

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the **Matter of** the Appeal of)
) **No. 84J-321-MA**
JESUS V. JACOBO)
aka **JESSIE JACOBO**)

For Appellant: John M. Kappos
 Attorney at Law

For Respondent: Philip **M. Farley**
 Counsel

O P I N I O N

This appeal is made pursuant to section **18646^{1/}**
of the Revenue and Taxation Code from the action of the
Franchise Tax Board in denying the petition of Jesus V.
Jacobo aka Jessie **Jacobo** for reassessment of a jeopardy
assessment of personal income tax in the amount of \$2,172
for the period January **1**, 1982, through September 22,
1982.

1/ Unless otherwise specified, all section references
are to sections **of** the Revenue and Taxation Code as in
effect for the period in issue.

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The issues presented by this appeal are whether appellant received unreported income from illegal sales of heroin during the period under appeal and, if so, whether respondent properly reconstructed the amount of that income.

On January 24, 1982, the Stockton Police Department (SPD) received information that a person was selling narcotics from a residence at 2258 East Lafayette in Stockton. On January 25, 1982, a confidential reliable informant (CRI) identified a photograph of appellant as the person selling narcotics at this address. The police instituted surveillance and observed "short-stay" drug traffic entering and leaving the house.

On February 10 and February 21, 1982, police intelligence indicated that appellant and a Robert Patron were still dealing heroin and that appellant was receiving heroin from one Boo Boo **Macias**.

On February 22, 1982, a CRI, furnished with city funds, made a controlled buy of heroin from appellant at his residence at 2258 East Lafayette. The police information indicated-appellant was carrying his heroin in a gray and black film container. On February **25**, 1982, a search warrant was secured for the appellant's address at 2258 **E.** Lafayette, Stockton, California.

On March 4, 1982, police received information from a **CRI** that appellant was still dealing heroin from his residence. The **CRI** stated he observed in excess of **30** bags containing approximately one-half gram of heroin each at that location. The SPD served their search warrant and searched appellant's residence; arrested several people as being under the influence of an opiate; and seized seven bottles of methadone and two hypodermic syringes. Police officers found an empty film container near the back door of the residence where appellant attempted to escape. The police concluded appellant had eaten the heroin contents before the police were able to enter.

On **May 14**, 1982, a **CRI** revealed that a David **Mazzetti** was supplying narcotics to **Stanley Munoz**, Boo Boo Macfas, and appellant. On September 9, 1982, police received information that a Gordon Miller from Modesto was coming into town and supplying appellant drugs on a daily basis. On September 22, 1982, police observed appellant making narcotics transactions at Stribley Park in Stockton. When police approached, appellant was

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observed throwing two balloons on the ground in front of him. Appellant was arrested and charged with possession of heroin for sale. The contents of the balloons tested positive for heroin. The amount of heroin found in the balloons was reported to be 1.5 grams. Later, appellant's probation report indicated the amount was **.70** grams of heroin. Police seized \$1,887 from appellant which was later turned **over** to respondent.

As a result of information obtained from arrest reports, surveillance reports, a confidential reliable informant, and search warrants and supporting affidavits, respondent determined that appellant had made sales 'of controlled substances during the period February 22, 1982, through September 22, 1982, resulting in taxable unreported California income of \$42,400. It was further determined that the collection of tax would be jeopardized in whole or in part by a delay in the assessment. A jeopardy tax assessment was issued for \$3,379.

The **determination of** taxable income was reached by calculating appellant's sales at two grams of heroin per day valued, pursuant to information from Western States Information Network (WSIN), at \$100 per gram. The WSIN compiles an index which lists the median price of various street drugs by area. (See Resp. Br., Ex. P.)' The \$100 price per gram was multiplied by two grams, the amount of heroin appellant allegedly sold per sale, and again by the number **of** days in the activity **per** 2/ **(212)**, thus arriving at an income of \$42,400.

This finding was based upon the quantity of heroin seized from the appellant at the time of his September 22, 1982 arrest (1.5 grams packaged in two balloons), and the two sales observed by police just prior to his arrest. The activity period used began with the controlled buy by the **CRI** on February 22, 1982, terminating with the appellant's arrest on September 22, 1982.

An Order to Withhold was issued **to the** SPD and \$1,887 was received. On October 12, 1982, respondent filed a state tax lien and on October 15, 1982, an Earnings Withholding Order for Taxes was served on the appellant's employer. Appellant protested and requested a hearing. On November 12, 1982, respondent replied,

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2/ **In** addition, appellant earned approximately \$1,835 **during** this period from his job as a forklift operator.

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acknowledging the communication as a petition for reassessment.

On or about January 24, 1983, respondent received a completed Financial Questionnaire and Statement of Financial Condition from appellant. No income was reported from the sale of drugs on the completed questionnaire.

On March 29, 1983, appellant was found guilty of a violation of section 11350 of the Health and Safety Code, possession of heroin, a felony, and later sentenced to six months in jail and five years probation. The conviction was based upon his September 22, 1982, arrest.

On April 28, 1983, after receiving appellant's financial statements, respondent informed appellant that before adjustments to the **assessment** could be made, he would have to make a full disclosure of his income from **drug sales**.

On July 11, 1983, a hearing on appellant's petition for reassessment was held by respondent. As a result, appellant's 1980 and 1981 returns were adjusted to reflect that he was a single person who **had** incorrectly filed jointly, and an abatement was made for 1982 of \$1,207. The amount of the abatement was determined by reducing the estimated drug sales from \$200 to \$100 per day (to reflect sales of one gram of heroin a day at \$100 per gram, leaving a tax owing **for** 1982 of \$2,172. This timely appeal followed.

The initial question presented by this appeal is whether appellant received any income from the illegal sale of heroin during the period in issue. Appellant contends that he was not engaged in the business of selling narcotics and points to the fact that he was eventually convicted **of possession** of heroin and not possession for sale. Respondent points to the following as evidence to support its conclusion that appellant **derived** unreported income from the illegal **sale** of narcotics: (1) police reports and files indicate between 33 and 42 contacts with appellant from 1970 to the date of his arrest in which appellant was suspected of possible narcotics involvement, including a December 1974 arrest; (2) numerous reports from **CRI's** to the SPD that appellant was involved in selling narcotics; (3) short-stay traffic was observed entering and leaving appellant's address which is indicative of drug sale activities (Appeal of Gregory Flores, Sr., Cal. St. Bd. of Equal., Aug. 1, 1984); (4) a

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controlled buy was made by a **CRI** under police **observa-**
tion; (5) a **CRI** observed in excess of 30 bags of heroin
in appellant's home on March 4, 1982; (6) police observed
appellant making what appeared to be a narcotics transac-
tion at the time of his arrest; and (7) additional police
information indicated that appellant was selling as much
as \$500 worth of heroin a day. This evidence, taken
together, establishes at least a prima facie case that
appellant received unreported income from the sale of
heroin during the appeal period. Since appellant has
offered no credible evidence to refute this prima facie
showing, we must conclude that he did receive unreported
income from the sale of illegal drugs during the appeal
period.

The second issue is whether respondent properly
reconstructed the amount of appellant's taxable income
from drug sales.

The California Personal Income Tax Law requires
a **taxpayer** to state specifically the items and amount of
his gross income during the taxable year. Gross income
includes all income from whatever source derived unless
otherwise provided in the law. (Rev. & Tax. Code,
§ 17071.) **Gross** income includes gains derived from ille-
gal activities, including the illegal sale of narcotics,
which must be reported on the taxpayer's return. (United
States v. Sullivan, 274 U.S. 259 [71 L.Ed. 1037] (1927);
Farina v. McMahon, 2 A.F.T.R.2d ¶ 58-5246 (1958).) Each
taxpayer **is required** to maintain such accounting records
as will enable him to file an accurate return. (Treas.
Reg. **§ 1.446-1(a)(4).**) In the absence of such records,
the taxing agency is authorized to compute a taxpayer's
income by whatever method will, in its judgment, clearly
reflect income. (Rev. & Tax. Code, **§ 17561**, subd. (b).)
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 (6th Cir. 1955); Appeal of
John and Codelle Perez, Cal. St. Bd. of Equal., Feb. 16,
1971.) Mathematical exactness is not required. (Harbin
v. Commissioner, 40 T.C. 373, 377 (1963).) Furthermore,
a reasonable reconstruction of income is presumed cor-
rect, and the taxpayer bears the burden of proving it
erroneous. (Breland v. United States, 323 F.2d 492, 496
(5th Cir. 1963); Appeal of Marcel C. Robles, Cal. St. Bd.
of Equal., June 28, 1979.)

In the instant appeal, respondent used the
projection method to reconstruct appellant's income from
the illegal sale of heroin. In short, respondent projected

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projected a **level** of income over a period of time. Because of the difficulty in obtaining evidence in cases involving illegal activities, the courts and this board have recognized that the use of some assumptions must be allowed in cases of this sort. (See, e.g., Shades Ridge Holding Co., Inc. v. Commissioner, ¶ 64,275 T.C.M. (P-H) (1964), affd. sub nom., Fiorella v. Commissioner, 361 F.2d 326 (5th Cir. 1966); Appeal of Burr MacFarland Lyons, Cal. St. Bd. of Equal., Dec. 15, 1976.) It has also been recognized, however, that a dilemma confronts the taxpayer whose income has been reconstructed. Since he bears the burden of proving that the reconstruction is erroneous (Breland v. United States, supra), the taxpayer is put in the **position** of having to prove a negative, **i.e.**, that he did not receive the income attributed to **him**. In order to ensure that use of the projection method does not lead to injustice by forcing the taxpayer to pay tax on income he did not receive, the courts and this board have held that 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); 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 MacFarland Lyons, supra.) 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. Bonauuro, 294 F.Supp. 750, 753 (E.D.N.Y. 1968), affd. sub nom., United States v. Dono, 428 F.2d 204 (2d Cir. 1970).) 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. v. Commissioner, supra.) In such instance, the **reviewing** authority may redetermine the taxpayer's income on the facts adduced from the record. (Whitten v. Commissioner, ¶ 80,245 T.C.M. (P-H) (1980); Appeal of David Leon Rose, Cal. St. Bd. of Equal., Mar. 8, 1976.)

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 SPD to reconstruct his taxable income from such illegal source. In the instant case, the data relied upon by respondent in reconstructing appellant's income was derived from information contained **in** investigative reports by SPD narcotics officers, the arrest report, the affidavit for a search warrant to search appellant's residence, the statements of the **CRI** made to the SPD and

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the probation report prepared prior to appellant's sentencing. On this basis, respondent determined that appellant: (1) had been selling heroin continuously for the period in question; (2) sold heroin for \$100 per gram; (3) sold an average of two grams a day (reduced later to one gram); and concluded that appellant realized an income of \$21,200 from such sales during the appeal period.

As for the first assumption, respondent concluded that appellant was engaged in the illegal sale of heroin for the period beginning February 22, 1982, and ending on the date of his arrest September 22, 1982. This determination was based upon information provided by the SPD after appellant's arrest when respondent issued the original jeopardy assessment. The **SPD received** information that appellant had been selling heroin in December 1981 and **January** 1982. A controlled **buy** was made on February 22, 1982, and appellant's house was searched on March 4, 1982, and police concluded he had ingested the heroin contents. Police continued to receive reports from a **CRI** that appellant was selling heroin.

The evidence clearly indicates that the appellant has been selling drugs for many years. However, respondent has treated the available evidence in a very conservative and judicious manner and assessed the appellant on only seven months. Therefore, we conclude that respondent's first assumption, that appellant sold heroin continuously for the period in question, is reasonable and supported by the evidence.

The second assumption, that appellant sold heroin for \$100 a gram, is supported by the record and is reasonable. As stated previously, respondent determined the street price of heroin by referring to information released from the **WSIN** which tracks street values of drugs for various law enforcement agencies. (**Resp. Br., Ex. P.**)

Respondent's last assumption as to the volume of sales activity is also reasonable. Respondent's estimate of the volume of appellant's sales activity is established by the following facts: (1) On February 2, 1982, a **CRI** purchased two balloons of heroin from the appellant. **When** appellant was arrested on September 22, 1982, he threw two balloons of heroin to the ground. The balloons contained between **.70** and 1.5 grams of heroin worth \$100 per gram. (2) On March 4, 1982, a **CRI** reported

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seeing in excess of 30 bags of heroin at appellant's residence. (3) On November 28, 1982, a CRI reported to police that appellant was selling up to \$500 worth of heroin per day. (4) On December 21, 1982, narcotics agents watched appellant's home between 1:30 p.m. and 3:00 p.m. and saw 11 persons enter, stay a short time, and leave. This short stay traffic is typical of narcotics traffic. (5) Respondent reduced appellant's estimated sales from \$200 to \$100 per day and accordingly abated a portion of the jeopardy assessment. The abatement was based upon the conflict between police reports stating the two balloons thrown away by appellant on September 22, 1982, contained 1.5 grams of heroin (Resp. Ex. N at 4), and the appellant's probation report stating they contained .70 grams of heroin (Resp. Ex. BB at 2). All evidence considered indicates the possibility appellant was selling considerably more.

The evidence is credible since it is composed of evidence seized, appellant's probation report, appellant's conviction, and police reports prepared by officers who had personal knowledge of the facts, who recorded them at or near the time they occurred, and had a duty to report them accurately.

Appellant objects to the use of this evidence on the grounds it is hearsay and, therefore, not admissible in certain forums. While we agree with appellant's characterization of much of the evidence as hearsay, it is nonetheless admissible evidence in a proceeding before this board and sufficient to establish a prima facie case. (See Appeal of Alfred M. Salas and Betty Lee Reyes, Cal. St. Bd. of Equal., Feb. 28, 1984, and numerous cases cited therein.)

Authority exists for reliance upon data acquired from informants to reconstruct a taxpayer's income from illegal activities, provided that there do not exist 'substantial doubts' as to the informant's reliability. (Cf. Nolan v. U.S., 539 F.Supp. 788 (D. Ariz. 1982); see also Appeal of Clarence Lewis Randle, Jr., Cal. St. Bd. of Equal., Dec. 7, 1982.) In the Appeal of Clarence Lewis Randle, Jr., 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 the Appeal of

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Carl E. Adams, decided by this board on March 1, 1983, we sustained respondent's determination which was based on an assumption that the taxpayer had been selling cocaine from his restaurant for 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 10 months, 2 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.

To sum up, the evidence before us creates a reasonable inference that appellant earned approximately \$21,200 selling heroin during the 212-day appeal period. This figure is computed by assuming that appellant sold approximately one gram a day during the **212-day** period and a gram sold for approximately \$100. 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 MacFarland Lyons, supra.) Appellant has presented no credible evidence that the modified assessment is erroneous. We find that **respondent's** projection of appellant's income from the illegal sales of heroin for the year 1982 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 assessment will be sustained.

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' 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 petition of Jesus V. **Jacobo** aka Jessie **Jacobo** for reassessment of a jeopardy assessment of personal income tax in the amount of \$2,172 for the period January 1, 1982, through September 22, 1982, be and the same is hereby sustained.

Done at Sacramento, California, this 6th day of May , 1986, by the State Board of Equalization, with Board **Members** Mr. Nevins, **Mr.** Collis, Mr. Bennett, Mr. Dronenburg and Mr. Harvey present.

Richard Nevins , Chairman
Conway H. Collis , Member
William M. Bennett , Member
Ernest J. Dronenburg, Jr. , Member
Walter Harvey* , Member

*For Kenneth Cory, per Government Code section 7.9