BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
WALTER L. JOHNSON)

For Appellant: Walter **L.** Johnson, in pro. per.

For Respondent: Crawford H. Thomas
Chief Counsel

Richard C. Creeggan
Counsel

O P I N I O N

This appeal is made pursuant to section 19059 of the Revenue and Taxation Code from the action of the Franchise Tax Board in denying the claim of Walter L. Johnson for refund of personal income tax in the amount of $252.00 for the year 1970.

The sole issue presented herein is whether respondent's determination that appellant received income in 1970 in the amount of **$10,000.00** from the sale of dangerous drugs **was** proper.

Appeal of Walter L. Johnson

During 1970 the appellant, Walter L. Johnson, lived in Westminster, California, with his alleged wife and her three children by a previous marriage. During the early part of 1970 he worked as a furniture salesman. From March 1970 until early February 1971 he was self-employed as a carpet salesman.

On February 3, 1971, appellant was arrested at his home and charged with sale of dangerous drugs, possession of dangerous drugs for sale, and possession of marijuana for sale. The arresting officers seized a quantity of drugs and $257.00 in cash. The money was turned over to the respondent Franchise Tax Board. On March 5, 1971, appellant entered a certified plea of guilty to the charge of possession of dangerous drugs for sale and in due course was sentenced to serve from two to ten years in state prison. Appellant is presently serving his term in the California State Prison in Chino, California.

On February 4, 1971, respondent was notified of the circumstances of appellant's arrest and was told that appellant had admitted selling dangerous drugs for at least six months prior to his arrest. On the day of his arrest appellant had sold $460.00 worth of drugs to one individual and an agent of the State Bureau of Narcotic Enforcement reported that appellant was a major Orange County narcotics dealer who made several sales of narcotics every week. Respondent therefore determined that it was reasonable to assume that appellant would make the equivalent of one $460.00 sale every week or about $2,000.00 in sales every month. This line of reasoning resulted in the conclusion that appellant had realized a minimum of $10,000.00 from the sale of illegal drugs in the last five months of 1970. Appellant's tax liability on this $10,000.00, after allowance for the personal exemption credit, amounted to $330.00. Respondent determined that the evidence of sales of illegal drugs indicated that the collection of this tax liability would be jeopardized in whole or in part by delay. As a result of this determination, a jeopardy assessment in the amount of $330.00 was issued on February 4, 1971, and the $257.00 seized from appellant was applied toward this assessment.

When appellant filed his separate personal income tax return for 1970, he reported income from wages in the amount of $1,738.80 and net income from business in the amount of $1,780.26. The self-assessed tax on the total reported income of $3,519.06 was $5.00, which appellant did not pay. Instead he claimed a refund of the $252.00 difference between the $257.00 seized when he was arrested and the $5.00 tax liability. When respondent sent appellant a questionnaire in an effort to obtain the information needed to accurately determine appellant's income in 1970, appellant answered by reiterating that his total income in 1970 was $3,519.06 and that he had received no income from the sale of medicine or drugs. He did not answer the questions pertaining to his living expenses during 1970. After considering all available evidence, respondent concluded that its reconstruction of income was reasonable and that appellant had failed to provide any data upon which to base a more accurate figure. Respondent therefore denied appellant's claim for refund and this appeal followed.

The substance of appellant's argument is that respondent's estimate of appellant's income from the sale of dangerous drugs was arbitrary and without foundation in fact, and therefore could not be used as a basis for the jeopardy assessment here in issue. He urges that there was no proof that he sold any dangerous drugs in 1970, arguing that had there been any such proof he would not have been permitted to plead guilty to the lesser offense of possession of dangerous drugs for sale. He further urges that unless respondent can produce "factual, documentary evidence--that [appellant] derived substantial income from the sale of narcotics," his claim for refund must be approved.

We do not find the arguments made by appellant to be persuasive. In the Appeal of John and Codelle Perez, Cal. St. Bd. of Equal., February 16, 1971, the facts and the basic issue were in all material respects identical to those presented here. We consider the decision in Perez to be controlling and quote therefrom at length in the following paragraphs:

Under the California Personal Income Tax Law, a...[taxpayer is] . ..required to state specifically the items of [his] ...gross income during the taxable year. (Rev. & Tax. Code, §§ 18401, 18402.) 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.) The United States Supreme Court has held that "gross income" includes gains derived from illegal activities, requiring the filing of a return reporting such gains. (United States v. Sullivan, 274 U.S. 259 [71 L. Ed. 1037].) On the basis of that decision, it has specifically been held that gain from the illegal sale of narcotics is taxable income, (Farina v. McMahon, 2 Am. Fed. Tax R.2d 5918.) --

Each taxpayer is required to maintain such accounting records as will enable him to file an accurate return. (Cal. Admin. Code, tit. 18, reg. 17561, subd. (a) (4); Treas. Reg. 1.446-1(a)(4).) In the absence of such records, the taxing authority is authorized to compute income by whatever method will, in its opinion, clearly reflect income. (Rev. & Tax. Code, § 17561, subd. (b); Int. Rev. Code of 1954, § 446(b); Breland v. United States, 323 F.2d 492; Harold E. Harbin, 40 T.C. 373.) The taxing authority's determination of a deficiency is presumptively correct, and the burden is on the taxpayer to prove that the correct income was an amount less,than that on which the deficiency assessment was based. (Kenney v. Commissioner, 111 F.2d 374.)

No particular method of reconstructing income is required of the taxing authority, as the circumstances will vary in individual cases. (Harold E. Harbin, supra.) 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.) In the absence of accounting records, the Commissioner of Internal Revenue has reconstructed the income of a motel on the basis of the number of fresh sheets rented by the motel during the taxable year (Agnellino v. Commissioner, 302 F.2d 797), and ... a gambler's income for one year on the basis of adding machine tapes for only four days of betting operations where that was the only information available, (Isaac T. Mitchell, T.C. Memo., June 27, 1968, aff'd, 416 F.2d 101.)

In view of the principles and precedents set forth above, and considering appellant's failure to offer any evidence to contradict respondent's reconstruction of his income, we must sustain respondent's action in denying the requested refund.

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,

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IT IS **HEREBY ORDERED, ADJUDGED AND DECREED,** pursuant to section 19060 of the Revenue and Taxation Code, that the action of the Franchise Tax Board in denying the claim of Walter L. Johnson for refund of personal income tax in the amount of $252.00 for the year 1970, be and the same is hereby sustained.

Done at Sacramento, California, this 17th day of September, 1973, by the State Board of Equalization.

_____, **Chairman**

_____, **Member**

_____, **Member**

_____, **Member**

_____, Member

ATTEST : _____, Secretary