BEFORE THE
CALIFORNIA UNEMPLOYMENT INSURANCE APPEALS BOARD

In the Matter of:

RESEDA MANOR, DBA
ALOHA CONSTRUCTION COMPANY
(Petitioner)

PRECEDENT
TAX DECISION
No. P-T-74
Case No. T-66-49

DEPARTMENT OF HUMAN
RESOURCES DEVELOPMENT

The petitioner has appealed from Referee's Decision No. LA-T-947 which denied its petition for reassessment. This petition was filed with respect to an assessment made by the Department on December 28, 1964 under the provisions of Unemployment Insurance Code section 1127 in the amount of $2,446.23 contributions and $244.31 penalty, together with interest as provided by law. The petitioner was assessed for alleged deficiencies in the contributions reported by it on the returns which it filed with the Department for the last three quarters of 1962 and the first three calendar quarters of 1963.

STATEMENT OF FACTS

During the period under review the petitioner was a corporation engaged in the construction and management of apartment buildings. It was one of a group of corporations related to each other through common ownership by one Sam Len. It occupied a key position in this group in connection with payroll records and the reporting of payroll taxes.

Prior to the events we are about to describe the Department had conducted ten audits of related Len corporations within a period of less than a year. One of these was an audit of the petitioner made with respect to the period extending from January 1, 1960 through March 31, 1962, a nine-calendar-quarter period immediately prior to the six-calendar-quarter one that we are now reviewing. During the course of these audits, Irvin Kaufman, a Department auditor, examined the books and records of the various Len corporations which were made available to him by the petitioner's general auditor, William Ruggles.

The accounting records of each corporation were established and maintained in accordance with the Hadley System. Each corporation had a regular double entry set of books, and maintained its own separate bank account. The petitioner also had a separate payroll bank account through which payroll payments were made.

The petitioner kept a payroll journal in which all payments from its payroll bank account were recorded. This journal reflected the petitioner's division of such payments into amounts paid for wages and amounts paid for other purposes, such as travel or auto expenses. As this division was made primarily for the petitioner's own internal bookkeeping purposes, it did not necessarily in itself always provide sufficient information to satisfy the Department's auditors as to the actual application of each such payment.

The petitioner also maintained a check register which was a numerical listing of the voucher checks which it issued on its general bank account. This record showed the name of the payee of each check and the construction job to which the payment was charged. It did not identify and detail the nature of the payment.

The voucher checks, themselves, were prepared in triplicate on pull-a-part forms. The first copy was the original check which was sent to the payee. The second copy was used to write up the transaction in the petitioner's cash journal, after which it was sometimes filed with the bank statement. If not, it was preserved for several years in the petitioner's dead letter file. The third copy was sometimes filed with the supporting invoice or other document to which it pertained. If not, it was also placed in the dead letter file where it could be referred to if the first or second copy could not be found.

Each voucher check contained an explanation of the payment, and each copy of the check contained the same information. The explanation placed on the check was only for the purposes of internal understanding. While in some instances it might prove adequate to satisfy Department auditors as to the nature of the payment, in other instances it might not be adequate to do so.

During the prior audit of the petitioner's books and records, auditor Kaufman identified certain payments which he concluded were taxable wage payments that had not been included in the petitioner's returns filed during the

seven-calendar quarters included in the period extending from April 1, 1960 through December 31, 1962. A deficiency assessment was made of the additional tax attributable to these unreported payments. The petitioner paid that assessment without seeking an administrative review of it.

During January of 1964 the Department received information in regard to a payment made to an individual who had filed an industrial relations claim. This information caused the Department to institute a further audit of the petitioner. The assessment under review resulted from this further audit but not from this information which precipitated it.

The audit commenced on January 15, 1964, with the assignment of the matter to auditor Kaufman. The following day he made his first attempt to contact Mr. Len by telephone. He was unable to reach him, so he left a message for Mr. Len to return his call.

Having received no response from Mr. Len by February 25, 1964, auditor Kaufman tried again to reach him by telephone at his office on that date. Thereafter, until June of 1964, auditor Kaufman made at least half a dozen more unsuccessful attempts to reach Mr. Len by telephone calls and letters. Finally, in June of 1964 the Department issued a subpoena to William Ruggles, the general auditor, to produce the petitioner's records.

Mr. Ruggles eventually appeared with an attorney, John F. Cronin, in response to the subpoena. He brought with him the records of the petitioner of the type which an employing unit is required to keep under the provisions of the Unemployment Insurance Code and Department regulations, such as the petitioner's payroll journal and its individual payroll returns. He did not produce certain books and records which Department auditors had examined during the previous audit.

Examination of the records produced indicated to auditor Kaufman that the petitioner's pattern of reporting taxable wage payments was similar to that which had been found deficient in the prior more extensive audit of the petitioner's records. Not being satisfied that the petitioner's tax liability had been correctly reported for the period under review, auditor Kaufman sent another letter to Mr. Len requesting that additional records be made available. This was followed by further attempts to obtain these additional records, without success.

Finally, on October 8, 1964 the Department caused the Marshall's Office to serve a subpoena on Mr. Len to appear at the Los Angeles Audit Office on October 26, 1964. On that date the hearing was continued to October 29, 1964 when Mr. Len appeared bringing a number of bound ledgers with him. An interview with Mr. Len was taken under oath and tape recorded.

In that interview Mr. Len did not cover the period under review so the hearing was continued to November 10, 1964. Meanwhile, on November 3, 1964 Mr. Len met with auditor Kaufman and his supervisor, auditor Rosene, at the office of a certified public accountant, Mr. Kraft. Mr. Len made available to the Department auditors only the petitioner's payroll journal, individual earnings record and some cancelled checks. Other records spelled out in the subpoena were not produced.

On November 27, 1964 auditor Kaufman prepared four work sheets of information on 104 specific payments reflected in the books and records that the petitioner had made available to him. On two of these work sheets he scheduled the dates and amounts of 67 specific payments reflected in the petitioner's payroll journal. These payments, in the aggregate amount of $4,924.43, were identified on the payroll journal only as car allowances.

On the other two work sheets auditor Kaufman scheduled the dates, payees and amounts of 37 other specific payments reflected in the petitioner's general check register. This listing was limited to the names of individuals whose names had also appeared at various times in the payroll journal. He was able to identify that two of these payments, in the aggregate amount of $700, were made to Harry Stewart whose services for the petitioner as a construction superintendent were performed in the State of Nevada. Because of this he was not further interested in the character of these two payments.

The remaining 35 specific payments scheduled from the general check register were made to 12 different individuals in the aggregate amount of $1,673.37. These individuals were Carl Davis, Cornell Evans, Joe Hiney, Tom Landers, Roberta Len, Admiral Love, Rene Robinson, W. A. Ruggles, B. W. Smith, Herman Sprowl, Frances Whann and Ralph Whann. The check register did not identify the character of these payments, but only the number of the construction jobs to which they were charged.

Auditor Kaufman was of the opinion that there were errors and omissions in the records that he audited. He felt that wage payments had

been made to individuals that were not reflected as such in the petitioner's payroll journal. However, except for the 102 unidentified payments which he scheduled on his work sheets in the aggregate amount of $6,597.80, there is no indication in the record of any other specific payments with respect to which he was seeking to obtain further information.

Sometime after November 27, 1964 auditor Kaufman and his supervisor, auditor Rosene, apparently abandoned any further attempt to obtain from petitioner the information that they felt they would need in order to base an assessment upon an audit of the petitioner's books and records. Auditor Rosene prepared a work sheet on which he scheduled the wage payments reported by the petitioner in each of the seven calendar quarters included in the period extending from April 1, 1960 through December 31, 1961. He did not include any wage payments reported by the petitioner for the first calendar quarter of 1960 or the first calendar quarter of 1962 which were also included in the period of the prior audit, but were not included in the assessment resulting from that audit.

Auditor Rosene then scheduled on this work sheet the wage payments which from the audit of the petitioner's books and records the Department had concluded the petitioner had made during these same seven calendar quarters. His work sheet reflects that with respect to the period extending from April 1, 1960 through December 31, 1961 the petitioner reported a total of $40,349.25 in taxable wage payments; that from the audit the Department concluded that the petitioner had actually made a total of $60,301.30 in taxable wage payments; and, that the difference of $19,952.05 in unreported taxable wage payments was equal to 49.4 percent of the reported taxable wage payments.

Auditor Rosene did not show on his work sheet the differences by individual quarters between the wage payments reported by the petitioner and the audited amounts. These, however, may be computed mathematically from the figures he did schedule, and from them it appears that by individual quarters the ratio of the difference in unreported taxable wage payments to reported taxable wage payments, varied from a high of 136 percent in the fourth quarter of 1960 to a low of three percent in the fourth quarter of 1961. As can be seen in the chart in Appendix I to this decision, this ratio was in general highest during the period between July 1, 1960 and June 30, 1961, and (from the absence of assessment of any deficiency) apparently had dropped to zero in the quarter immediately preceding the period under review in the present proceeding. [Appendix removed in accordance with California Code of Regulations, title 22, section 5109(e).]

On the same date that auditor Rosene prepared his work sheet, auditor Kaufman also prepared another work sheet on which he scheduled the taxable wage payments reported by the petitioner for the six-calendar-quarter period under review, which in the aggregate amounted to $105,735.37. Then upon the basis that auditor Rosene's work sheet had developed unreported taxable wages equal to 49.4 percent of the reported taxable wages in a previous assessment period, auditor Kaufman estimated that the petitioner had not reported taxable wages for the period under review equal to 50 percent of the amount of taxable wages that it had reported. He (incorrectly) computed this unreported amount to be $52,917.69. (The proper computation would be $50 less.) The assessment in question was made solely upon the basis of this estimation and not upon the basis of the information developed from the audit of the petitioner's books and records with respect to the assessment period, or from any other source pertaining directly to that period.

At the hearing before the referee, the petitioner took the position that it had properly reported its tax liability for the period under review. Mr. Len stated that all of the petitioner's payroll records and cancelled checks had been available, and were still available in transfer files, and that at the request of the Department he had even supplied it with cancelled checks, check records and ledger books for its examination which had nothing to do with the petitioner's true payroll. The petitioner did not introduce any of its books or records into evidence at the referee's hearing, nor did the Department or the referee ask to have any of them produced.

In support of its position that its tax liability had been correctly reported to the best of its knowledge, the petitioner presented evidence to the referee tending to show the character of some of the 102 payments which auditor Kaufman had scheduled on his work sheets on November 27, 1964. Frances Whann, the manager of the Aloha Insurance Agency, a related corporation, explained that seven payments made to her from the petitioner's general checking account in the aggregate amount of $150.12 were to replenish a petty cash fund that she used for various company purposes like the purchase of stamps or the entertainment of customers. She also explained that she received a $20 car allowance in the checks drawn on the payroll bank account. Her family car was used each day when she picked up the rental deposits for petitioner from the apartment house managers. It was also used at least twice a week when she went out to pick up customers' insurance policies and requests and returned them to the office for review.

Tom Landers was identified by Mrs. Whann as a certified public accountant who did bookkeeping work for the petitioner like Mr. Ruggles did.

On auditor Kaufman's work sheets there are four payments to him at weekly intervals each in the amount of $125. The status of Mr. Ruggles, whose payments were not reported as wages upon the basis that he was an independent contractor, has not been specifically challenged by the Department.

B. W. Smith was identified by Mrs. Whann as a laborer and a truck driver who went on errands and also did cleanup work for the company. He had a $25 cash fund. There are four payments to him in the aggregate amount of $100.14 on auditor Kaufman's work sheets.

Carl Davis was identified as a laborer who drove a truck part time with B. W. Smith. There is one payment to him in the amount of $150 on auditor Kaufman's work sheets. Ralph Whann was identified by Mr. Len as a mechanic who did occasional repairs for the petitioner on a contract basis, or occasionally purchased things like a battery for the petitioner for which he would be reimbursed by these payments.

According to Mrs. Whann, all of the people listed on auditor Kaufman's work sheets did work that would require them to go about from job to job. Each of them received a travel allowance, or had a petty cash fund from which he made expenditures for the petitioner. He was reimbursed for these expenditures.

The Department does not contend that the 102 specific payments scheduled by auditor Kaufman were in fact wages, but only that at an earlier stage of the audit, before it made its assessment against the petitioner on a different basis, these were payments about the character of which it then desired additional information. The difficulties it encountered in trying to obtain such information from the petitioner considered in the light of its past audit experience with the Len corporations caused the Department to believe that there had been a general underreporting of the petitioner's tax liability. Accordingly, the Department made its assessment upon the basis of a broad estimation of that liability without reference to the 102 specifically scheduled payments, and it now views any explanation of the character of such individual items as neither sufficient to explain the alleged deficiency in the petitioner's reported liability or even material to its disproof.

The petitioner asserts that the Department's estimate of a 50 percent deficiency in the petitioner's reporting is fantastic. It points out that this

estimate does not tie into its payroll records for the period under review. It contends that the estimate is based on operations during another period of time that lack comparability.

During different periods of time there have been substantial variations in the character as well as the size of the petitioner's business activities which might affect the comparability of its wage payments. During one period, the petitioner was an owner-builder. During the assessment period, it had sold all of its real estate and did only contract building. It also did management and maintenance work for others in connection with apartment houses.

During the period under review, the petitioner reported taxable wage payments of $105,735.37. This amount was more than two and a half times the taxable wage payments of $40,349.25 which the petitioner reported for the slightly longer period which was used by the Department as a basis for its estimate. A comparison on a quarterly basis of the wages reported by the petitioner and of the deficiencies assessed against it, is shown in a bar graph in Appendix II to this decision. [Appendix removed in accordance with California Code of Regulations, title 22, section 5109(e).]

The petitioner paid the smaller assessment for the previous period upon which the Department's estimate is based without seeking administrative review of it. Mr. Len asserts that the petitioner did this, not because it believed this earlier assessment was correct, but simply to buy peace. Repeated audits and demands for information by the Department have come to be met increasingly by delays and refusals on the part of the petitioner until the relations between the two have become exceedingly strained. It is petitioner's contention that it is being harassed by Department personnel.

REASONS FOR DECISION

The petitioner's complaint that it was harassed by Department personnel is one that we can consider only within the framework of the question as to whether the petitioner was afforded administrative due process. Generally speaking, Department personnel (as distinguished from those of the appeals division) are directed and controlled by the Director of the Department. The legislature has not given us a general review jurisdiction over their conduct in the performance of their duties. In the main, therefore, any complaints in this regard should be addressed to the Director of the Department of Human Resources Development.

We are, of course, concerned in our review of the assessment with whether the petitioner has been denied in any way the due process to which our constitutions or statutes entitle it. In considering this question, we cannot ignore the background of strain which has developed in the relationships between the petitioner and the Department. Both parties in their dealings with each other have grown highly impatient.

Department personnel have become irritated by the petitioner's resistance to what they believe to be their legitimate attempts to carry out their administrative duties under the law. Petitioner's Mr. Len on the other hand has, after experiencing ten audits in the course of a relatively few months, become equally irritated with what he believes to be unjust and unnecessary probings by the Department into the private affairs of his corporations. This is not a setting in which adjudicators should be prepared to expect much give and take from either party.

It does appear, however, from the evidence before us that the Department had a legitimate need for more information from the petitioner and its records in regard to the character of the various payments made by the latter during the period under review. It also appears from the law that the Department was not lacking in legal power to compel the attendance of persons and the production of records from whom and which it should have been able to compute accurately an assessment of any deficiency in the petitioner's reporting of its tax liability. (Hill v. Brisbane (1944), 66 Cal. App. 2d 15, 151 P. 2d 578; Unemployment Insurance Code section 311; Government Code sections 11180 through 11191) True, the Department tried for nearly a year to obtain the information that it desired from the petitioner in order to do this, but the record leaves much unexplained in regard to the degree, extent and effectiveness with which it pursued this objective considering the great powers of the law that it had behind it to aid it in its purpose.

All we really know is that at a certain stage in the audit while the Department was in the process of examining records produced by the petitioner in response to a subpoena, its auditors apparently decided to abandon the pursuit of further available information that they felt that they needed to compute the petitioner's true tax liability. They resorted instead to the making of an assessment upon the basis of a formula which they derived from the Department's prior audit experience with the petitioner. They made what is generally referred to as an "estimated" assessment.

It is, of course, fundamental that an assessment based upon an estimate of wages cannot be sustained unless the Department has legal authority to use estimation in making an assessment. There are certain circumstances under which such authority has been expressly conferred by statute. For example, Unemployment Insurance Code section 1126 states that:

> "1126. If any employing unit fails to make a return as required under this division the director shall make an estimate based upon any information in his possession or that may come into his possession of the amount of wages paid for employment in the period or periods for which no return was filed and upon the basis of such estimate shall compute and assess the amounts of employer and worker contributions payable by the employing unit . . . ." (underscoring added)

In Haines v. Department of Employment (1954), 125 Cal. App. 2d 304, 270 P. 2d 72, which case was a judicial review of our Tax Decision No. 1878, an appellate court upheld the making of estimated assessments by the Department under the similar provision of the Unemployment Insurance Act that has now become code section 1126. The assessments in that case covered certain quarters for which the taxpayers did not file returns. Those quarters were interspersed among others for which returns were filed.

The Department's estimation of wages in the Haines case was based on information in regard to the taxpayer's receipts from trucking operations, obtained from transportation tax reports filed with the Transportation Tax Division of the State Board of Equalization. The Department established a ratio between the wages reported to it during the quarters for which the taxpayer filed returns, and the receipts disclosed by the transportation tax returns for those same quarters. It then estimated the unreported wages for each of the quarters for which the taxpayer filed no returns in an amount bearing the same ratio to the transportation tax receipts which the taxpayer reported to the State Board of Equalization for those quarters.

There are a number of other tax laws that have been enacted by our legislature which contain the same kind of provisions expressly authorizing the making of estimated assessments in the manner and under circumstances similar to those set forth in Unemployment Insurance Code section 1126. These may be found in Revenue and Taxation Code sections 6511 (sales and use taxes), 7660 (gas tax), 8801 (diesel tax), 9901 (truck tax), 11311 (private car tax), 12423 (insurance taxes), 18682 (personal income tax), 25932

(corporation franchise and income taxes), 30221 (cigarette tax), and 32291 (alcoholic beverage tax). This type of procedure has been upheld on judicial review in connection with corporate income taxes in West Publishing Company v. McColgan (1946), 27 Cal. 2d 705, 166 P. 2d 861, affirmed 328 U.S. 823, 90 L. Ed. 1603, 66 S. Ct. 1378, and in connection with the use tax in People v. West Publishing Company (1950), 35 Cal. 2d 80, 216 P. 2d 441.

These judicial decisions support the general proposition that when a taxpayer does not file a return required of him by a tax law, then under the authority of a statute expressly so providing, the tax administrator may estimate the base from which the tax liability is computed. They specifically support the authority of the Department to compute and assess a tax liability under code section 1126 upon the basis of an estimate of wages paid for employment in any period for which no return is filed. They also stand for the proposition that a taxpayer who does not contest the accuracy of such an assessment in appropriate proceedings at administrative levels, may not do so thereafter on judicial review.

In the matter before us, however, the petitioner did file returns for each of the quarters included in the period under review. The assessment against the petitioner was not made under code section 1126, but rather under code section 1127. There is no express provision in that latter section authorizing the Department to compute tax liability upon the basis of estimate of wages paid for employment when it is not satisfied with a return that has been filed.

Code section 1127 states that:

> "1127. If the director is not satisfied with any return made by any employing unit of the amount of employer or wage-earner contributions, he may compute the amount required to be paid upon the basis of facts contained in the return or returns or upon the basis of any information in his possession or that may come into his possession and make an assessment of the amount of the deficiency. . . ." (underscoring added)

The absence of any provision in this statute expressly authorizing the use of estimation makes it necessary to inquire as to whether, and if so, to what extent such authority may exist by implication. The judicial decisions discussed above, resting as they do on express statutory authority, neither support, nor do they necessarily foreclose, the possibility that authority to use estimation may be implied, at least to some extent, in the circumstances

described in code section 1127. For guidance in resolving this question we must look elsewhere, and, unfortunately, there are no judicial decisions arising directly out of assessments made under code section 1127 itself to assist us in this regard.

However, this difference in the grant of authority between code sections 1126 and 1127 is not unique to the Unemployment Insurance Code. Every one of the laws that we mentioned above which has a provision similar to code section 1126 for making estimated assessments when no return has been filed, also has a companion provision similar to code section 1127 for assessing deficiencies when the tax administrator is not satisfied with a return that has been filed. These companion assessment provisions are Revenue and Taxation Code section 6481 (sales and use taxes), 7670 (gas tax), 8776 (diesel tax), 9876 (truck tax), 11314 (private car tax), 12422 (insurance taxes), 18583 (personal income tax), 25662 (corporation franchise and income taxes), 30201 (cigarette tax), and 32271 (alcoholic beverage tax).

There is no express provision in any of these laws authorizing the use of estimation in connection with the making of a deficiency assessment after a return has been filed.

Deficiency assessments of taxes made under some of the laws listed above have been reviewed in judicial decisions in which the method of determining the deficiency has been described by the court. The significant thing in regard to our inquiry here is that minor amounts of estimation do appear to have been used. Generally speaking, however, the gross amount of what might constitute the tax base was established by direct information not dependent upon estimation. Then whatever portion of that gross that the tax administrator was satisfied was not properly taxable was allowed as a deduction, leaving to the taxpayer the burden of proving any greater entitlement to deduction.

Thus in the two related cases of Rathjen Bros. v. Collins (1942), 50 Cal. App. 2d 765, 123 P. 2d 925, and Rathjen Bros. v. Collins (1942), 50 Cal. App. 2d 774, 123 P. 2d 930, the State Board of Equalization made a deficiency assessment of alcoholic beverage taxes. The calculation of this tax was based on the physical quantity (in gallons) of distilled spirits sold in this state. The board's method of determining the deficiency which it assessed was in each case as follows:

From an audit examination of the taxpayer's books and records, the board's auditors determined the quantity or distilled spirits possessed and acquired by the taxpayer during the assessment period. From this same source, they also determined the quantity of distilled spirits on hand at the close of the assessment period, and the quantity disposed of in what they considered to be nontaxable transactions. The resulting difference, less an allowance in one case for spillage and in the other for breakage, was adopted by the board as the quantity of distilled spirits subject to tax. The tax due on that quantity was calculated, and the excess of the calculation over the amount paid was assessed as a deficiency.

The board allowed the taxpayer the full amount of breakage which it claimed. The only estimation involved was in connection with the allowance for spillage which was given in accordance with a specific provision of the law authorizing a "reasonable loss tolerance." That allowance amounted to only one part per thousand of the gallonage taxed, and, significantly we note, was by way of deduction from the base of the tax rather than by way of augmentation of it.

In People v. Schwartz (1947), 31 Cal. 2d 59, 187 P. 2d 12, the State Board of Equalization made a deficiency assessment of sales taxes under Revenue and Taxation Code section 6481, using the following method to determine the deficiency. An audit examination was made of the retailer's bank deposits and cash disbursements. When it was found that they substantially exceeded the gross receipts from sales reported by the taxpayer, the latter was called upon to explain the excess. To the extent that it was not explained in a manner consistent with information derived from the taxpayer's books and records during the audit, the board considered this excess to be additional taxable sales. No estimation was involved in developing the information upon the basis of which the tax was computed.

The methods of determining the deficiencies assessed in these cases were acceptable to the courts. This, however, does not mean that these are the only acceptable methods. The courts really did not consider that question. A case that is at least more suggestive of judicial thinking in regard to the limits of acceptability in the methods of determining deficiencies is Maganini v. Quinn (1950), 99 Cal. App. 2d 1, 221 P. 2d 241. This case also involved deficiency assessments under Revenue and Taxation Code section 6481 which were determined in the following manner:

First an audit examination was made of the taxpayer's records in order to determine the average rates of markup on costs as reflected by the sales reported on the filed returns. Then the auditor applied the average normal markup used by like businesses in the community to the taxpayer's cost of goods sold during the taxable period. Based on these average normal markups as applied to the taxpayer's sales, a computation of tax was made and a deficiency assessed.

The taxpayer then filed a petition for redetermination, whereupon a second audit was made. Not only was it a more detailed and comprehensive investigation, but it also was conducted by an entirely different method. From the taxpayer's records, the quantity of stock purchased and disposed of by him during the assessment period was determined.

The sale of beverages constituted the bulk of the taxpayer's business. A computation was made of the number of drinks which the total quantity of inventory would yield, less a tolerance for spillage. To the aggregate thus obtained were applied the prices charged by the taxpayer for drinks.

With respect to this method, the court said at 99 Cal. App. 2d, page 7, 221 P. 2d pages 244 and 245:

> "From the foregoing we conclude that respondents here did not exceed their authority in the manner in which their second audit was conducted and the deficiency determined." (underscoring added)

The court then went on to say about the audit that:

> "It was predicated in the main upon facts and figures obtained from the appellant's own records, and from information as to the manner in which his business has been conducted. No preadopted percentage of proceeds over costs was applied, and those portions of the audit which were of necessity dependent upon estimate such as the eight per cent tolerance for spillage, were if not correct, subject to be controverted by the appellant." (underscoring added)

The Maganini case appears to us to offer a sensible approach to the question of implied authority to use estimation in making an assessment

under a statute that contains no express authority to do so. Certainly in interpreting such a statute, significance must be given to the fact that it exists in direct contrast to another provision of the same tax law expressly authorizing the use of estimation under different and more compelling circumstances. Likewise, significance must be given to the fact that this is a typical dichotomy present in a large number of tax laws that our legislature has enacted.

Under these laws, the legislature has expressly given the tax administrators a rather broad power to resort to estimation in assessing a taxpayer who has been derelict in his duty to report information essential to the tax computation. We do not think, however, that it can be said that by implication, the legislature also intended to give them this same broad power to use estimation in assessing a taxpayer who has complied with the reporting requirements of the law. Really the most that can be said is that by implication it intended to give the tax administrator the incidental authority that he needed to perform his duty of making assessments in proper situations.

Implied authority should always be viewed in terms of being incidental - as existing not for itself, but because it is necessary to carry out other authority that has been expressly granted. As such it must also be flexible. It must grow or contract in accordance with the extent of the necessity out of which it arises.

Under some circumstances, the necessity that gives rise to the implied authority may be such as to require only that a tiny portion of the tax base need be estimated; under other circumstances, the necessity may require estimation of a larger portion; it is conceivable that circumstances could exist making it necessary to estimate most, or even all, of the tax base. The essential thing is that the authority be commensurate with, but not exceed, the necessity, and that the criterion of necessity in the use of estimation is the extent to which direct information is not obtainable.

The real question here then is whether any such necessity existed in connection with the assessment under review. The record shows that the petitioner had very extensive books and records with which the Department had become familiar from previous audit experience, and which had in the past provided the Department with sufficient information to compute directly the assessment of a deficiency in the petitioner's reporting. The record reflects that in connection with the audit for the assessment under review, the Department had difficulty in getting the petitioner's Mr. Len to produce all of

those books and records that its auditors wanted to examine, but it in no way explains why the Department did not pursue to consummation its attempts to compel the petitioner to produce the records and information that it desired and which it felt that it needed.

If Mr. Len refused to comply with the Department's subpoenas, the Department had the power under the law to initiate steps that could have culminated in Mr. Len being cited before a superior court which could have punished him for contempt (Unemployment Insurance Code section 311; Government Code sections 11180 through 11191). In such a proceeding he would have had to answer to a court as to why he did not produce the records which the Department wanted to examine, but at the same time, he could also have had an opportunity to raise many of the complaints against the Department's actions which he now makes. This is brought out in Hill v. Brisbane (1944), supra 66 Cal. App. 2d 15 at page 19, 151 P. 2d 578 at page 581, wherein the appellate court said:

> "The relevancy of the material sought, the reasonableness of the demand, or questions of harassment could well have been inquired into by the superior court."

Such a proceeding, the court points out, is no place to litigate the merits of the taxpayer's tax liability. There is little that he can show by way of defense to proper administrative action, but there is an element of balance against improper administrative action in it.

In the light of all of this, what the record before us really reflects is not necessity, but irritation. It was an irritation that led the Department auditors to devise a formula for estimating a deficiency that carried with it a punishing wallop - over three times the amount of anything that might truly be called fact or information. Even in the West Publishing Company cases, where no returns had been filed, and the tax administrators assessed under statutes expressly authorizing the use of estimation, their estimates did not depart from information in their possession by more than 25 percent.

In the matter at hand, what the Department assessed was not a tax at all. It was a penalty for contempt which under the law it is solely the province of a court to impose. We cannot uphold such a penalty under the guise of an implied authority to use estimation in making an assessment because of necessity.

We do fully recognize that underneath all of this the Department may have had a legitimate basis for being dissatisfied with the petitioner's reporting. Certainly, we cannot accept the petitioner's contention that it retains sole authority to determine which of its expenditures constitute taxable wages. However, in the record before us the only documents which might conceivably support a portion of the Department's assessment are auditor Kaufman's schedules of the 102 specific payments about which he sought further information that he was unable to obtain cooperatively. We note that witnesses for the petitioner offered reasonable explanations with regard to many of these payments, and the Department failed to present any affirmative evidence that a single one of the listed payments was for taxable wages. By its own admission, the Department gave no consideration to these schedules in calculating its estimated assessment.

We conclude that the assessment, in its entirety, constitutes an attempted imposition of a penalty for contempt improperly assessed without authority of law.

DECISION

The decision of the referee is reversed. The petition for reassessment is granted.

Sacramento, California, May 19, 1970

CALIFORNIA UNEMPLOYMENT INSURANCE APPEALS BOARD

ROBERT W. SIGG, Chairman

LOWELL NELSON

CLAUDE MINARD

JOHN B. WEISS

DON BLEWETT