



BEFORE THE STATE: BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
ESTATE OF LAWRENCE FOLEY, DECEASED)

Appearances:

For Appellant: Bruce W. Stilson
 Attorney at Law

For Respondent: David M. Hinman
 Counsel

O P I N I O N

This appeal is made pursuant to section 18594 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of the Estate of Lawrence Foley, Deceased, against proposed assessments of additional personal income tax and fraud penalties in the following amounts for the years specified:

<u>Year</u>	<u>Proposed Assessment</u>	<u>Fraud Penalty</u>
1964	\$ 713.71	\$ 535.29
1965	2,345.26	1,172.63
1966	2,356.43	1,178.22

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and pursuant to section 18646 of the Revenue and Taxation Code from the action of the Franchise Tax Board in denying the petition of the Estate of Lawrence Foley, Deceased, for reassessment of jeopardy assessments of personal income tax in the amounts of \$14,000.00 and \$24,351.59 for the periods beginning January 1, 1967, and ending September 25, 1967, and September 27, '1367, respectively.

Lawrence Foley (hereinafter Foley) was arrested in September 1967 on various drug-related charges, Upon learning of the arrest respondent terminated Foley's 1967 taxable year and issued the two jeopardy assessments in question. Thereafter respondent reconstructed Foley's income for the years 1964 through 1967 by the net worth method, and issued the proposed assessments of tax and fraud penalties under appeal. Subsequently, however, the Internal Revenue Service (hereinafter IRS) performed an independent net worth reconstruction of Foley's income for those years. The IRS's computation of Foley's taxable income for the year 1967 was substantially lower than respondent's, and in addition the IRS assessed negligence penalties against Foley but not fraud penalties. Respondent accordingly revised its assessments to conform to the federal action. Respondent has informed us that the revised assessments are as follows:

<u>Year</u>	<u>Assessment</u>	<u>Negligence Penalty</u>
1964	\$ 7 1 3 .71	\$214.12
1965	2,345.26	117.26
1366	2,356.43	117.02
1967	16,087.52	804.38

Foley died in jail while awaiting trial on the above mentioned drug charges, and his estate has filed this appeal. The issues presented are: (1) whether respondent's revised estimate of Foley's taxable income, based upon the federal net worth reconstruction, was arbitrary and excessive; (2) whether Foley was married and therefore entitled to file joint returns during the appeal years; and (3) whether respondent's jeopardy assessment procedures are unconstitutional. Additional facts will be set forth in our discussion of these issues.

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(1) The net worth reconstruction

Both the state and federal income tax regulations require each taxpayer to maintain such accounting records as will enable him to file a correct return. (Cal. Admin. Code, tit. 18, reg. 17561, subd. (a) **(4)**; Treas. Reg. **§ 1.446-1(a)(4)**.) Where the taxpayer's records are **missing**, incomplete or inaccurate, the taxing agency may reconstruct his income by whatever method will, in its opinion, clearly reflect income. (Rev. & Tax. Code, **§ 17561**, subd. **(b)**; Int. Rev. Code of 1954, **§ 446(b)**.) Mathematical exactness is not required (Harold E. Harbin, 40 T.C. 373, 377 (1963)), but if the reconstruction is shown to be excessive, the reviewing authority may revise the computation on the basis of the available evidence. (Appeal of David Leon Rose, Cal. St. Bd. of Equal., March **8**, 1976.) Where, as **here**, respondent's determination of the **taxpayer's** income is based on changes made to his federal returns by the IRS, the taxpayer "shall concede the accuracy of such determination or state wherein it is erroneous." (Rev. & Tax. Code, **§ 18451**.)

Based on the IRS's net worth analysis, respondent determined that Foley had earned over \$100,000 in unreported taxable income during the appeal years. Appellant contends, generally, that this determination is unreasonable because it conflicts with the income shown on Foley's accounting records and tax returns. Appellant also argues that if Foley had in fact earned that much money, he would have been able to post bail on the drug charges instead of awaiting trial in jail.

Foley's failure to post bail, while relevant, does not establish that respondent's estimate of his income **is** erroneous. Furthermore, with regard to Foley's accounting records, appellant makes the following statement on page 4 of its memorandum of points and authorities:

Any errors in reporting were due to a failure of Mr. Foley to accurately **account** to his accountant, .. **Such** errors are to be expected in the case of a man of Mr. Foley's propensities as his dealings

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involved **large** amounts of **money**, illegal transactions and frequent and casual transfer of large sums of money, often while drunk.

While this statement perhaps falls short of an admission that Foley's accounting records are not accurate, it certainly indicates that they are unreliable. Under the circumstances any conflict between Foley's books and the IRS's reconstruction must be resolved against appellant. (See Merritt v. Commissioner, 301 **F.2d** 484 (5th Cir. 1962); Morris Lipsitz, 21 T.C. 917 (1954), affd., 220 **F.2d** 871 (4th Cir. 1955).)

Appellant also objects to two specific items in the net worth reconstruction: First, the treatment of a mortgage on certain real property owned by Foley; and second, the failure to allow any deduction for alleged gambling losses.

The real property in question, which is located on Oak Street in San Francisco, was purchased by Foley for **\$260,064.31** sometime in 1965. Foley apparently paid part of the purchase price as a down payment and borrowed the remainder. The indebtedness was secured by two trust deeds on the property. Thereafter the market value of the property declined sharply, and in 1967 Foley obtained a settlement of the note secured by the second deed of trust, which at **that** time had a face value of **\$54,813.70**, for approximately \$24,000.

In its net worth analysis the IRS valued the Oak Street property at its cost basis, **\$260,064.31**, reduced by the outstanding liabilities on the property. When the second note was settled in 1967, the IRS correctly reduced the outstanding liabilities by the face value of the **note**, but failed to make any adjustment to the cost basis of the property. The action was erroneous. Under the circumstances of this case, the settlement of the second note was in substance an adjustment to the purchase price and should have been treated as such. (See Hirsch v. Commissioner, 115 **F.2d** 656 (7th Cir. 1940); Inter-City Television Film Corp., 43 T.C. 270 (1964); Brighton Recreations, Inc., ¶ 61,029

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P-H Memo. T.C. (1961).) Respondent's assessment for 1967 shall be modified accordingly.

With regard to the alleged gambling losses, subdivision (d) of Revenue and Taxation Code section 17206 provides that "[l]osses from wagering transaction [sic] shall be allowed only to the extent of the gains from such transactions." This subdivision is essentially identical to section 165(d) of the Internal Revenue Code of 1954. In order to establish his right to a deduction under these provisions, the taxpayer must show by competent evidence that he in fact sustained the alleged losses, and that his winnings from gambling equaled or exceeded the alleged losses. (Stein v. Commissioner, 322 F.2d 78 (5th Cir. 1963); Henry Zooloomian, ¶ 69,107 P-H Memo. T.C. (1969).)

Foley reported \$170,000 as income from gambling on his original 1967 California personal income tax return. Foley did not keep accurate records of his gambling activities, however, and his accountant states that the \$170,000 figure was merely an estimate. Subsequently Foley filed an amended 1967 return claiming \$100,000 as gambling losses. Respondent disallowed the entire deduction.^{1/}

1/ At the oral hearing in this matter, much of the argument was directed toward the treatment of the alleged gambling losses in respondent's net worth reconstruction. It appeared that respondent had added the alleged losses to Foley's income as "nondeductible expenditures." (But see Bodoglau v. Commissioner, 230 F.2d 336, 341 (7th Cir. 1956).) However, since respondent has revised its assessment to conform to the federal net worth reconstruction, and since it does not appear that the alleged losses were added to income in the federal reconstruction, the point is moot.

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In partial support of the deduction, appellant alleges that \$17,000 in checks which Foley issued payable to "cash " represent gambling losses. No evidence has been submitted to prove this allegation, however. Moreover, appellant admits that Foley was engaged in many other income-producing activities, both legal and illegal, in addition to gambling. There is no evidence in the record to show what portion of Foley's income, if any, was in fact attributable to gambling rather than these **other** activities. **Absent** proof of the alleged gambling losses, and absent proof of the amount of gambling winnings against which such losses might be offset, we conclude that the claimed deduction was properly disallowed; (Henry Zooloomian, supra.)

(2) Foley's marital status

During the appeal years Foley lived with a woman named Dolores Moore, also known as Dolores Foley, allegedly his common-law wife. Respondent determined that Foley was not entitled to file joint returns, however, because there was no proof of the common-law marriage.

At the oral hearing in this matter Foley's former attorney testified, from personal knowledge, that prior to 1964 Foley and Dolores Moore had lived together in Texas and had there held themselves out to the public as being married. Under Texas law, such facts support an inference that the couple had agreed presently to become man and wife, and that they had therefore entered into a valid common-law marriage. (Rush v. Travelers Insurance Co., 347 S.W.2d 758 (Tex. Civ. App. 1961).) Such a marriage is recognized in California. (Civ. Code, § 4104; Colbert v. Colbert, 28 Cal. 2d 276 [169 P.2d 6331 (1946)].) We conclude that Foley was married during the appeal years and was therefore entitled to file joint returns for those years.

(3) Respondent's jeopardy assessment procedures

Respondent collected a total of **\$38,351.59** in cash under the two jeopardy assessments for 1967. Appellant contends that the jeopardy assessment procedures are unconstitutional because this money was collected before

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Foley was afforded an opportunity for a hearing on the validity of the assessments.

It is the policy of this board to refrain from deciding constitutional questions in cases involving proposed assessments of additional tax. (Appeal of Maryland Cup Corp., Cal. St. Bd. of Equal., March 23, 1970.) Although there is some question as to whether this policy should be invoked in jeopardy assessment cases, we need not resolve that question here, since the constitutional issue raised by appellant is clearly without merit. In Dupuy v. Superior Court, 15 Cal. 3d 410 [124 Cal. Rptr. 900; 541 P.2d 5401 (1975)], the California Supreme Court specifically upheld the constitutionality of a prehearing seizure of the taxpayer's assets pursuant to a jeopardy assessment. The federal cases on which appellant relies (e.g., Laing v. United States, 423 U.S. 161 [46 L. Ed. 2d 416] (1976)) are not to the contrary, since they deal with an aspect of the federal jeopardy procedures which has no counterpart in the California Revenue and Taxation Code.

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 18595 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of the Estate of Lawrence Foley, Deceased, against proposed assessments of additional personal income tax and fraud penalties in the following amounts for **the years specified:**

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and the action of the Franchise Tax Board in denying the petition of the Estate of Lawrence Foley, Deceased, for reassessment of jeopardy assessments of personal income tax in the amounts of **\$14,000.00** and **\$24,351.59** for the periods beginning January 1, 1967, and ending September 26, 1967, and September 27, 1967, respectively, be and the same are hereby modified to reflect the revised assessments conforming With the federal action and in accordance with the attached opinion.

Done at Sacramento, California, this **26th day** of July, 1977, by the State Board of Equalization.

William W. Bennett Chairman
John A. Geor, Member
Mr. [unclear], Member
John [unclear], Member
[unclear], Member