



BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeals of)
ERNEST J. AND EVELYN PRIMM; OTTO J. AND)
FRANCES P. DOSCH; CHARLES A. AND FRANCES M.)
GOODWIN; KARL M. AND ANNABEL ROTHENBORG;)
and LOYD S. AND HELEN N. PETTEGREW)

Appearances:

For Appellants: Dorothy Kendall, Attorney at Law

For Respondent: Burl D. Lack, Chief Counsel;
James Philbin, Junior Counsel

O P I N I O N .

These appeals are made pursuant to Section 18593 of the Revenue and Taxation Code from the action of the Franchise Tax Board on protests to proposed assessments of additional personal income tax for the year 1952 in the amounts of \$1,589.36 against Ernest J. and Evelyn Primm; \$12.04 against Otto J. and Frances P. Dosch; \$61.26 against Charles A. and Frances M. Goodwin; \$41.80 against Karl M. and Annabel Rothenborg; and \$46.86 against Loyd S. and Helen N. Pettegrew,

Appellants are members of a partnership which operated a legal draw poker establishment in Gardena, California, known as the Monterey Cafe. The house (Monterey Cafe) collected half-hourly seat rentals from all players, It employed so-called house players to make up the necessary minimum of players to start games or keep them in progress, House players were provided with money with which to bet and pay seat rentals, and were ordered to play in a conservative manner. When a house player left a game, he returned to the house all of the money remaining in his possession, reduced from the original amount by his payment of betting losses and seat rentals or increased by his net winnings. At the end of the year in question, the total of the amounts returned by the house players was less than the total of the amounts originally provided them, The difference was deducted by the house as a business expense. No books were kept to distinguish between the seat rentals and the betting losses paid by the house players.

The Franchise Tax Board contends that the deduction was improper because wagering losses are deductible only to the extent of wagering gains. Appellants contend that the amount

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claimed as a deduction was deductible in full as a business expense or as a business loss.

The relevant sections of the Revenue and Taxation Code are as follows: (1) Section 17301(a) (now 17202(a)) provides that in computing net income there shall be allowed as a deduction all ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business; (2) Section 17306 (now 17206) provides that in computing net income there shall be allowed as a deduction losses sustained **during** the taxable year if incurred in business or in any transaction entered into for profit; (3) Section 17308 (now Section 17206(d)) provides that losses from wagering **trans-**actions shall be allowed only to the extent of the gains from such transactions.

Substantially identical counterparts of the above sections are contained in the United States Internal Revenue Code. A Federal court, stating that the provision of the Internal Revenue Code relating specifically to wagering losses is exclusive, has overruled the contention of the Commission of Internal Revenue that a person must show that he gambled for profit in order to deduct any of his gambling losses (Humphrey v. Commissioner, 162 Fed. 2d 853, cert. den. 332 U.S. 817). It has also been held that a professional gambler must rely for deduction of his losses on the wagering loss provision rather than the provision relating to business losses (Skeeles v. U. S., 95 Fed. Supp. 242). The California District Court of Appeals has cited the Humphrey case with approval. Although the question of whether Section 17308 is the exclusive provision for allowing gambling losses was not expressly raised, the California court considered that section, and no other section allowing deductions, in determining that losses of a professional gambler are in the nature of deductions rather than exclusions from gross income (Hetzel v. Franchise Tax Board, 161 Cal. App. 2d 224).

Clearly, the Monterey Cafe was engaged in wagering transactions through its use of house players. That being so, the losses which it suffered in those transactions were necessarily wagering losses. It is apparent from the Federal cases cited above that Appellants may not choose to deduct those amounts in full as business losses rather than as wagering losses. This conclusion is fortified by the approach taken by the California court in the Hetzel case.

Appellants argue, however, that these sums were ordinary and necessary expenses of their business and that, even if Section 17308 is the exclusive provision for allowing them as losses, it does not stand in the way of claiming them as business expenses under Section 17301(a). We cannot

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agree. Despite the fact that in the above-cited cases there was no mention of the possibility of claiming the losses there involved as business expenses, the reasoning, explicit in the Federal cases and implicit in the California case, is applicable here. The amounts lost through the house players were undoubtedly wagering losses, even if they fell also into the broad category of business expenses.—Since Section 17308 deals specifically with wagering losses, it controls their deductibility. Appellants may not avoid the limitation contained in the section by calling the wagering losses business expenses any more effectively than they can avoid the limitation by calling them business losses.

Some portion of the amounts disallowed as deductions by the Franchise Tax Board includes seat rentals paid by the house players. Although the house itself originally provided the funds for these rentals, it is possible that the house included them in gross income together with rentals paid by persons other than house players. The record before us does not establish whether this was the case nor does it indicate the amount of the house player seat rentals. Under the circumstances, we can make no adjustment with respect to this item,

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 on protests to proposed assessments of additional personal income tax for the year 1952 in the amounts of \$1,589.36 against Ernest J. and Evelyn Primm; \$12.04 against Otto J. and Frances P. Dosch; \$61.26 against Charles A. and Frances M. Goodwin; \$41.80

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against Karl M. and Annabel Rothenborg; and \$46.88 against Loyd S. and Helen N. Pettegrew, be and the same is hereby sustained.

Done at Sacramento, California, this 23rd day of July, 1959, by the State Board of Equalization.

Paul R. Leake, Chairman

George R. Reilly, Member

Alan Cranston, Member

John W. Lynch, Member

Richard Nevins, Member

ATTEST: Dixwell L. Pierce, Secretary