Joseph F. Giddio, 54 T.C. 1530 (1970).) The choice as to the method of reconstructing income lies with the taxing agency, the only restriction being that the method be reasonable under the circumstances. (Carson v. United States, 560 F.2d 693 (5th Cir. 1977); Herbert Schellenbarg, 31 T.C. 1269 (1959).) Moreover, where a taxpayer has failed to maintain any books or records of his transactions, respondent's method need not compute net income with mathematical exactness in order to be reasonable. (Harry Gordon, 63 T.C. 51 (1974); Harold E. Harbin, 40 T.C. 373 (1963).) "Under such circumstances, approximation in the calculation of net income is justified." (Harris v. Commissioner, 174 F.2d 70, 73 (4th Cir. 1949).) Thus, so long as some reasonable basis has been used to reconstruct income, respondent's determination will be presumed correct, and the taxpayer bears the burden to disprove such computation even-though crude. (Breland v. United States, 323 F.2d 492 (5th Cir. 1963).)

In general, the existence of unreported income may be demonstrated by any practical method of proof that is available in the circumstances of a particular case. (Davis v. United States, 226 F.2d 331 (6th Cir. 1955); Appeal of Karen Tomka, Cal. St. Bd. of Equal., May 19, 1981.) In the instant matter, respondent employed the

now familiar projection method to reconstruct appellant's income from the illegal sale of heroin. The projection method based upon statistical analysis and assumptions gleaned from the evidence is an acceptable method of reconstruction. (Mitchell v. Commissioner, 416 F.2d 101 (7th Cir. 1969); Fiorella v. Commissioner, 361 F.2d 326 (fth Cir. 1966); Appeal of David Leon Rose, supra.) However, in order to ensure that use of the projection method does not lead to injustice by forcing the taxpayer to pay tax.on income that he did not receive, 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); Willits v. Richardson, 497 F.2d 240 (5th Cir. 1974); 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, Cal. St. Bd. of Equal., Dec. 15, 1976.) In other words, 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 (E.D.N.Y. 1968), affd. sub nom., United States v. Dono, 428 F.2d 204 (2d Cir. 1970): Appeal of Burr McFarland Lyons, supra.) If the reconstruction is found to be based on assumptions lacking corroboration in the record, the assessment is deemed arbitrary and unreasonable. (Shades Ridge Holding Co., Inc., ¶ 64,275 P-H Memo. T.C. (1964), affd. sub nom., Fiorella v. Commissioner, supra.) In such instance, the reviewing authority may redetermine the taxpayer's income on the facts adduced from the record. (Mitchell v. Commissioner, supra; F. 0. Whitten, Jr., ¶ 80,245 P-H Memo. T.C. (1980); Appeal of David Leon Rose, supra.)

Inasmuch as appellant has not disclosed his income from the sale of heroin, respondent was forced to rely upon the reports and information obtained from the Los Angeles County Sheriff's Department to reconstruct his taxable income from such illegal sources. First, respondent determined that appellant was engaged in the business of selling heroin. Because we have already found that appellant received income from heroin trafficking during the years under review, it follows from that discussion that appellant was engaged in that illegal business. We note that there is additional data provided by the Sheriff's Department which corroborates appellant's narcotics activity. Specifically, when applying to the Beverly Hills Municipal Court for the second search warrant, Deputy Sullivan made mention of

confidential information proffered by "W.E. TIP," a private criminal witness program, implicating appellant and his wife in heroin dealing from their condominium. Thus, we find sufficient credible evidence in the record to sustain' this first assumption.

As for the second assumption, respondent concluded that appellant was engaged in the illegal sale of heroin for the two-year period beginning January 1, 1980, and ending December 31, 1981. This determination was based upon information provided by the Sheriff's Department shortly after appellant's second arrest when respondent issued the original jeopardy asessments. Bearing in mind that respondent reconstructed appellant's income only after his second arrest for possession for sale in January 1982, we find corroboration for the supposition that appellant conducted heroin sales during 'the latter half of the year 1981. Discovery of the bank records revealed that on August 6, 1981, just two weeks after his first arrest, appellant began renting the bank safe deposit box in which the deputies discovered eight grams of heroin and a firearm. In the approximately five-month period between August and December 1981, bank records also show that appellant made 42 visits to the depository; In January 1982, appellant made ten additional visits to the bank before being arrested. In view of what was seized from the safe deposit box, the frequency of appellant's visits has a tendency in reason to show that appellant was selling heroin during this period and using the bank deposit box to sequester the heroin that he sold.

Nor do we find fault *in* respondent's projection of appellant's narcotics activity back another six months to January 1981. The first confidential informant related that appellant had been his supplier "during a period of time during the past 18 months" that he had been using and selling heroin himself. (Resp. Br., Exh. A10.) Information from an untested confidential informant will be considered reliable if the information that he supplies proves to be accurate and ultimately results in the seizure of narcotics and appellant's arrest and subsequent conviction. (Appeal of Clarence Lewis Randle, Jr., Cal. St. Bd. of Equal., Dec. 7 1982; Appeal of Harold S. Sandler, Cal. St. Bd. of Equal:, Oct. 10, 1984.) On the basis that the information supplied by the first tipster led to a successful seizure of heroin and appellant's conviction for possession of controlled substances, we judge his communication to be credible and supportive of

the proposition that appellant was trafficking in heroin during the first six months of 1981 as well.

However, there is an insignificant factual basis in the record to uphold respondent's projection of appellant's narcotics activity back another full year through 1980. The first confidential informer, for example, did not say that appellant had been selling him heroin for the whole 18 months since January 1980, only that appellant had been his supplier for a portion of that time. The only evidence which corroborates heroin sales by appellant in 1980 is a letter bearing the stamped signature of one Sergeant J. W. Hawksley of the Sheriff's Department. This letter was written in June 1982, apparently for the purpose of documenting the 1980 jeopardy assessment. It describes what several confidential informants told the sergeant about "John's" heroin dealing in 1980. However, the letter does not set forth any specific narcotics transactions or the dates or amount of any sales. Nor does it appear that the informers identified appellant as "John" or that any of this information was ever used by law enforcement authorities to effect an undercover purchase, 'obtain a warrant, or effect an arrest.

It is true that authority exists for reliance upon data acquired from informants to reconstruct a taxpayer's income from illegal activities, provided fhat there do not exist "substantial doubts" as to the informant's reliability. (Cf. Nolan v. U.S., 49 Am.Fed.Tax R.2d 941 (1982); see also Appeal of Clarence Lewis Randle, supra.) In the Appeal of Clarence Lewis Randle, supra, we upheld the assumption that the taxpayer had been in the business of selling controlled substances for the prior 46 weeks on the basis of a statement of a single informer. There was reason to believe, however, that the information was reliable since other intelligence provided by the informer resulted in the seizure of 78 grams of narcotics and the subsequent conviction of the taxpayer. Similarly, in Appeal of Carl E. Adams, supra, we sustained respondent's assumption that the taxpayer had been selling cocaine from his restaurant in the 13 months prior to his arrest. In that case, the duration of the taxpayer's illegal activities was substantiated by a single tipster but other information that he provided to a detective led to a seizure of contraband and the taxpayer's arrest. In addition, during the prior ten months, two other confidential reliable informants had disclosed to the same detective that they had purchased controlled substances from the

taxpayer and one of them participated in a police-supervised buy. . .

In the instant appeals, none of the information contained in the letter by Sergeant Hawksley was demonstrated to have been reliable by any subsequent seizure or arrest. The letter itself has none of the indicia of trustworthiness of a police crime report, having been written by a non-arresting sheriff's officer approximately two years after the informers had given him the information. (See Appeal of Peter O. and Sharon J. Stohrer, Cal. St. Bd. of Equal., Dec. 15, 1976.) Finally, we observe that appellant has submitted copies and translations of Iranian bank drafts which account for the origin of the majority of the deposits made in 1980 into his savings accounts. We find then that there is reasonable and credible factual basis for projecting appellant's heroin sales activity back only one year through 1981.

The third assumption in respondent's reconstruction formula was that appellant sold one-half ounce of heroin per week in 56 one-fourth gram quantities costing $200 each. Our review of the evidence reveals that there is sufficient credible evidence to support this projection of the volume of appellant's sales of heroin during 1981. When sheriff's deputies opened his bank safe deposit box, they found eight grams of heroin. We have previously stated that because of the risks inherent in the illegal sales of narcotics, it is "reasonable to assume that a dealer would only have on hand the amount of drugs which could be easily and quickly disposed of." (Appeal of Clarence P. Gonder, Cal. St. Bd. of Equal., May 15, 1974.) Looking at the number of safe deposit access tickets that appellant completed between August and December 1981, appellant visited the depository on a twice-weekly basis. Based upon the number of grams seized from the bank safe deposit box and the number of visits each week to the bank, it is reasonable to conclude that in a week's time appellant sold heroin in the amount of 16 grams, which is approximately one-half of an ounce. The $200 figure for the sale price of a quarter gram of heroin comports with narcotics data provided by law enforcement agencies in previous appeals of this nature.

In its second set of assessments, respondent disallowed the 50-percent cost of goods sold deduction for each of the years under review.. As we have discussed on prior occasions, this deduction is now statutorily prohibited where a taxpayer's gross income is derived

from illegal activities. (Former Rev. & Tax. Code, § 17297.5, repealed by Stats. 1983, Ch. 488, and reenacted as § 17282.) 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.) While the assessment disallowing the deduction for 1980 cannot be sustained in light of our reversal of the original assessment, the assessment eliminating the deduction for 1981 will be upheld. In addition, respondent's imposition of a negligence penalty (Rev. & Tax. Code, § 18684) and a penalty for failure to file a timely return (Rev. & Tax. Code, § 18681) for 1980 must be reversed since these penalties were based upon the amount of tax liability determined by the assessments for 1980. (See Appeal of A. J. Bima, Cal. St. Bd. of Equal., Aug. 17, 1982.)

Finally, appellant has contended that respondent's receipt of the funds from his bank accounts to satisfy the subject jeopardy assessments was improper. Respondent's authority to issue, jeopardy assessments is conferred by Revenue and Taxation Code section 18641 and its decision to issue the assessments for the appeal years is not subject to review by this board. (Appeal of Karen Tomka, supra; Appeal of John and Codelle Perez, Cal. St. Bd. of Equal., Feb. 16, 1971.) Furthermore, the contention that a-tax levy of respondent upon the bank funds seized by police authorities was improper has been rejected by this board on prior instances. (See Appeals of Manuel Lopez Chaidez and Miriam Chaidez, supra; Appeal of Bruce James Wilkins, Cal. St. Bd. of Equal., May.4, 1983; see also Horack v. Franchise Tax Board, 18 Cal.App.3d 363 [95 Cal.Rptr. 717] (1971).)

In summary, we find that respondent's projection of appellant's income from the illegal sales of heroin for the year 1981 to be reasonable when scrutinized against the record in this appeal. Given that appellant has the burden of proving that the reconstruction of his income was erroneous, we must conclude that respondent properly reconstructed appellant's income for that year, for appellant has chosen to deny all complicity in any narcotics sales and failed to offer any evidence to aid in a more precise calculation of his income. Based on the foregoing, respondent's assessments for 1980 will be reversed and the assessments for 1981 will be sustained.

Appeals of Siroos Ghazali

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 petitions of Siroos Ghazali for reassessment of jeopardy assessments of personal income tax in the amounts of $31,141.95, including penalty, for 1980, and $30,747 for 1981, and for reassessment of supplemental jeopardy assessments of personal income tax in the amounts of $33,633.60, including penalty, for 1980, and $32,032 for 1981, be and the same is hereby reversed with respect to the assessments for 1980. In all other respects, the action of the Franchise Tax Board is sustained.

Done at Sacramento, California, this 9th day Of April , 1985, by the State Board of Equalization, with Board Members Mr. Dronenburg, Mr. Collis, Mr. Nevins and Mr. Harvey present.

Ernest J. Dronenburg, Jr. , Chairman

Conway H. Collis , Member

Richard Nevins , Member

Walter Harvey* , Member

, Member

*For Kenneth Cory, per Government Code section 7.9