

BEFORE THE STATE BOARD OF EQUALIZATION  
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of )  
JEFFREY PAUL **PULIZZI** ) No. **84J-3-KP**

For Appellant: R i c h a r d **Fannan**  
Attorney at Law

For Respondent: Kathleen **M. Morris**  
Counsel

O P I N I O N

This appeal is made pursuant to section **18646<sup>1/</sup>** of the, Revenue and Taxation Code from the action of the Franchise Tax Board in denying the petition of Jeffrey Paul **Pulizzi** for reassessment of a jeopardy assessment of personal income tax in the amount of \$143,628 for the year 1982.

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

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The issue presented by this appeal is whether respondent properly reconstructed appellant's unreported income for the year at issue.

In November 1982, an informant reported to the Redondo Beach Police Department that appellant was a major supplier of marijuana. After receiving that information, the police became aware that appellant was a fugitive with several outstanding warrants from other states. On January 5, 1983, appellant was arrested while having his hair cut. During the **arrest**, the police seized a bag in appellant's possession which contained 6 **1/2** ounces of marijuana and \$38,950 cash. A search of appellant revealed a slip of paper with three sets of calculations and two separate lists containing the first names of individuals opposite **several** columns of numbers.. Appellant was not charged with any crime in California but was extradited **to Florida** to serve a sentence stemming from a conviction for possession of marijuana for sale.

Upon being notified of appellant's arrest, respondent determined that the collection of appellant's personal income tax for 1982 would be jeopardized by delay. **Respondent** further determined through the projection method of income reconstruction that **appellant's** tax liability was over \$143,000. Upon further review of its **assessment during** the course of this appeal, however, respondent determined that there were insufficient facts to support **this** estimation of income. Respondent modified **its** estimation by determining that the sheet of paper found on appellant during his arrest was a "pay and **owe**" sheet detailing sales of narcotics. Despondent added the figures written on the paper to arrive at its present estimate of income from narcotics sales and adjusted its assessment to reflect a tax liability of \$13,592. During the course of this appeal, appellant has maintained his position that the cash found during his arrest represented taxable income for 1982 but disputes respondent's determination that the figures on the slip of paper signify narcotics sales.

Under the California Personal Income Tax Law, a taxpayer is required to state the items of his gross income during the taxable year. (**Rev. & Tax. Code, S 18401.**) **Except** as otherwise provided by law, gross income is defined to include **"all** income from whatever source derived" (**Rev. & Tax. Code, S 17071**), and it is well established that any gain from the sale of narcotics

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constitutes gross income. (Farina v. McMahon, 2 A.F.T.R.2d (P-H) ¶ 58-5246 (1958).)

Each taxpayer is required to maintain such accounting records as will enable him to file an accurate return, and 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; I.R.C. § 446.) Where a taxpayer fails to maintain the proper records, an approximation of net income is justified even **if** the calculation is not exact. (Appeal of Siroos Ghazali, Cal St. Bd. of Equal., Apr. 9; 1985.) Furthermore, the existence **of** unreported income may be demonstrated by any practical method of proof that is available and it is the taxpayer's burden of proving that a reasonable reconstruction of income **is** erroneous.. (Appeal of Marcel C. Robles, Cal. St. Bd. of Equal., June 28, 1979.)

Due to **the** illegal nature of the sale of narcotics, it is not unusual to find that a drug dealer **does** not keep any records **of his** narcotics sales. When records of drug sales are discovered, they are often written--in such a manner that only a person with intimate knowledge of the illegal activities can decipher the information in those records. (Appeal of Rosa Gallardo, Cal. St. Bd. of Equal., July 29, 1986.) Accordingly, if there is some basis to believe that records discovered during an investigation of a taxpayer's illegal activities relate to those activities, respondent is justified in deciphering and relying on the information contained in those records to reconstruct the taxpayer's income. (Appeal of Rosa Gallards, supra; see **also** Appeal of Mart Conrad Wende, Cal. St. Bd. of Equal., Mar. 1, 1983; Appeal of James Eugene Ely, Cal. St. Bd. of Equal., Sept. 30, 1980.) If, however, **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, ¶ 64,275 T.C.M. (P-H) (1964), affd. sub nom., Fiorella v. Commissioner, 361 F.2d 326 (5th Cir. 1966).) In such instance, the reviewing authority may redetermine the taxpayer's income on the facts adduced from the record. (Mitchell v. Commissioner, 416 F.2d 101 (7th Cir. 1969); Whitten v. Commissioner, ¶ 80,245 T.C.M. (P-H) (1980); Appeal of David Leon Rose, Cal. St. Bd. of Equal., Mar. 8, 1976 .)

Respondent's reconstruction of appellant's income rests upon its determination that the piece of

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paper found on appellant during his arrest was a "pay and owe" sheet. This assumption is based on the fact that the paper was found on a drug dealer and that appellant was found with cash and marijuana. We do not find this assumption persuasive. **There** must be more evidence than the past acts and the character of the appellant to support an interpretation that the papers are records of his **drug** sales; the writing itself must include some indicia that reasonably identifies the recordations as evidencing drug sales. (Appeal of Rosa Gallardo, supra; Appeal of Karliden Sherpa, Cal. St. Bd. of **Equal.**, May 6, 1986.)

There is nothing on the sheet in question which readily supports the conclusion that the figures were records of drug sales or even **that** respondent correctly **interpreted the figures** on the **paper** arrive at its estimate of income. First, the only words on the sheets **are** the first names of individuals and one notation "pd." Second, there were up to three columns following each name. These columns do not appear to bear any relation to each other or to the number listed above or below each notation as would be expected **from a** running total of sales and/or inventory; Furthermore, some of the numbers in the columns do not correspond to any name. -Third, the **three calculations on the sheet do not appear to bear any relation** to any of the listed numbers on the front side of the sheet. Finally, appellant has stated that the three totals on the sheet were rough attempts by him to determine how much cash was in the bag he carried. **There** is nothing in the record to dispute this explanation and his contention is supported by the fact that the **three** totals are within a few **thousand of** each other, and that the calculation on the back side of the sheet figure is almost exactly the amount of cash found on appellant **during his** arrest. (Cf. Appeal of Rosa Gallardo, supra; Appeal of Karliden Sherpa, supra.) **Further**, his explanation provides at least some reason for a series of calculations that would otherwise have no objective **logical connection.**

While respondent's failure to support its determination that the sheet recorded drug sales would normally end our inquiry in **appellant's favor**, appellant has admitted that the money found during his arrest was taxable income to him. Such an admission is sufficient evidence to **support the** validity of an assessment based on the admitted amount of income, (Appeal of Dennis and Cynthia Arnold, Cal. St. Bd. of Equal., May 6, 1986.)

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There is no evidence in the record, however, that ties appellant to a larger amount of taxable income in 1982 than he has admitted to.

In summary, without more evidence **to support** respondent's determination that the records found on appellant during his arrest were drug records and that **all** of the figures represented separate and distinct sales of narcotics which may all be assumed to be taxable income, we find that respondent's reconstruction derived from the use of the sheet of paper described above was based on conjecture rather than on fact. (See Appeal of Larry R. Maynard, Cal. St; Rd. of Equal., Feb. 4, 1986.) Due to appellant's admissions, however, respondent's reconstruction is upheld in the amount of the cash found in his possession at the time of his arrest. Respondent's jeopardy assessment must be modified accordingly.

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ORDER

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 Jeffrey Paul Pulizzi for reassessment **of a** jeopardy assessment of **personal income** tax in the amount of \$143,628 for the year 1982, be and the same is hereby modified in accordance with this opinion.

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.

<u>Richard Nevins</u>	, Chairman
<u>Conway H. Collis</u>	, Member
<u>Ernest J. Dronenburg, Jr.</u>	, Member
<u>Walter Harvey*</u>	, <b>Member</b>
	, Member

\*For Kenneth Cory, **per** Government Code section 7.9