BEFORE THE STATE BOARD OF EQUALIZATION.

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of	)	
	)	No. 84J-1119-KP
RAYMOND F. BOWEN	)	
	)	

Appearances:

For Appellant: James Victor Kosnett
Attorney at Law

For Respondent: Philip M. Farley
Counsel

O P IN 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 Raymond F. Bowen for reassessment of a jeopardy assessment of personal income tax in the amount of $32,381 for the year 1982 and for the amount of $25,007 for the period January 1, 1983, to February 22, 1983.

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

The issue presented by this appeal is whether respondent properly reconstructed appellant's income for the year and period at issue (hereinafter referred to as "the periods").

On February 10, 1983, the Los Angeles Sheriff's Department was contacted by a confidential reliable informant who stated that he had purchased cocaine from appellant on approximately six occasions during the prior two months. The informant also mentioned that appellant was wanted in Nevada for "truck hijacking." On February 22, 1983, appellant was arrested on the outstanding warrant from Nevada. Found in his vehicle at the time of appellant's arrest was a vial of mannite, a substance commonly used to dilute cocaine prior to its sale, and 27 men's shirts wrapped for retail sale. A subsequent search of appellant's residence and business revealed 17.7 ounces of cocaine, over $11,000 in cash, a ledger, numerous weapons, and other paraphernalia associated with narcotics trafficking. Eventually, appellant pled no contest to one federal count of conspiracy to possess stolen property stemming from the Nevada warrant. On December 14, 1984, appellant-entered a no contest plea to the charge of possession of a controlled substance for sale.

Upon being informed of'the above-described events, the Franchise Tax Board (FTB) determined that appellant had unreported income from sale of cocaine, the sale of stolen property, and the sale of legitimate goods from his business. The FTE also determined that collection of the tax upon that income was jeopardized by delay. Assessments were immediately issued, which appellant protested. Upon review of its action, the FTB reduced its assessment to the amounts presently on appeal. In reaching the present assessments, respondent determined that appellant had sold cocaine at a rate of 18 ounces a week from December 10, 1982, to the date of his arrest. The FTB also reviewed the ledger seized at the time of appellant's arrest, and determined that the ledger contained records of stolen items appellant sold since the beginning of 1982. The FTB added all of the figures, in the book to arrive at its income reconstruction for those alleged sales. Finally, the FTB determined that appellant had gross sales from his legitimate business of $400 a week since April 1, 1982. Appellant objected to these estimations of income, and this appeal followed.

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, § 18401.) Except as otherwise provided by law, gross income is defined to include "all income from whatever source derived" (Rev. & Tax.

Code, § 17071.) Each taxpayer is required to maintain such accounting record; 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 to prove that a reasonable reconstruction of income is erroneous. (Appeal of Marcel C. Robles, Cal. St. Bd. of Equal., June 28, 1979.)

Respondent's estimation of appellant's income from his legitimate business' sales comes from appellant's admissions. Although appellant failed to report any income on his tax returns from his store's operation, during his protest hearing he admitted that the previous store's owner grossed $300 to $400 a week while being open only on weekends. Appellant further stated that he had improved the store's appearance and was open more days a week than the previous owner. Appellant, however, failed to provide any records of his business' operation. Consequently, respondent determined that appellant's business, being open several more days than under the prior owner, must have generated at least $400 a week in gross sales. Therefore, appellant was determined to have made that amount since he purchased the store.

Appellant argues that he did not sell as much as has been determined by respondent. Appellant has failed, however, to provide any supporting evidence, such as his business records, to show that he made less than respondent's estimation. Consequently, as respondent's determination with regard to gross sales from appellant's business was based on appellant's statements, and since appellant has failed to provide evidence to contradict respondent's estimation of income, we find that appellant has failed to satisfy his burden of proving that he had earned less income from his business than has been determined by respondent's reasonable estimation. (See Appeal of Dennis and Cynthia Arnold, Cal. St. Bd. of Equal., May 6, 1986.)2/

2/ Although appellant may have been entitled to claim deductions from his candy store operation, there has been no attempt by appellant to prove his entitlement to any such deduction. (See New Colonial Ice Co., Inc. v. Helvering, 292 U.S. 435 [78 L.Ed. 1348] (1934).)

The second portion of respondent's reconstruction concerns appellant's alleged cocaine sales. In the instant matter, respondent employed the'now-familiar projection method to reconstruct appellant's income from the sale of narcotics.. The projection method is based upon statistical analysis and assumptions gleaned from the evidence and is an acceptable method of reconstruction. (Mitchell v. Commissioner, 416 **F.2d** 101 (7th Cir. 1969); Appeal of Siroos Ghazali, supra.) To insure, however,' that the method does not lead to injustice by forcing the taxpayer **to** pay tax on income he did not receive, each assumption involved in the reconstruction must be based upon fact rather than on conjecture. (Lucia v. United States, 474 **F.2d** 565 (5th Cir. 1973); Appeal of Siroos Chazali, 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 a taxpayer is due and owing. (Appeal of Siroos Ghazali, supra.)

Appellant argues that he did not sell cocaine. We note, however, that appellant pled no contest to **possession** of narcotics for sale. Furthermore, appellant was **found** at the time of his arrest to have over one pound of cocaine under his control, an excessive amount for personal use. Finally, prior to appellant's arrest, the sheriff's informant stated that he had purchased cocaine from appellant six times over! a specified two-month period. Consequently; we find there is **sufficient** evidence to sustain respondent's determination that appellant **has unreported income from the sale of narcotics. The next** question is whether respondent properly reconstructed the number **of sales** of cocaine.

Respondent determined that appellant was selling over one pound of cocaine a week during the period at issue. This amount was based upon the amount of cocaine found to be under appellant's control at the **time of** his arrest. Based upon the risks inherent in the illegal drug **trade,** we have found it reasonable to assume that a dealer would only have on hand an amount of drugs that he could easily and quickly dispose of, and we have found that a one week time period for such a. disposition is also reasonable. (See Appeal of Richard E. Koch, Cal. St. Bd. of Equal., June 10, 1986; Appeal of Gregory **Flores,** Sr., Cal. St. Bd. of Equal., Aug. 1, 1984.) It must be noted, however, that appellant was found to have 17.7 ounces of cocaine under his control at the time of his arrest. Respondent rounded this amount up to 18 ounces in its calculations. Following the reasoning expressed in Koch and Flores, appellant may only be attributed with sales in theamount of drugs actually found under his control. Consequently, appellant may only be assumed to have sold 17.7 ounces of cocaine a week.

(See Appeal of Richard E. Koch, supra; Appeal of Gregory Flores, Sr., supra.) Respondent's calculation must be adjusted accordingly.

Respondent's second factor in its reconstruction is the assumption that appellant sold the cocaine for $1,600 an ounce. This figure apparently represents an average price for an ounce of cocaine during 1982-1983. As appellant has failed to dispute the price, we find that respondent was reasonable to rely upon police estimations of the average price of cocaine during the periods in question in calculating appellant's weekly sales.

Respondent's final assumption was that appellant had been selling cocaine from December 10, 1982, to the date of his arrest, February 22, 1983. This two-plus month period was established by the informant's statement made prior to appellant's arrest, that he, the informant, had purchased cocaine from appellant for the "past two months." A taxing agency may rely upon data acquired from informants to reconstruct a taxpayer's income provided that there does not exist "substantial doubts" as to the informant's reliability. (See Nolan v. United States, 49 A.F.T.R.2d 941 (1982); Appeal of Carl E. Adams, Cal. St. Bd. of Equal., Mar. 1, 1983; and, Appeal of Clarence Lewis Randle, Cal. St. Ed. of Equal., Dec. 7, 1982.) The informant in this case knew of appellant's outstanding warrant in Nevada; he specified a set number of sales he conducted with appellant; and, he provided a set time frame within which appellant was to have sold cocaine. Unlike the circumstance set forth in several recent opinions, the informant in this case stated, prior to appellant's arrest, detailed knowledge of appellant's activities, including, and most importantly, an exact time frame of the sales. (Cf. Appeals of Siroos Ghazali, supra; Appeal of Larry R. Maynard, Cal. St. Bd. of Equal., Feb. 4, 1986; Appeal of Richard E. Koch, supra.) Upon appellant's arrest, much of what the informant told the police regarding the appellant's cocaine sales and the outstanding warrant for appellant's arrest was confirmed, thereby lending credence to the alleged time frame for those cocaine sales. (See Nolan v. United States, supra; Appeal of Carl E. Adams, supra; and, Appeal of Clarence Lewis Randle, supra.) Consequently, respondent had ample justification to rely upon the informant's statements in developing its income estimation from the cocaine sales..

Accordingly, we find that all three assumptions relied upon by respondent in arriving at its estimation of appellant's income derived from cocaine sales are based upon credible evidence in the record. Other than the mathematical mistake of rounding the amount of cocaine sold per week from 17.7 ounces

to 18 ounces, we find that respondent has properly reconstructed appellant's income from cocaine sales for the periods specified above.

The bulk of respondent's reconstruction of appellant's total income comes from a belief that appellant was heavily involved in the trafficking of stolen property. This assumption is based upon a statement by the informant that appellant sold stolen property; an interpretation by the FTB that the ledger found during the search of appellant's business contains records of sales of stolen goods; appellant's arrest on the "truck hijacking" warrant; and, the number of shirts packaged for retail sale found in appellant's car and home. The inference drawn by these factors, according to the FTB, is that appellant must have been selling stolen property. We disagree.

Unlike the statements regarding appellant's involvement in narcotics, we do not find the informant's comment that appellant was involved with the sale of stolen goods persuasive. The informant never said that he witnessed or participated in any sale of stolen goods by or with appellant. Further, appellant was not found with any known stolen property under his control. It was assumed by the arresting officer, and subsequently respondent, that the shirts found during appellant's arrest were stolen. It was later admitted by the arresting officer, however, that there was no proof the shirts were "hot". Further, appellant produced a receipt for the shirts. Although respondent questions the receipt's authenticity, no evidence has been produced to substantiate the FTB's doubts.

Respondent's point regarding the "truck hijacking" charge is also unpersuasive. Appellant pled no contest to a charge of conspiracy to possess stolen property, not a charge of conspiracy to sell stolen property. Appellant's explanation as to his involvement in the "truck hijacking", that he was simply helping a friend drive the truck to Nevada, is consistent with the federal charge.

Finally, a close examination of the ledger alleged to contain records of sales of stolen property casts doubt upon respondent's interpretation of those records. Many of the pages contain notations that are obviously phone numbers, not "sales". Second, many of the notations have the words "On Me" scribbled after them, an odd notation that has no obvious connection with stolen goods. Third, appellant's own auditors apparently wrote on one page that the figures on that page are probably not records of stolen goods. Finally, only one page in the book contained the notation "stolen goods". Even if we were to assume this notation indicated an exchange of stolen

property, the notation gives us no clue as to whether appellant was selling or buying the goods. Simply stated, we do not have evidence that appellant sold a single item of stolen property.

In summary, there is no conclusive evidence in the record to show that appellant had any connection with the selling of stolen property at any time during the periods at issue. While respondent is successful at painting a picture of an individual of dubious character, we are not here to judge appellant's life. There is simply nothing in the record to show the existence of previously unreported income from the sale of stolen property. Without evidence of any taxable event, respondent's determination is rank speculation.

Consequently, we, find that that portion of respondent's reconstruction of appellant's income based upon the alleged sale of stolen property is arbitrary and unreasonable, and must, therefore, result in a modification of respondent's determination. On the other hand, except fcr the mathematical change with regard to the amount of cocaine sold per week, we find that respondent's assessments with regard to appellant's income derived from the sales of cocaine and from the sales of legitimate goods from his business are supported by evidence presented on appeal and must be sustained. Accordingly, respondent's action in this matter will be modified in accordance with this opinion.

Appeal of Raymond F. Bowen

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 Raymond F. Bowen for reassessment of a jeopardy assessment of personal income tax in the amount of $32,381 for the year 1982 and in the amount of $25,007 for the period January 1, 1983, to February 22, 1983, be and the same is hereby modified in accordance with this opinion. In all other respects, the action of the Franchise Tax Board is sustained.

Done at Sacramento, California, this 1st day of June 1988, by the State Board of Equalization, with Board Members Mr. Dronenburg, Mr. Bennett, Mr. Collis, and Mr. Davies present.

Ernest J. Dronenburg, Jr., Chairman

William M. Bennett, Member

Conway H. Collis, Member

John Davies* **, Member

, Member

*For Gray Davis, per Government Code section 7.9

**Abstained