BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
) No. 84J-710-GO
RICHARD E. DAVIS)

For Appellant: Jack I. Mann
Attorney at Law

For Respondent: Philip 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 Richard E. Davis for reassessment of a jeopardy assessment of personal income tax in the amount of $4,767 for the period January 1, 1982, to December 5, 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.

The primary issue is whether respondent properly reconstructed the amount of income appellant received from illegal bookmaking activities during the appeal period. More specifically, the inquiry has been reduced to whether respondent properly attributed a 10-percent bookmaking commission to appellant.

Appellant admits that he was involved in a bookmaking operation in San Diego County during the calendar year 1982. (App. Br. at 1.)[2/] Indeed, an intensive investigation by the San Diego Sheriff's Department and San Diego Police Department indicated that an elaborate bookmaking organization utilized appellant's apartment to receive wagers by telephone during the period at issue. Law enforcement surveillance disclosed that appellant and seven other individuals had, since August 1982, conspired to set up a large scale bookmaking operation. On December 2, 1982, a search warrant was issued for appellant's apartment (Resp. Br., Ex. B) and on December 5, 1982, law enforcement officers did, in fact, search his apartment, which apparently was staffed by appellant and one other individual.

That search produced extensive written records which chronicled wagers by event and date. A summary of the written evidence indicates the following wagers placed in 1982:

Dates	Amounts
November 23 through November 30	$324,668
December 1 through December 5	227,819
Total	$552,487

Average Daily Handle = $42,499

In addition to these written records, various tapes of telephone conversations confirmed the volume of wagers which was placed during that period. A summary of the tape recorded evidence indicates the following confirming wagers:

2/ The record indicates that appellant had a history of bookmaking activity having been arrested on July 3, 1974, and October 25, 1981, in Los Angeles for illegal bookmaking activities.

Dates	Amounts
November 23 through November 28	$224,919
November 29 through December 4	240,017
Total	$464,936

Average Daily Handle = $38,745 (Resp. Br., Ex. C-27.)

Lastly, respondent's review of appellant's personal bank records indicate that $32,892.59 was deposited into his accounts for 1982. (Resp. Br., Ex. D.)

Respondent reviewed its records and found that appellant had never filed a California tax return. Based upon the above information, respondent determined that appellant's bookmaking activities had resulted in unreported taxable California income for at least the period January 1, 1982, through December 5, 1982. Respondent also concluded that collection would be jeopardized in whole or in part by delay in assessment. Based upon police reports, surveillance reports, the appellant's prior history of bookmaking, the search warrant and supporting affidavit and evidence seized, respondent determined appellant's total taxable income to be $67,000 for the period at issue.

After a hearing on a petition for reassessment at which appellant contended he was paid only $1,000 per month plus a bonus for his services in the bookmaking operation, respondent adjusted the assessment to $57,600 for the period at issue. The revision involving the commission was based upon computing a commission of 10 percent of appellant's one-half of the total handle for the period November 1 through December 5, 1982. Denial of appellant's protest led to this appeal.

On appeal, appellant states that he accepts the findings of respondent except that he should not be charged the IO-percent bookmaking commission of $27,517. Appellant argues that it is inconsistent to charge him for the estimated commissions from bookmaking when the record indicates that he was a salaried employee and not one of the principal managers or financial backers of the bookmaking aperation. (App. Br. at 2.) Respondent answers that based upon the documented handle established by written records over a two-week period noted above,

half of which was attributed to appellant,[3] its allocation to him of 10 percent in commissions, or $27,517, based upon only the period for which actual records are available is conservative. Respondent notes that appellant himself admits that he was paid $1,000 per month plus bonuses (Resp. Br., Ex. I) and that the 10-percent figure is a common bonus paid to telephone spots in bookmaking operations. (Emphasis added.) (Resp. Br. at 10.) Accordingly, as framed by the parties, the only issue is the reasonableness of the 10-percent factor.

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 illegal activities, including bookmaking, 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 (P-B) ¶58,5246 at 5918 (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 his 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 correct, 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.)

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., Fiorelba v.

[3] Apparently, the other half was attributed to appellant's co-worker in the telephone operation,

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 this 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.) Stated another way, there must be credible evidence in the record which, if accepted as true, would "induce a reasonable belief" that the amount of tax assessed aqainst the taxpayer is due and owing. (United States v. Bonaquro, 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 such evidence is not f orthcoming, the assessment is arbitrary and must be reversed or modified. (Appeal of Burr MacFarland Lyons, supra; Appeal of David Leon Rose, Cal. St. Bd. of Equal., Mar. 8, 1976.)

As indicated above, appellant admitted that he received a bonus. Moreover, the police report indicates that the employee's salary was based upon a percentage of the total wagers. (Resp. Br., Ex. C-27.) Respondent estimated that bonus at 10 percent of one-half of the documented wagers. Appellant has presented no evidence indicating that his bonus or percentage differed-from that used by respondent. Accordingly, we have no choice but to conclude that appellant has not met his burden of proving that the reconstruction is erroneous, and respondent's action must, therefore, be sustained.

Appeal of Richard E. Davis

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 D E C R E E D , pursuant to section 18595 of the Revenue and Taxation Code, that the action of the Franchise Tax Board in denying the petition of Richard E. Davis for reassessment of a jeopardy assessment of personal income tax in the amount of $4,767 for the period January 1, 1982, through December 5, 1982, be and the same is hereby sustained.

Done at Sacramento, California, this 10th day of September, 1986, by the State Board of Equalization, with Board Members Mr. Nevins, Mr. Collis, Mr. Dronenburg and Mr. Harvey present.

Richard Nevins , Chairman

Conway H. Collis , Member

Ernest J. Dronenburg, Jr. , Member

Walter Harvey* , Member

_____ . Member

*For Kenneth Cory, per Government Code section 7.9