BEFORE THE STATP BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeals of)
)
FRED G. AND FRANCES CCRSETTI)
DOMENIC APD RAE GIANNTNI)

Appearances:

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

For Respondent: F. Edward Caine, Senior Counsel

O P I N I O N

These appeals are made pursuant to Section 18594 of the Revenue and Taxation Code from the action of the Franchise Tax Board on protests to proposed assessments of additional personal income tax against Fred G. and Frances Corsetti in the amounts of $573.51, $1,641.41 and $1,373.35 for the years 1952, 1953 and 1954, respectively, against Domenic Giannini in the amount of $380.32 for the year 1952, against Rae Giannini in the amount of $389.61 for the year 1952, and against Domenic and Rae Giannini in the amount of $1,733.32 for the year 1953.

Appellants Fred G. Corsetti and Domenic Giannini were partners in the G & C Novelty Company. G & C operated a coin machine business in and near Eureka. The company owned multiple-odd bingo pinball machines, music machines and bowlers. The equipment was placed in restaurants, bars 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 G & C and the owner of the location where the machine was placed. Equipment was placed in approximately 35 locations.

The gross income reported in G & C's returns was the total of the amounts retained by G & C from locations. Deductions were taken for depreciation, cost of phonograph records, salaries and other business expenses,

Respondent determined that G & C was renting space in the locations where its machines were placed and that all the coins deposited in the machines constituted gross income to G & C. 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 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 G & C and each location owner were the same as those considered by us in Appeal of C. B. Hall, Sr., Cal: St. Rd. 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 held in the Hall appeal, if a coin machine is a game of chance and cash is paid to winning players, then the operator is engaged in an illegal activity within the meaning of Section 17359. The multiple-odd bingo pinball machines here involved are substantially identical to the machines which we held to be games of chance in Hall. There is a conflict in the evidence as to whether it was the general practice to make cash payouts to players of these machines.

In 1956, Respondent's auditor interviewed eight location owners who had multiple-odd bingo pinball machines owned by G & C in 1952, 1953 and 1954. Of these eight, five stated that cash payouts were made in lieu of free games, one declined to comment, and two stated that cash payouts were not made. However, Respondent's auditor testified that one of those stating that cash payouts were not made included in his statement not only the years 1952, 1953 and 1954, but all years in which he had operated in that place of business. Later the same day, Respondent's auditor again visited this place of business and witnessed a player of' a multiple-odd bingo pinball machine receiving cash in lieu of free games. At the hearing of these appeals, five location owners denied having made payouts, Two of them had stated to Respondent's auditor in 1956 that cash payouts were made.

Respondent's auditor interviewed Appellants Domenic Giannini and Fred G. Corsetti in 1956 and at that time both stated that it was the general practice of location owners to make cash payouts to players for free games not played off. At the Fearing of this matter, Appellant Fred G. Corsetti attempted to give the impression that he had no knowledge of whether location owners were making such cash payouts. However, from his evasive method of answering questions, we conclude that he knew that such cash payouts were being made.

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.

The evidence indicates that the same collector collected from all types of machines and that the same repairman repaired all types of machines. Furthermore, many locations serviced by G & C had both a music machine and a pinball machine or a bowler and a pinball machine, We thus find that there was a substantial connection between the illegal activity of operating multiple-odd bingo pinball machines and the legal activity of operating music and amusement machines. Therefore, Respondent was correct in disallowing all deductions for expenses of the entire business.

We next consider whether Respondent's computation of gross income was correct. The collector for G & C 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 net proceeds after the amounts claimed by the location owners for expenses. Since there were not complete records of amounts paid to winning players and other expenses initially paid by the location owner, Respondent made an estimate of the unrecorded amounts.

Respondent's auditor, at the time of interviewing the eight location owners mentioned above, also asked them for an estimate of the percentage which the payouts bore to the total amounts in the multiple-odd bingo pinball machines. Estimates were made by the five location owners who stated that such cash payouts were made. Based on the average of these estimates, Respondent's assessment was computed on the assumption that the cash payouts equalled 35% of the total amounts deposited in the machines.

As we also held in Hall, supra, Respondent's computation of gross income is presumptively correct. 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 protests to proposed assessments of additional personal income tax against Fred G. and Frances Coraetti in the amounts of $573.51, $1,641.41 and $1,373.35 for the years 1952, 1953 and 1954, respectively, against Domenic Giannini in the amount of $380.32 for the year 1952, against Rae Giannini in the amount of $389.61 for the year 1952, and against Domenic and Rae Giannini in the amount of $1,733.32 for the year 1953, 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