BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
GERATD AND HELEN BARRON)

Appearances:

For Appellants: Archibald M. Mull, Jr.,
Attorney at Law

For Respondent: Wilbur F. Lavelle, Assistant Counsel
Israel Rogers, Assistant Counsel

OPINION

This appeal is made pursuant to Section 18594 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Gerald and Helen Barron to proposed assessments of additional personal income tax in the amounts of $4,073.27, $7,610.44, $14,654.06, $18,422.72 and $18,838.47 for the years 1951, 1952, 1953, 1954 and 1955, respectively.

Appellant Gerald Barron owned and operated a coin machine business in and near San Mateo. The business name was G. Barron Music Company. The Company owned multiple-odd bineo pinball machines, music machines, shuffleboards, shuffle alleys and miscellaneous amusement devices. On the averane, during the years in question, it owned about 50 pinball machines, about 40 music machines and about 25 other pieces of equipment.

The equipment was placed in bars, restaurants and other locations. The proceeds from each machine, after exclusion Of expenses claimed by the location owner in connection with the operation of the machine, were divided equally between the location owner and Barron.

The gross income reported for State tax purposes by Appellants from the G. Barron Music Company business was the total of amounts retained from locations. Deductions were taken for depreciation, cost of phonograph records, salaries and other business expenses.

Respondent determined that Rarron was renting space in the locations where the machines were placed and that all the coins deposited in the machines constituted gross income to Barron. Respondent also disallowed all expenses pursuant to Section 17359 (now 17297) of the Revenue and Taxation Code which read:

> In computing net income, no deductions shall be allowed to any taxpayer'on any of his gross income

> derived from illegal activities as defined in Chapters 9, 10 or 10.5 of Title 9 of Part 1 of the Penal Code of California; nor shall any deductions be allowed to any taxpayer on any of his gross income derived from any other activities which tend to promote or to further, or are connected or associated with, such illegal activities.

The evidence indicates that the operating arrangements between Barron and each location owner were the same as those considered by us in Appeal of C. B. Hall, Sr., Cal. St. Bd. of Equal., Dec. 29, 1958, 2 CCH Cal. Tax Cas. Par. 201-197, 3 P-H State & Local Tax Serv. Cal. Par. 58145. Our conclusion in Hall that the machine owner and each location owner were engaged in a joint venture in the operation of the machines is, accordingly, applicable here.

As we also held in Hall, if a coin machine is a game of chance and cash is paid to winning players, the operator is engaged in an illegal activity within the meaning of Section 17359. The multiple-odd bingo pinball machines here involved are substantially indentical to the machines which we held to be games of chance in Hall.

The owners of two locations in which multiple-odd bingo pinball machines furnished by Barron were operated during the period in question testified that cash payouts were made to players for free games not played off, that at the time of a collection the location owner received from the proceeds of the machine the amount of such cash payouts and other expenses in connection with the machine, and that the balance of the proceeds of the machine was divided equally with Barron.

A person who was a collector and mechanic for the G. Barron Music Company was asked with respect to the multiple-odd bingo pinball machines, "Did you expect that the location owner would make payouts off the machine?;?, and he answered, "They usually did." He was also asked, "Did you find in the course of your experience that you had just as much play off the pinball machines that did not make payouts than those that did?", and he answered, "No. The ones that paid out got the most play." He also testified that when he made collections it was the virtually universal practice of the location owners who had multiple-odd bingo pinball machines to claim amounts from the proceeds of the machines for cash payouts to players for free games not played off.

Appellant Gerald Barron was asked, "Now, did all of your locations make payouts as far as you know?", and he answered, "Well, as far as I know, I think they did."

From the evidence before us, we conclude that it was the general practice to make cash payouts to players of multiple-odd

bingo pinball machines for free games not played off. Accordingly, these machines were operated illegally and Respondent was correct in applying Section 17359.

Most of the locations which had equipment from Barron had both a music machine and a pinball machine. We thus find there was a substantial connection between the illegal activity and the legal activity and Respondent was correct in disallowing all deductions of the entire business.

The collector for the company prepared a collection report at the time of each collection and left a copy with the location owner. The amounts included on the reports were the proceeds after exclusion of the amounts claimed by the location owners for expenses. Sincetherewere no records of amounts paid to winning, players and other expenses initially paid by the location owners, Respondent made an estimate of the unrecorded amounts.

At the time of the audit in 1357, Respondent's auditor asked Barron what the percentage of payouts was on the ninball machines and Barron told the auditor that the auditor should know better than Barron himself because he had made audits of this type before. In the absence of any evidence as to the percentage of payouts, Respondent assumed that the payouts on multiple-odd bingo pinball machines averaged 50% of the amounts deposited in the machines. The 50% fipure was used because it was what Respondent had found in audits of other ninball operators in the area.

The company's journal records did not break down income between multiple-odd bingo pinball machines and other tvnes of machines. However, the collection reports indicated separately the amounts for music, pinball and other equipment where there was more than one machine in a location. Respondent's auditor analyzed the collection reports covering a period of two months out of each of the years in question and determined the percentage of recorded income from multiple-odd bingo ninball machines and from other types of machines. The percentages were as follows:

Year	Pinball	Other
1951	50.34%	49.66%
1952	51.56	48.44
1953	72.38	27.62
1954	76.78	23.22
1955	78.50	21.50

Respondent determined the amount of recorded income derived from pinball machines in each year by applying these percentages to the total recorded income for the year. The payouts

were then determined by applying the 50% payout percentage to the computed pinball income for each year.

As we also held in Hall, supra, Respondent's computation of gross income is presumptively correct. There were no records of the amounts paid to players of multiple-odd bingo pinball machines for free games not played off. Respondent's method of estimation was reasonable under the circumstances and, therefore, except for the reduction due to our conclusion that Appellants and each location owner were engaged in a joint venture, Respondent's computation of gross income is sustained.

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 the protest of Gerald and Helen Barron to proposed assessments of additional personal income tax in the amounts of $4,073.27, $7,610.44, $14,654.06, $18,422.72 and $18,838.47 for the years 1951, 1953, 1953, 1954 and 1955, respectively, be and the same is hereby modified in that the gross income is to be recomputed in accordance with the Opinion of the Board. In all other respects, the action of the Franchise Tax Board is sustained.

Done at Sacramento, California, this 13th day of December, 1961, by the State Board of Equalization.

John W. Lynch, Chairman

Geo. R. Reilly, Member

Paul R. Leake, Member

_____, Member

_____, Member

ATTEST: Dixwell L. Pierce, Secretary