

BEFORE ~~THE~~ STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA



In the Matter of the Appeal of)
LEO AND ERMA GIANNONE)

For Appellants: Heller, Ehrman, White & McAuliffe,
Attorneys at Law

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

O P I N I O N

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 Leo and Erma Giannone to proposed assessments of additional personal income tax in the amounts of \$28.29, \$28.20, \$28.20 and ~~\$84.78~~ for the years 1952, 1953, 1954 and 1955, respectively.

Appellant Leo Giannone was a partner with Roy Blackman in **the G. & R. Smoke Shop in San Francisco from October 1, 1951, to April 30, 1955**, and the sole proprietor of the G. & R. Smoke Shop thereafter until January 1, 1956.

The G. & R. Smoke Shop sold tobacco products, candies, greeting cards, magazines and other similar items. In addition, dice games, pinball machines and crane machines were maintained on the premises and were played by customers of the store. Players who won at the dice games were allowed to select merchandise at the regular retail price in redemption of their winnings.

Respondent disallowed all expenses on the tax returns filed for the G. & R. Smoke Shop pursuant to Section 17297 (17359 prior to June 6, 1955) of the Revenue and Taxation Code which reads:

In computing taxable 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.

Appeal of Leo and Erma Giannone

In Appeal of Woerner, this day decided, we held that the conducting of a dice game played for merchandise credit is prohibited by Penal Code Section 330. Woerner also involved claw machines the operation of which was held to be prohibited by Penal Code Section 330a. Accordingly, there was illegal activity and Respondent was correct in applying Section 17297.

From the facts submitted to us it may be inferred that the illegal activity contributed from 30% to 60% of the gross profit of the G. & R. Smoke Shop. It is thus clear that the illegal activity was a substantial or the primary business activity. Merchandising, even if independently profitable, served as a front for the illegal activity. Therefore, merchandising was associated or connected with the illegal activity and the expenses of the entire business were properly disallowed.

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 HLREBY 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 Leo and Erma Giannone to proposed assessments of additional personal income tax in the amounts of \$28.29, \$28.20, \$28.20 and \$84.78 for the years 1952, 1953, 1954 and 1955, respectively, be and the same is hereby affirmed.

Done at Sacramento, California, this 25th day of April, 1962, by the State Board of Equalization.

Geo. R. Reilly, Chairman
Alan Cranston, Member
John W. Lynch, Member
Paul R. Leake, Member
Richard Nevins, Member

ATTEST: Dixwell L. Pierce, Secretary