



87-SBE-047

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
THOMAS MANGIONE) **No. 84J-413-MA**
)

Appearances:

For Appellant: **Thomas Mangione,**
in pro per.

For Respondent **Paul Petrozzi**
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 **Thomas Mangione** for reassessment of a jeopardy assessment of **personal** income tax and penalty in the amounts of **\$4,314.75** and **\$3,356.88**, respectively, for the **year** **1981.**

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

∴ Appeal of Thomas Mangione

The sole issue to be decided in this appeal is whether respondent's denial of a deduction for cost of goods sold pursuant to section 17297.5 was proper.

After a lengthy investigation, appellant was arrested by deputies of the San Bernardino Sheriff on October 29, 1981. He ultimately pleaded guilty to a single charge of receiving stolen property. Subsequently, respondent conducted its own investigation and concluded that appellant had failed to report income from the purchase and sale of stolen property. A proposed assessment was issued and became final without appeal. Thereafter, section 17297.5 was enacted which prohibited the allowance of a deduction of any expenses, including cost of goods sold, incurred in the procurement of income from illegal activities. In view of this statutory enactment, the Franchise Tax Board recomputed appellant's tax liability and issued the assessment which is the subject of this appeal.

Appellant contends that his deduction for cost of goods sold should not be denied because he was a legitimate businessman who was only involved in a single illegal act.

Respondent contends that appellant's actions place him squarely within the purview of section 17297.5; therefore, he is not entitled to a cost of goods sold deduction.

The first issue we are concerned with is procedural in nature. Throughout his appeal, appellant has continually tried to attack respondent's original computations as reflected in the first assessment issued October 31, 1983. It is his contention that the two assessments are intertwined and that his appeal of the second assessment, in effect, opens the door to the issues raised in the first. At each juncture respondent has pointed out that appellant is foreclosed from appealing the amount and computation with regard to the first assessment. We must agree with respondent.

The first assessment was issued by respondent on October 31, 1983, for the taxable year 1981. Although specifically advised of the necessity to protest within 30 days, appellant did not object to the assessment until December 2, 1983, thereby forfeiting his right to appeal the original computations of income and assessment of tax. By letters dated February 10, 1984, and March 16, 1984, appellant was notified by this Board that because

Appeal of Thomas Manqione

his appeal of the first assessment was not timely filed, this Board did not have jurisdiction in the matter. Appellant cannot now appeal the amount and computation of the October 31, 1983, assessment because the original determination is final. (See Appeal of Frank Edward and Florence Bess, Cal. St. Bd. of Equal., Feb. 17, 1959; Appeal of George S. Allen, Cal. St. Bd. of Equal., Dec. 17, 1957.) This forecloses any discussion of whether-respondent correctly computed appellant's total income for the year at issue including whether respondent properly **established respondent's opening** net worth. In any event, appellant has filed a return for 1981 in which he states his gross income was \$150,541, an amount greater than ~~the~~ \$133,750 estimated by respondent. (Hrg. Trans. at 20.)^{2/}

Between the months of March 1980, and September 1981, the San Bernardino County Sheriff's Office received reports that the jewelry shop owned by appellant and his wife was the site of purchases of stolen merchandise. The sources of this information were concerned merchants within the building complex where appellant's business was located, and convicted **and/or** suspected burglars who sold their stolen merchandise (primarily jewelry) to appellant and had made statements to the effect that appellant was a "well known fence in the **Redlands** area."

On the basis of this information, detectives from the Redland's Police worked with Sheriff's deputies in an undercover operation focused upon appellant's alleged "**fencing**" activities. On different occasions, the undercover officers, equipped with concealed recording devices, contacted appellant and his sales clerk and completed several transactions. Appellant personally bargained and negotiated with the special investigators and purchased the offered items from them with full awareness that the items had been 'stolen.' (See Resp. Br., Ex. **E.**) Appellant also purchased assorted jewelry, sterling silver, and a microwave oven from the officers. He indicated to the officers that he melted the stolen metal into bars for easier resale.

As a result of the information supplied by the undercover operators, a search warrant was obtained to

2/ Appellant claimed a \$110,012.98 cost of goods sold deduction on the 1981 return. During the same period, he reported sales to this Board of \$13,091. (Hrg. Trans. at 14.)

Appeal of Thomas Mangione

search appellant's jewelry store, workshop, and personal residence. In addition to the "stolen" items purchased from the undercover operators, the search also netted a \$2,000 gold watch which was positively identified as stolen merchandise.

On October 29, 1981, appellant was arrested with \$2,193 on his person. He was charged with three felony counts of crimes described in Sections 664 and 496 of the California Penal Code (attempt to receive stolen property) and one felony count involving section 496 of the Penal Code (concealing stolen property). As a result of a plea bargain, appellant pleaded guilty to one count of concealing stolen property. This resulted in a conviction, for which appellant was granted supervised probation for a period of three years, under very specific terms and conditions.

On October 30, 1981, Detective Steve Harrison of the **San Bernardino Sheriff's Department** called respondent's agents and informed them of appellant's arrest and the circumstances surrounding it. In researching its files, respondent learned that appellant had ^{not} filed state tax income returns since at least 1976.^{3/} Based on statements made by appellant's daughter (who worked in his shop) and assorted **documents** accumulated during the course of the criminal investigation, respondent's agents estimated the amount of income from appellant's illegal activities during the period January 1 through October 29, 1987, as \$133,750; it subtracted the cost of goods sold, \$40,125, and calculated the tax due on the \$93,625 balance. Respondent then levied an assessment on the basis that the collection of the tax would be jeopardized by delay.

Appellant, thereupon, petitioned for reassessment, and a hearing was held on **December 14, 1982**. After completing its review, respondent determined that the jeopardy assessment should be **affirmed**. In the meantime, section 17297.5 had been passed which, according to respondent, required the disallowance of the deduction

3/ Appellant subsequently filed returns for the years **1976** through 1981 on November 15, 1983, after the respondent had issued its November 3, 1983, assessment which included a 25 percent failure to file penalty pursuant to section 18681. A return for 1982 was filed on March 13, 1985. (See Resp. Post Hrg. Reply Br., **Ex.K.**)

Appeal of Thomas Mangione

for cost of goods sold in a case such as this and required the issuance of an additional assessment. As noted above, appellant failed to appeal the original jeopardy assessment in a timely manner and it became final.

The sole question which remains is whether appellant should be allowed a deduction for cost of **goods** sold. Appellant contends that he is entitled to **a** deduction for cost of good sold because he is a legitimate businessman whose activities did not fall within the scope of section 17297.5. We disagree.

Section 17297.5 provides, in pertinent part, as follows:

(a) In computing taxable income, no deductions (including deductions for cost of goods sold) shall be allowed to any taxpayer on any of his or her gross income directly derived from illegal activities . . . nor shall any deductions be allowed to any taxpayer on any of his **or** her gross income derived from any other activities which directly tend to promote or to further, or are directly connected or associated with, those illegal activities.

(b) A **prior**, final determination by a court of competent jurisdiction of this state in any criminal proceedings or any proceeding in which the state, county, city and county, city, or other political subdivision was a party thereto on the merits of the legality of the activities **of** a taxpayer or predecessor in interest **of** a taxpayer shall be binding upon the Franchise Tax Board and the State Board **of** Equalization.

(c) This section shall be applied with respect to taxable years which have not been closed by a statute **of** ~~1~~⁴ ~~year~~ mutations, res judicata, or otherwise. ~~4~~

4/ Section 17297.5 (Stats. 1982, Ch. 1028, § 1, p. 3751) **was** effective September 14, 1982, and, as detailed in subdivision (c), is applicable to all **years** still open under the statute of limitations.

Appeal of Thomas Mangione

We agree with respondent's contention that appellant clearly fits within the criteria of **every** aspect of section 17297.5, in that he was involved in illegal activity and used his jewelry business to further his illegal activity.

We think that it was reasonable for respondent to conclude that appellant was clearly **involved in** illegal activities in that, at the very least, he was engaged in the business of receiving stolen property. The Sheriff's office had received numerous tips from area businesspeople and convicted or suspected burglars that appellant was dealing in stolen merchandise. In addition, appellant made incriminating statements to undercover officers concerning his knowledge **of** the illegal nature of his acts. Finally, after his arrest, appellant pleaded guilty to one count of receiving stolen property. Appellant's plea of guilty was accepted by **a** court of competent jurisdiction and is therefore binding upon both respondent and this board. (Rev. 6 Tax. Code

§ 17297.5(b).) **The statute is** clear that no deductions shall be allowed to any taxpayer on **gross** income derived from any other activities which directly tend to promote or to further, or are directly connected or associated with an illegal activity. Taken together, **the** evidence clearly suggests that appellant's jewelry store was used as a front for his **fencing** activities. As such, he is not entitled to any deduction for cost of goods sold for any part **of** the income earned from his store **or** his fencing activities.

Appellant's contention that his conviction of one count of receiving stolen property cannot be used **as** the basis for a finding that he engaged in illegal activity **as** provided in section 17297.5 because his conviction has now been expunged from his record as provided in section 1203.4 **of** the Penal Code, is without merit. Section 1203.4 **of** the Penal Code provides that a probationer who has successfully completed his probation may have the information or accusation against him dismissed and that he shall, thereafter, be released from all penalties and disabilities resulting from the conviction. In construing this section, the California Supreme Court noted that **"it** cannot be assumed that the legislature intended that such action by the trial court under section 1203.4 should be considered as obliterating the fact that the defendant had been finally adjudged-guilty of a crime..

(In re Phillips, 17 **Cal.2d** 55, 61 [109 P.2d. 344] (1941)), in any event, the mere fact of appellant's **conviction** is not the only evidence used by respondent **to**

Appeal of Thomas Manqione

support a finding of illegal activity. Rather, it is all of the evidence taken together--the undercover **investigation**, the items seized as a result of the search warrant, and the conviction--which support such a finding.

Appellant's final contention, that he no longer intended to be a California resident because he intends to leave the state at some point in the future is completely immaterial.

For the reasons stated above, respondent's action in this matter is sustained in all respects.

Appeal of Thomas Mangione

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 **Thomas** Mangione for reassessment of a jeopardy assessment of personal income tax plus penalty in the amounts of **\$4,314.75** and **\$3,356.88**, respectively, for the year 1981, be and the same is hereby sustained.

Done at Sacramento, California, this **17th day** of June , **1987**, by the State Board of Equalization, **with** Board Members Mr. Collis, Mr. Dronenburg, Mr. Bennett, Mr. Carpenter and Ms. Baker present.

Conway H. Collis , Chairman
Ernest J. Dronenburg, Jr. , **Member**
William M. Bennett , **Member**
Paul Carpenter , Member
Anne Baker* , Member

*For Gray Davis, per *Government Code* section 7.9

BEFORE THE STATE BOARD OF EQUALIZATION
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Thomas Mangione) 84J-413-MA
)

ORDER DENYING PETITION FOR REHEARING

Upon consideration of the petition filed July 14, 1987, by Thomas Mangione for rehearing of his appeal from the action of the Franchise Tax Board, we are of the opinion that none of the grounds set forth in the petition constitute cause for the granting thereof and, accordingly, it is hereby ordered that the petition be and the same is hereby denied and **that our** order of June 17, 1987, be and the same is hereby affirmed.

Done at Sacramento, California, this 31st day of March, 1988, by the State Board of Equalization, with Board Mebers Mr. Carpenter, Mr. Bennett, Mr. Collis, and Mr. Davies present.

_____, Chairman

Paul Carpenter, Member

William M. Bennett, Member

Conway H. Collis, Member

John Davies*, Member

*For Gray Davis, per Government Code section 7.9