



O P I N I O N



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Appeals of Salvatore J. and Prances Campagna, et al.

We are here concerned with the operation of' four separate businesses during certain periods as follows:

Towne Company - Nay 3, 1951, to **December** 31, 19%

Towne Company, **Digger** Division - **May 3, 1951**, to  
December 31, 1952

Fontana **Music** Company - January 1, **1952**, to  
December 31, 1953

G. I. Novelty Company - **May 5**, 1951, to December 31, 1953

Each Appellant owned an interest in one or more of the businesses during all or a portion of the time with which we are concerned.

The Towne Company was a partnership which operated a coin machine business in and near San Bernardino. It owned about **17** multiple-odd bingo pinball machines, 2 or 3 flipper pinball machines, some punchboards, some console slot machines, some music machines, some shuffleboards, and miscellaneous amusement equipment.

The Towne Company, **Digger** Division, was a partnership which operated a coin machine business in and near San Bernardino. It owned **digger** machines (also called claw machines or crane machines), **multiple-odd bingo pinball** machines, console slot machines, music machines, punchboards, **shuffleboards** and some miscellaneous amusement equipment.

The G. I. Novelty Company was a partnershin which operated a coin machine business in and near Fontana. The **types of equip-**ment it owned included multiple-odd **bingo pinball machines**, flipperpinball machines, music machines, puns, children's rides, and miscellaneous amusement equipment.

The Fontana **Music** Company was a sole **proprietorship** owned by Salvatore J. Campagna. It operated a coin machine business in and near Fontana. Included in the types of equipment owned were multiple-odd bingo pinball machines, music machines, shuffleboards, and **miscellaneous amusement** equipment.

Each of the businesses in question placed its equipment in bars, restaurants and other locations. The proceeds from the equipment in each location, after exclusion of **expenses** claimed by the location owner in connection with the oneration of the equipment, were divided equally between the business and the location owner.

The gross income of each business reported in tax returns was the total of the amounts retained by it from locations. Deductions were taken for salaries, depreciation and other business expenses.

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Respondent determined that each of the businesses with which we are concerned was **renting** space in the locations where its machines or punchboards were placed and that all the coins deposited in the machines or paid for play of the punchboards constituted gross income to the machine **owner**. Respondent also disallowed all expenses pursuant to Section 17359 (now 17297) of the Revenue and Taxation Code which read:

In computing net income, no deduction 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 **deduc-**tions 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 each of the businesses in question and each of the location owners were the same as those considered **by us in Appeal of C. B. Pall, Sr., Cal. St. Bd. of Equal., Dec. 29, 1958, 12 CCH Cal. Tax Cas. Par. 201-197, 3 P-H State & Local Tax Serv. Cal. Par. 58145.** Our conclusion in Pall that the machine owner and each location owner were **engaged in** a joint venture in the operation of the machines is, accordingly, applicable here.

From the evidence, we conclude that it was the general practice to pay cash on request to players of multiple-odd bingo pinball machines for free games not played off. The multiple-odd bingo pinball machines were **substantially** identical to the machines which we held to be games of chance in Hall. Accordingly, these machines were operated in violation of Section 330a of the Penal Code and Respondent was correct in disallowing deductions from gross income from such machines.

From the evidence, we conclude that it was the general practice to pay cash on **request** to players of **claw** machines in redemption of figurines which the players had obtained from the claw machines. The claw machines were substantially identical to the machines which we held to be **games** of chance in Appeal of Peter Perinati, Cal. St. Bd. of Equal., April 6, 1961, 3 CCH Cal. Tax Cas. Par. 201-733, 3 P-H State & Local Tax Serv. Cal. Par. 58191, and in Appeal of Edward J. Seeman, Cal. St. Bd. of Equal., July 19, 1961, 3 CCH Cal. Tax Cas. Par. 201-625, 3 P-F State & Local Tax Serv. Cal. Par. 58208. Accordingly, these machines were operated in violation of Section 330a of the Penal Code and Respondent was correct in disallowing deductions from gross income from such machines.

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The evidence indicates that something of value was furnished to winning players of punchboards. Accordingly, the punchboards were operated in violation of Section 330a of the Penal Code and Respondent was correct in disallowing deductions from gross income from punchboards.

Generally, a representative of the machine owner or punchboard owner collected from the machines or punchboards once a week. At the time of the collection the **representative** prepared a collection report in duplicate and left one copy with the location owner. The collection report included the amount of the proceeds from the machines or punchboards after exclusion of the amount claimed by the location owner for expenses.

In the case of the G. I. Novelty Company, however, the auditor for Respondent in the course of his **investigation** discovered nine collection reports which showed the gross amount in the machine, the expenses, and the remaining proceeds to be divided between the location owner and the G. I. Novelty Company. The total of the expenses shown on these nine reports was 50.6% of the gross amount in the machines. Respondent, for the purpose of its assessment, rounded this figure to 50% and assumed that the payouts on all multiple-odd bingo pinball machines of the G. I. Novelty Company equalled 50% of the **gross** amount deposited in the machines.

In the course of his investigation, Respondent's auditor interviewed several location owners who had **machines owned** by the Towne Company, by the Towne Company, **Digger** Division, and by the Fontana Music Company. Based on estimates of **percentages** of payouts given by these location owners, Respondent's assessments as to these three companies were made on the assumption that the payouts on multiple-odd bingo pinball machines equalled 55% of the amounts deposited in the machines. The testimony of **Appellant** Salvatore J. Campagna at the hearing on these appeals confirmed that this 55% was quite close to the actual amount.

At the time of his investigation, Respondent's auditor interviewed Mrs. Towne. In their discussion concerning punchboards, **Mrs.** Towne indicated that they were manufactured so as to produce a 50% payout. Respondent's assessments with **respect** to the Towne Company and the Towne Company, **Digger** Division, are on the basis that 50% of the gross receipts from **punchboards** was paid out to winning players.

In the audit of another taxpayer in the San Bernardino area who operated claw machines, Respondent's auditor came upon a series of collection tickets for claw machines which showed the gross amount in the machines, the amount for redemption of figurines to players who obtained figurines from the machines, and the net proceeds to be divided between the machine owner and the

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location owner. These collection tickets produced an average amount for redemption equal to 70% of the amounts in the machines. Respondent's assessments as to the Toarne Company and the Towne Company, Digger Division, are based on a payout percentage of 70% for claw machines.

Since there were no complete records of amounts paid to winning players, and other expenses initially paid by the location owners, Respondent made estimates of these unrecorded amounts. As to the Towne Company and Towne Company, Digger Division, Respondent's estimate of the unrecorded cash payouts was computed by combining the assumed payout percentages stated above with the amount of income shown on the records as derived from pinball machines, claw machines, and punchboards, respectively. Respondent assumed that there were no cash payouts with respect to music machines, shuffleboards and miscellaneous amusement equipment. The amount shown in the records as income from slot machines was so small that Respondent made no attempt to compute estimated cash payouts on the slot machines.

The records of neither the G. I. Novelty Company nor the Fontana Music Company showed separately the income from multiple-odd bingo pinball machines and the income from other types of equipment.

As to the G. I. Novelty Company, Respondent's auditor interviewed Appellant Alfred G. Edelmann, a partner, and of the total income of the business, Mr. Edelmann estimated the percentage derived from multiple-odd bingo pinball machines. Respondent's estimate of unreported cash payouts was derived by combining the payout percentage stated above with the income from such pinball machines as estimated by Mr. Edelmann.

As to the Fontana Music Company, Respondent's auditor interviewed Appellant Salvatore J. Campagna, the owner, in the summer of 1954. At that time the Fontana Music Company had about 40 multiple-odd bingo pinball machines and about 30 pieces of other types of equipment. In the absence of a better method of estimating the income from such pinball machines, Respondent's auditor assumed that for the period in question, 4/7 of the recorded income of the Fontana Music Company was from multiple-odd bingo machines and 3/7 from other types of equipment. Respondent's estimate of the unrecorded cash payouts as to the Fontana Music Company was computed by combining the payout percentage stated above with this estimate of income from multiple-odd bingo pinball machines.

Appellants have presented no evidence to indicate that Respondent's method of estimating unrecorded cash payouts was erroneous. As we also held in Fall, supra, Respondent's computation of gross income is presumptively correct. There were no complete records of the amounts paid to winning players.

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Respondent's method of estimation was reasonable under the circumstances and, therefore, except for the reduction due to our conclusion that each owner of machines or punchboards and each location owner were engaged in a joint venture, Respondent's computation of gross income is sustained.

Each of the businesses in question appears to have been operated as a unit. There was evidence that as to each of the businesses the same collector collected from all types of machines and the same repairman repaired all types of machines. There was, thus, a substantial connection between the illegal activities of operating multiple-odd bingo pinball machines, claw machines or punchboards, and the legal activity of operating music machines, shuffleboards, and other pieces of amusement equipment. Accordingly, Respondent was correct in disallowing all expenses of the businesses in question.

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 as follows:

<u>Appellant</u>	<u>year</u>	<u>Amount</u>
Salvatore J. and Frances Campagna	1951	\$1,134.03
	1952	3,844.88
	1953	7,125.39
Dwight F. and Nell M. Towne	1951	932.45
Dwight F. Towne	1952	549.83
Nell M. Towne	1952	1,557.38
	1953	4,939.64
	1954	2,572.68
Alfred G. and Julia E. Edelmann	1951	\$ 129.80
	1952	1,763.83
	1953	3,323.37
Dick Jay and Beulah E. Harrison	1951	1,351.63
	1952	1,374.07
	1953	1,876.10
Mathew G. and Sophie Janes	1953	461.90

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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