BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

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

Appearances:

For Appellant: Donald E. Stevens
Attorney at Law

For Respondent: Philip M. Farley
Counsel

OPINION

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 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.

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.

Appeal of Irving Hoffman

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, 1980, 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 pled guilty to one violation 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; I.R.C. § 446.) Where a-taxpayer fails to-main;-tain the proper records, an approximation of net income is ju.stified even if the calculation is not exact. (Appeal of

198

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 estimations on: (1) statements allegedly made by the confidential informant that appellant had been selling drugs for two years; (2) a statement by another informant that appellant sold two to four kilograms of cocaine a week; 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 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.) 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 not outrageous. Therefore, we find that respondent's determination as to the amount of cocaine sold by appellant during the latter stages of his drug sales is substantiated by the record.

The second factor, the length of time respondent alleges appellant was engaged in the sale of, at least, two kilogram 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 typed 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 throughly 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, 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 on 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.

While we find that the evidence relied upon by respondent does not support a finding that appellant sold two kilograms of cocaine per week since the beginning of 1980, there are other indications in the record that appellant was involved with the sale of some drugs since at least the beginning of 1980. On November 16, 1979, appellant was arrested and charged with possession of six grams of cocaine. Furthermore, appellant was observed by experienced narcotics officers from December 2, 1980, to the time of his arrest, to be conducting what appeared to their trained eyes to be numerous drug sales. Finally, we note that subsequent to the arrest in question, appellant was also arrested and convicted of conspiracy to smuggle cocaine into this country. While these activities do not "fill in" the fifteen-month gap to rehabilitate respondent's reconstruction in its entirety, they do establish a pattern of behavior. This pattern indicates that appellant was involved in the sale of narcotics from at least November 16, 1979. Furthermore, the pattern appears to indicate that appellant went on from a relatively small-time drug seller to become a drug dealer of much larger proportions. Consequently, we find that there is sufficient evidence in the record to support an income estimation of unreported income based upon sales of cocaine beginning at six grams a week, commencing November 16, 1979, to two kilograms a week on March 18, 1981.2/

In anticipation of this decision, 'appellant argues that this board may not consider appellant's 1979 arrest since, as a result of his plea bargain, appellant successfully participated in a drug diversion program. Appellant contends that Penal Code section 1000.5, bars the use of appellant's arrest in any manner that would deny him a "benefit" as described in that section.

Penal Code section 1000.5, stated, in relevant part, that

> Upon successful' completion of a diversion program the arrest upon which the diversion was based shall be deemed to have never occurred. The divertee may indicate in response to any question concerning his prior criminal record-that he was not arrested or diverted for such offense. A

2/ Our projection may only include the periods on appeal. Consequently while our increasing sales projection starts on November 16,' 1979, the only income that may be attributed to appellant for-the periods at issue is that which he received after December 31, 1979.

> record pertaining to an arrest resulting in successful completion of a diversion program shall not, without the divertee's consent, be used in any way which could result in the denial of any employment, benefit, license, or certificate.

We do not find appellant's argument persuasive. It is clear from the language of section 1000.5, that the section is attempting to prevent discrimination against a successful divertee. Here there is no discrimination. All that is being required of appellant is that he pay his fair share of tax on income he received during the periods at issue, something that is required of all citizens. To rule as appellant requests would create, not deny, a benefit of tax-free income to appellant. Therefore, we find that appellant cannot hide behind section 1000.5 in an effort to avoid his legitimate tax obligation described above.

Therefore, respondent's estimation of income will be modified to reflect the progressively increasing amount of sales described above over the periods on appeal.

Appeal of Irving Hoffman

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 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, 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 26th day of July 1988, by the State Board of Equalization, with Board Members Mr. Dronenburq, Mr. Carpenter, Mr. Collis and Mr. Davies present.

Ernest J. Dronenburg, Jr., Chairman

Paul Carpenter, Member

Conway H. Collis, Member

'John Davies* **, Member

_____ Member

*For Gray Davis, per Government Code section 7.9

**Abstained