BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
GEORGE H. AND MIRIAM B. DURLESTER)

For Appellants: George H. Durlester, in pro. per.

For Respondent: James W. Hamilton
Acting Chief Counsel

Paul J. **Petrozzi**
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 George H. and Miriam B. Durlester against proposed assessments of personal income tax and penalties in the following amounts for the years specified:

Year	Tax	Fraud Penalty	Delinquency Penalty
1969	**$3,133.26**	**$1,566.63**	$783.31
1970	**2,848.84**	**1,424.42**	

Subsequent to the filing of this appeal, respondent conceded that the fraud penalties are improper and should be withdrawn. The issues remaining for decision are: (1) whether respondent erred in its reconstruction of appellants' income for the years in question; and (2) whether the delinquency penalty for failure to file a timely return for the year 1969 was properly imposed.

Appellants, husband and wife, are California residents. George H. Durlester (hereinafter appellant) is employed in a supervisory position with a cannery in Stockton, California. Respondent, after searching its own records, concluded that it had never received an income tax return from appellant for the year 1969. Upon further investigation, including a review of records of the bank where appellant maintains a checking account, respondent also discovered that appellant's bank deposits in the years 1969 and 1970 substantially exceeded the amount of his net salary income.

When respondent asked appellant to explain these bank deposits, appellant stated that some of them represented loans. He also admitted that during the appeal years he had gambled extensively (principally in gin rummy games) at a country club to which he belongs. Any winnings from these games were usually paid to appellant by check, With the payee designated as "Cash," and appellant customarily deposited such winnings in his checking account. He also paid most of his gambling losses by checks issued to "Cash." Appellant did not keep accurate records of his winnings and losses, however, nor did he retain his cancelled checks nor maintain an adequate check register.

Because of the inadequacy of appellant's records, respondent reconstructed his taxable income for the years in question. It employed a version of the bank deposits and cash expenditures method. Under this method, taxable income is determined by: (1) totaling bank deposits for the year in question which the taxpayer is unable to identify as originating from a nontaxable source: (2) adding thereto undeposited gross receipts which likewise have not been identified as originating from a nontaxable source: and (3) subtracting any allowable exclusions or deductions. (See Percifield v. United States, 241 F.2d 225 (9th Cir. 1957); Plotkin, Government Theories of Proof in Tax Fraud: An Analysis of Most-Used Methods, 37 J. Tax. 211, 212 (1972).)

Using this method, respondent determined that appellant had received gross receipts of $51,314 and $88,211 in 1969 and 1970, respectively. It determined further that these receipts came from the following sources:

Year	Loans	Employer	Gambling and Other Unidentified
1969	$10,443	$32,648	$ 8,223
1970	29,873	30,422	27,916

Finally, respondent determined that appellant was not entitled to any deductions for alleged gambling losses. The proposed assessments in question were based on these determinations.

The use of the bank deposit method of reconstructing income where the taxpayer's records are inaccurate or incomplete has long been sanctioned by the courts. (See, e.g., Goe v. Commissioner, 198 F.2d 851 (3d Cir. 1952), cert. den., 344 U.S. 897 [97 L. Ed. 6931 (1952); Hague Estate v. Commissioner, 132 F.2d 775 (2d Cir. 1943), cert. den., 318 U.S. 787 [87 L. Ed. 1154] (1943).) While the mere proof of bank deposits does not establish the receipt of income, evidence linking bank deposits with an identified income-producing activity is one method of creating an inference that the deposits represent income. (Gleckman v. United States, 80 F.2d 394 (8th Cir. 1935), cert. den., 297 U.S. 709 [80 L. Ed. 996] (1936); see also Hague Estate v. Commissioner, supra: Goe v. Commissioner, supra.) Moreover, a reasonable reconstruction by this method is presumed correct, and the taxpayer has the burden of disproving the computation. (Estate of Mary Mason, 64 T.C. 651 (1975).) For the reasons expressed below, we conclude that appellant has failed to meet this burden for the most part, but that he has successfully shown that the reconstruction is erroneous in two respects.

Appellant first contends that the reconstruction of gross receipts was excessive because it counted some items twice, that is, amounts which he allegedly deposited in his checking account, withdrew, and then redeposited at a later date. He also contends that the receipts which respondent attributed to gambling and other taxable sources erroneously included nontaxable loans. In support of these contentions appellant has offered "analysis sheets" purporting to show the source of ail his bank

deposits. Appellant prepared these "analysis sheets" after respondent contacted him, however, and since he admittedly did not keep accurate, contemporaneous financial records, the "analysis sheets" are presumably no more than self-serving estimates and guesses. Moreover, respondent has already attributed large portions of appellant's receipts to nontaxable loans. Absent reliable evidence of redeposits or of loans in excess of those already allowed, we must reject appellant's contentions on these points. (Pearl Zarnow, 48 T.C. 213 (1967).)

Appellant also contends that some of the bank deposits which respondent treated as gambling receipts were in fact contributions to a partnership or joint venture. He states that he received $2,750 in 1969 and $14,962 in 1970 from a Mr. Arthur Samuels, a business acquaintance, upon the condition that he and Samuels would share any proceeds from gambling with this money. Respondent concedes that appellant received these amounts from Samuels, but contends that the money was part of appellant's gambling winnings and not advances to a partnership or joint venture.

In a statement made to respondent's auditors, Samuels substantially corroborated appellant's story. This statement is particularly impressive since it was against Samuels' own interest and could have resulted in attributing some income from gambling to him. 1/ Moreover, appellant seems to have been at least a moderately successful gambler, and it is therefore not inherently incredible that Samuels would have chosen to bankroll him. Respondent has introdueed no evidence which Would lead us to disbelieve Samuels' statement. Accordingly, we conclude that the amounts appellant received from Samuels were not gambling winnings and should have been treated as nontaxable receipts. (Cf. Edgar Mercer Burleson, ¶ 53,279 P-R Memo. T.C. (1953).)

1/ In this appeal, however, appellant does not claim that any of his alleged gambling winnings were attributable to the partnership. In fact, he states that he earned no net winnings from gambling with Samuels' money.

Appellant next relies on subdivision (d) of Revenue and Taxation Code section 17206, which allows a deduction for gambling losses to the extent of gambling winnings. He contends that his winnings during the appeal years were entirely offset by losses. Again, however, he has offered in evidence only the "analysis sheets", which we have already rejected as being unreliable. Because of the lack of evidence, we cannot conclude that appellant is entitled to deductions for gambling losses in the amounts claimed.

However, we also cannot accept respondent's conclusion that appellant is entitled to no gambling loss deductions at all. It is a matter of common knowledge that one who gambles as extensively as appellant, even though he may have net winnings over a period of time, will invariably suffer losses at some of his gaming sessions. (See Corum's Estate v. Commissioner, 260 F.2d 551, 552 (6th Cir. 1958).) In our opinion respondent's failure to recognize that appellant sometimes lost at gin rummy, and that such losses at least partially offset the winnings he deposited in his checking account, is unreasonable. (Martin Goldfield, ¶ 67,129 P-H Memo. T.C. (1967).) Moreover, the courts have consistently made allowances for gambling losses even where the taxpayer's records are meager or nonexistent. (See, e.g., Herman Drews, 25 T.C. 1354 (1956); Dominic J. Fiaschetti, ¶ 67,033 P-H Memo. T.C. (1967); Harold E. Harbin, ¶ 58,190 P-H Memo. T.C. (1958).) On the basis of the available evidence, and bearing in mind that appellant's failure to keep adequate records must be counted against him, we conclude that appellant suffered deductible gambling losses in the amount of $300 in 1969 and $2,000 in 1970. (See Mitchell v. Commissioner, 416 F.2d 101 (7th Cir. 1969); Harry Bennett, ¶ 68,071 P-H Memo. T.C. (1968); B. H. Bickers, ¶ 60,083 P-H Memo. T.C. (1960); Martin Goldfield, supra.)

The cases upon which respondent relies to justify total disallowance are inapposite. In Oswald Jacoby, ¶ 70,244 P-H Memo. T.C. (1970), the court in fact partially allowed claimed losses. In Plisco v. United States, 306 F.2d 784 (D.C. Cir. 1962), there was no evidence of the taxpayer's gross income and an estimate of losses could not be made. Here, however, respondent's own reconstruction is evidence of appellant's gross income. (Cf. Harry Bennett, supra,)

The final issue is whether the failure to file penalty was properly imposed. This penalty is authorized by section 18681 of the Revenue and Taxation Code. Appellant contends that he did file a timely return, but he has presented no evidence to support this contention. Since he bears the burden of proof on this issue (Appeal of Thomas T. Crittenden, Cal. St. Bd. of Equal., Oct. 7, 1974), we must accordingly hold in favor of respondent.

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 $8595 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on'the protest of George H. and Miriam B. Durlester against proposed assessments of personal income tax and penalties inthe following amounts for the years specified:

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be and the same is hereby modified in accordance with respondent's withdrawal of the fraud penalties and in accordance with the views expressed in this opinion. In all other respects respondent's action is sustained.

Doneat Sacramento, California, this 28th day of September , 1977, by the State Board of Equalization.

_____, Chairman

_____, Member

_____, Member

_____, Member

_____, Member