BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
) No. 82J-883-LB
IRVING HOFFMAN)

Appearances:

For Appellant: Donald E. Stevens
Attorney at Law

For Respondent: Philip M. Farley
Counsel

OPINION ON PETITION FOR REHEARING

On July 26, 1988, we modified the action of the Franchise Tax Board in denying the petition of Irving Hoffman for reassessment of a jeopardy assessment of personal income tax in the amounts of $364,894 for the year 1980 and $69,214 for the period January 1, 1981 to March 18, 1981. On August 24, 1988, appellant filed a timely petition for rehearing pursuant to section 18596 of the Revenue and Taxation Code.

The issue in this appeal is whether respondent's reconstruction of appellant's income for the year 1980 and the short period January 1, 1981 to March 18, 1981, was reasonable. In our original opinion a major question involved the length of time appellant had been selling cocaine. Our concern was whether there was sufficient evidence to establish that appellant was selling cocaine as of January 1, 1980, the start of the first jeopardy assessment period. Respondent's sole support for its, position that appellant was selling two kilograms of cocaine per week as early as January 1, 1980, was a statement made by one of the investigative officers three days after respondent began its investigation. That statement, which was not part of any official report, indicated that, at an unknown time, one informant claimed that appellant had been selling drugs for two years, while a second informer stated that appellant was selling in large quantities for six months prior to his 1981 arrest. We rejected this 'post-arrest police report' for the reasons set out in Appeal of Roland Aranda Garcia, decided March 4, 1986, and Appeal of Siroos Gazali, decided April 9, 1985. However, by relying on appellant's arrest on November 16, 1979, for, what we understood was, possession of six grams of cocaine, we concluded that appellant was selling small quantities of cocaine by the first of 1980. Consequently, we found that the record supported A finding that appellant was selling cocaine beginning with six grams a week commencing January 1, 1980, and increasing to two kilograms a week by March 18, 1981.

As appellant correctly points out in the petition for rehearing, however, appellant's November 1979 arrest was not for dealing in cocaine, but merely for the misdemeanor violations of sections 11377(b) (possession of barbiturates) and 11357(c) (possession of marijuana) of the Health and Safety Code. Respondent does not challenge this assertion. Therefore, there is no longer any acceptable evidence to justify a finding that appellant was dealing in cocaine as of January 1, 1980. Thus, we conclude that our original opinion must be further modified to reflect these facts. for ease of reference in the future, the entire text of our opinion in this matter, incorporating the modifications, is set out below.

MODIFIED OPINION

The issue presented by this appeal is whether respondent's reconstruction of appellant's income for the year and period at issue is reasonable.

On December 2, 1380, the Los Angeles Police Department Narcotics Division received information from a confidential informant that appellant was selling cocaine and marijuana on a

daily basis. As a result of that "tip," a police investigation of appellant's activities was instituted. On several occasions during the investigation, officers observed appellant engaging in what appeared to be narcotics transactions. On March 17, 1981, appellant and another man were arrested in appellant's vehicle. A search of the car revealed two kilograms of cocaine. A subsequent search of an apartment visited by appellant just prior to his arrest uncovered an additional eleven kilograms of cocaine. Appellant subsequently was convicted of one count of possession of a controlled substance with the intent to sell.

On March 18, 1981, respondent was notified of appellant's arrest and determined that appellant had unreported income for 1980 and the short period January 1, 1981, to March 18, 1981 (hereinafter referred to as "the periods"), and that the payment of tax on the income would be jeopardized by delay. Respondent issued an assessment, which it later reduced. The reduced assessment was based on the projection method of income reconstruction which assumed that appellant was selling two kilograms of cocaine a week at $45,000 a kilogram since the beginning of 1980. In its assessment, respondent did allow a 50 percent deduction for the cost of goods sold. Subsequently, appellant petitioned for a reassessment of his tax liability, which respondent denied, and this appeal followed. On appeal, appellant does not deny his involvement in the drug trade. He does, however, continue to argue that respondent's assessment is unreasonable as it is based upon conjecture and not upon fact.

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 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; Int. Rev. Code, § 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.)

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 mathematical computations 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 Ghazali, 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.) If some or all of the elements relied upon by the respondent are not supported by the appellate record, the reviewing authority may redetermine the taxpayer's' income on the facts adduced from the record. (Appeal of Siroos Ghazali, supra.)

Respondent's revised estimate of income attributes to appellant a large amount of unreported income for the periods at issue. Respondent based its estimation on: (1) a statement by an informant that appellant sold two to four kilograms of cocaine a week; (2) statements allegedly made by a confidential informant that appellant had been selling drugs for two years; and (3) a Department of Justice's price sheet which estimated that the cocaine sold for $45,000 a kilogram during the appeal periods, a price which appellant apparently concedes. Consequently, our inquiry is whether there is sufficient evidence in the record to support respondent's first two assumptions.

Our initial question is concerned with whether respondent properly determined the quantity of appellant's drug trafficking. 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.) Furthermore, appellant was found to have access to an additional eleven kilograms of cocaine, which is another indication that the two kilograms figure attributed to appellant's recent weekly sales was reasonable and conservative. Therefore, we find that respondent's determination as to the amount of cocaine sold by appellant during the surveillance periods is substantiated by the record.

The second factor, the length of time respondent alleges appellant was engaged in the sale of, at least, two kilograms of cocaine per week, is less clear. Respondent assumes that appellant had been selling at least two kilograms a week for more than one year. The only evidence relied upon by respondent to show that appellant had been so involved in the drug trade is a statement made by one of the investigating officers three days after respondent began its investigation. That statement, which was not part of any official report, indicates that, at an unknown time, one of the informants stated that appellant had been selling drugs for two years. The writing also claims that a second informant, heretofore unknown, stated that for the six months prior to his arrest, appellant had sold two to four kilograms per month.

We have thoroughly discussed the use of Post-arrest police 'reports" in the Appeal of Roland Aranda Garcia, decided March 4, 1986, and in the Appeal of Siroos Ghazali, supra. In essence, those cases state that due to the prohibition against making an estimation of unreported income out of whole cloth (see Lucia v. United States, supra), post-arrest documents that "fill in" respondent's estimations of income will be looked upon with a jaundiced eye. There must be some 'independent evidence, either garnered prior to or during an arrest or investigation, that at least partially corroborates the post-arrest document to lend enough credence to that information to allow an accurate estimation of income to be based thereon. (Appeal of Roland Aranda Garcia, supra; Appeal of Siroos Ghazali, supra.

In the present case, such substantiation is lacking. None of the investigation reports written prior to appellant's arrest discuss the amount of time appellant had allegedly been selling two kilograms of cocaine per week. Secondly, we find it odd that the information did not come to respondent in the normal circumstances, written on police stationary or as part of a police report. Rather, the note was written on a plain sheet of paper. Furthermore, the signing officer was not aware of the actual duration or quantity of appellant's sales activities himself, but rather depended upon the word of the alleged confederates of appellant, one of whom had not been mentioned in any pre-arrest document.

For these reasons we must reject the 'post-arrest police report. " We find no reason to change this determination on petition for rehearing notwithstanding respondent's argument to the contrary. This is not a novel determination, we are mereiy applying the settled principles set out in Prior appeals. (See-Appeal of Roland Aranda Garcia, supra; Appeal of Siroos Ghazali, supra.)

In the absence of this evidence, we find that the record does not support a finding that appellant sold two kilograms of cocaine per week since the beginning of 1980. While appellant was arrested on November 16, 1979, on drug charges, the charges did not involve cocaine, nor did the surrounding investigation indicate that any cocaine was found within appellant's access or control. Therefore, the 1979 arrest does not establish a starting point for applying the projection method of reconstructing appellant's income from cocaine sales.

However, once surveillance of appellant commenced on December 2, 1980, his extensive drug involvement became apparent. Therefore, it is reasonable to conclude that appellant was selling two kilograms, of cocaine a week as of December 2, 1980, and continued to sell cocaine at such a rate until his arrest on March 18, 1981.

Therefore, respondent's reconstruction of appellant's income must be modified in accordance with this opinion.

Appeal of Irving Hoffman

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 petition of appellant for rehearing of the appeal of Irving Hoffman from the action of the Franchise Tax Board in denying the petition for reassessment of a jeopardy assessment of personal income tax in the amounts of $364,894 for the year 1980 and $69,214 for the period January 1, 1981, to March 18, 1981, be and the same is hereby denied, and that our order of July 24, 1988, be and the same is hereby modified in accordance with this opinion. In all other respects our prior order of July 24, 1988, is hereby affirmed.

Done at Sacramento, California, this 2nd day of August, 1989, by the State Board of Equalization, with Board Members Mr. Carpenter, Mr. Collis, Mr. Bennett, Mr. Dronenburg, and Mr. Davies present.

Paul Carpenter, Chairman

Conway H. Collis, Member

William M. Bennett, Member

Ernest J. Dronenburg, Jr., Member

John Davies*, Member

*For Gray Davis, per Government Code section 7.9