BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
ROBIN L. PREWITT)

For Appellant: Robin L. Prewitt, in pro. per.

For Respondent: Bruce W. Walker
Chief Counsel

Timothy W. Boyer
Counsel

O P I N I O N

This appeal is made pursuant to sections 18646 and 18594 of the Revenue and Taxation Code from the action of the Franchise Tax Board in denying the petition of Robin L. Prewitt for reassessment of a jeopardy assessment of personal income tax in the amount of $2,800 for the period beginning January 1, 1968, and ending September 13, 1968.

The principal issue is whether respondent's reconstruction of appellant's alleged income from narcotics sales is reasonable.

On August 28; 1968, a police informant received 13.9 grams of methamphetamine from one Jane Roe[1/] as a "free sample." The informant told officers of the San Mateo Police Department about the gift, advising the officers that Jane Roe, her boyfriend John Doe, and appellant Robin L. Prewitt were dealing in dangerous drugs. An undercover policewoman was then assigned to investigate the trio for possible violations of the narcotics laws. At this time appellant was also being investigated by the San Carlos Police Department concerning a recent theft of 200 pounds of amphetamine from a chemical, company.

During the next two weeks the undercover policewoman made two "buys" from John Doe and Jane Roe. In the first "buy," which took place on September 3, she purchased 85 grams of methamphetamine from them for $375 in marked bills. The second "buy" occurred on September 12 under the following circumstances. The undercover officer first telephoned John and arranged to purchase one pound of the drug from him for $1,100. John then drove to appellant's home in Redwood City, which &as under surveillance. After spending a few minutes inside the house John emerged carrying a brown paper bag, went to meet the undercover officer, and completed the sale. For some reason not explained in the record, John reduced the selling price to $1,000, which the officer paid in marked bills.

Immediately after the second "buy," the undercover policewoman asked John if he could obtain an additional, five pounds of amphetamine. John said he could provide the officer with five pounds of high quality dextroamphetamine for $1,500 per pound, but that there would be a 45 minute delay because he would have to go to Redwood City to pick up the drugs.

1/ 'Respondent has reque'sted that, in cases involving alleged narcotics sales., the names of persons not party to the appeal be kept confidential.

He explained that he was "in partnership" and "had the stuff stashed." After attempting unsuccessfully to telephone appellant, John then drove to appellant's house in Redwood City and went inside. When he attempted to leave the area a short time later, he was apprehended by the police officers who had been watching appellant's residence. The officers then entered the residence and arrested appellant.

At the time of the arrest, police officers discovered the following items, inter alia, on appellant's person or in his home: A large quantity of illegal weapons; 34 grams of methamphetamine; 6.4 grams of dextro-amphetamine; $700 in marked bills, later identified as part of the $1,000 which the undercover policewoman had given to John Doe; and an additional $991 in unmarked bills. Appellant was subsequently charged with, and convicted of, one count of unlawful possession of a machine gun and one count of possession of restricted drugs.

Respondent issued the jeopardy assessment in question on September 13, 1968, the day following appellant's arrest. Soon thereafter respondent requested appellant's employer to turn over any wages due to appellant. The employer replied that appellant had been on medical leave since July 2, 1968, that he had not received a paycheck since that date, and that he was therefore entitled to a total of $344.70 in back wages and accrued vacation credits. The employer forwarded that amount to respondent. Respondent also acquired the $991 in unmarked bills which had been seized by the police when appellant was arrested. Respondent applied this money, a total of $1,335.70, in partial satisfaction of the jeopardy assessment. Appellant subsequently petitioned for a reassessment and requested a refund of the money seized from him, but the petition was denied. This appeal followed.

If a taxpayer does not maintain adequate accounting records, respondent may reconstruct his income by whatever method will, in its opinion, clearly reflect

income. (Rev. & Tax. Code, § 17561,. subd. (b).) 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 assumed that appellant, John Doe, and Jane Roe had been selling drugs as a "partnership" from August 1, 1968, up to and including the day of the arrest. Respondent next assumed that the trio had sold an average of one pound of drugs each day for an average selling price of $1,100 per pound. From this respondent concluded that the trio had earned $50,640 in gross receipts from drug sales. Finally, respondent assumed that appellant had received a 70 percent share of the gross receipts, or $35,450.[2/] Respondent treated all this latter amount, without any deductions or exclusions, as taxable income to appellant.

The method which respondent used to reconstruct appellant's income may be termed the "projection method." A reconstruction based on this method, if reasonable, is presumed correct, and the taxpayer bears the burden of showing wherein it is erroneous. (Appeal of Walter L. Johnson, Cal. St. Bd. of Equal., Sept. 17, 1973.) The presumption is rebutted, however, if the taxpayer shows that the reconstruction is based on assumptions which are not supported by the evidence. (Appeal of David Leon Rose, Cal. St. Bd. of Equal., March 8, 1976.) As we explained in the Appeal of Burr McFarland Lyons, decided this day:

2/ Respondent's arithmetic is in error. There are 43 days in the period August 1, 1968, through September 12, 1968, inclusive. Sales of one pound per day at $1,100 per pound therefore amount to $47,300; of which a 70. percent share would be $33,110.

> . . . 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. (Citation.) If such evidence is not forthcoming, the assessment is arbitrary and must therefore be reversed or modified. (Citation.)

For the reasons expressed below, we have determined that some of the assumptions underlying the reconstruction in this case are without support in the record, and that the assessment is therefore excessive and must be modified.

The record reveals that police officers began to investigate appellant's involvement in narcotics sales on August 28, 1968. On that date an informant told the police that appellant, John Doe, and Jane Roe were dealing in dangerous drugs. Subsequent investigation indicated that this information was correct. Although appellant was not directly involved in the sales to the undercover officer, John referred to his "partner" in Redwood City, attempted to telephone appellant while negotiating the sale of five pounds of dextroamphetamine, and twice drove to appellant's home apparently to pick up drugs. Moreover, appellant had a large amount of cash in his possession when he was arrested, even though he had not received a paycheck from his employer in over two months. Some of that cash was money that the police had used to purchase drugs from John Doe. Taken together, these circumstances create a reasonable inference that appellant, John Doe, and Jane Roe were dealing in narcotics during the 16 days from August 28 through September 12. There is no evidence, however, to implicate appellant in any narcotics transactions prior to August 28. To the extent that respondent's assessment includes income allegedly received prior to that date, therefore, it is without foundation and excessive. [Appeal of David Leon Rose, **supra.**]

The assumption that appellant and his associates sold an average of one pound of drugs per day is also without foundation. Respondent argues that this assumption is reasonable because police officers suspected appellant of

being a "major Bay Area drug salesman who engaged in the illicit traffic several times a week." The officers' suspicions, in turn, seem to have been based on their belief that appellant had stolen 200 pounds of amphetamine from a drug company. The record is devoid of any evidence to support these suspicions and beliefs, however. Such suspicions, since they are neither explained in nor supported by the record, are an insufficient basis on which to assume that the trio's sales averaged one pound per day.

Considering the record as a whole, there *is* evidence from which it may reasonably be inferred that *the* trio sold an average of 0.6 pounds of drugs per day. We refer to the fact that John Doe sold 85 grams (about .19 pounds) on September 3 and one pound on September 12, an average of approximately 0.6 pounds. While we recognize that a two-day sample is not an entirely trustworthy basis for estimating the normal level of a taxpayer's business activity, we believe it is acceptable under the circumstances of this case. Where, as here, there is evidence of drug sales over a 16-day period, it is not unreasonable to consider a two-day sample as representative of the entire 16 days, absent evidence to the contrary. (Hamilton v. United States, 309 F. Supp. 468, 472-473 (S.D.N.Y. 1969), aff'd, 429 F.2d 427, cert. denied, 401 U.S. 913 [27 L. Ed. 2d 812]; Isaac T. Mitchell, T.C. Memo., June 27, 1968, aff'd, 416 F.2d 101, cert. denied, 396 U.S. 1060 [24 L. Ed. 2d 754.1.)

The remaining assumptions which underlie respondent's reconstruction find some support in the record. The assumption that the trio sold drugs for an average selling price of at least $1,100 per pound is justified by the following evidence: The price for the September 3 sale, 85 grams for $375, is approximately equal to $2,000 per pound; the negotiated price for the sale of one pound on September 12 was $1,100, later discounted to $1,000; and the price for the proposed five pound sale on September 12 was $1,500 per pound. The assumption that appellant received a 70 percent share in the sale proceeds is also reasonable, since appellant, when he was arrested, had in his possession $700 of the $1,000 received from the September 12 sale.

To sum up, the evidence before us creates a reasonable inference that appellant and his associates earned $10,560 in gross receipts from drug sales during the period August 28 through September 12, 1968, computed by assuming that they sold an average of 0.6 pounds of drugs per day at $1,100 per pound. It is also reasonable to assume that appellant received 70 percent of those receipts, or $7,392. 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 McFarland Lyons, supra.)

The conclusion that the reconstruction is reasonable does not necessarily 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 0. and Sharon J. Stohrer, decided this day.) In an attempt to meet this burden, appellant claims that the $700 in marked bills, which were discovered in his possession when he was arrested, had been given to him by John Doe as repayment of a loan rather than as payment for drugs. Appellant's allegation is not supported by any evidence, however, and it is also unconvincing when weighed against the other evidence of his involvement in drug sales. Accordingly, we conclude that appellant has failed to establish that the modified assessment is erroneous.

Finally, there is one additional issue which deserves to be mentioned. In computing appellant's taxable income from narcotics sales, respondent followed its standard practice and did not allow any exclusion from gross receipts for the cost of goods sold. As we indicated in the Appeal of Peter 0. and Sharon J. Stohrer, supra, respondent's practice in this regard is of questionable validity. In this case appellant has not raised the issue, but if he now wishes to do so he may file a timely petition for rehearing.

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,

Appeal of Robin L. Prewitt

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 protest of Robin L. Prewitt against a jeopardy assessment of personal income tax in the amount of $2,800 for the period beginning January 1, 1968, and ending September 13, 1968, be and the same is hereby modified in accordance with this opinion. In all other respects the action of the Franchise Tax Board is sustained.

Done at Sacramento, California, this 15th day of December, 1976, by the State Board of Equalization.

_____, Chairman

_____, Member

_____, Member

_____, Member

_____, Member

ATTEST: _____, Executive Secretary