



BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeals of)
STUART ARONOFF, et al.)

Appearances:

For Appellants: Thomas W, LeSage, William B.
Beirne and Louis C. Hoyt,
Attorneys at Law

For Respondent: Wilbur F. Lavelle, Associate Tax
Counsel, and Israel Rogers,
Assistant 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 of a number of individuals named in the order attached hereto, against proposed assessments of additional personal income tax for the years 1951, 1952, 1953 and 1954.

Collectively, the Appellants herein operated six business establishments in the city of Santa Monica from May 23, 1951 to October 5, 1954. These business establishments were called "Blackout," "Vogue," "Jade," "Cameo," "Shamrock," and "Nate Franklin's." Each of the Appellants herein was the owner of or a partner in one or more of these businesses. In each of the business establishments a certain game was played, which will be described hereafter,

Partnership and individual tax returns were filed for the period in question. Respondent disallowed all expenses attributable to these businesses 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.

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It is **Respondent's** contention that the operation of the game in question was a lottery as defined in section 319 of the Penal Code. Section 319 is in Chapter P of Title 9 of Part 1 of the Penal Code.

The Supreme Court has declared that there are three elements of a **lottery**: (1) a prize, (2) distributed by chance, and (3) consideration. (California Gasoline Retailers v. Regal Petroleum Corp., 50 Cal. 2d 844.) In the case of the games in question the players paid a consideration to play and prizes were awarded to winners.

Before reaching the question of whether the winners of the games were determined by chance, we must consider several contentions of Appellants as to the scope of our examination.

The six businesses each received a business license from the city of Santa Monica. The licenses expired each June 30 but were renewed. In 1954, however, the chief of police refused to renew the licenses on the ground that the games were illegal because the winners were determined by chance.

Appellants appealed to the city council and a public hearing was held on August 17, 1954. At the beginning of the hearing the city attorney stated that the issue before the council was the factual one of whether, on the basis of the evidence, it appeared that the winners of the games were determined predominantly by chance or predominantly by skill. The evidence before the city council consisted of a statement of how the games were played, this statement having formed part of the application for a license; a compilation of the actual results of a number of games; testimony of Appellant Roy C. Troeger concerning the operation of the games and offering the observation that "**the experienced player will accomplish a greater number of wins than the inexperienced player**"; and testimony of a physicist that the games were predominantly games of skill because the statistics compiled from the actual results of a number of games showed a grouping which could not occur as a result of chance alone. The city **council's** decision was that the games were predominantly games of skill,

A taxpayer of Santa Monica then brought a proceeding against the city of Santa Monica in the superior court to prohibit the city from issuing the licenses on the ground that the games were illegal lotteries. The trial judge took evidence and concluded that the games were **predominantly** games of chance and therefore illegal. He orally announced his decision on October 5, 1954, and the operators of the games immediately closed down,

This judgment was appealed and on August 17, 1956 the California Supreme Court reversed. (Nathan H. Schur, Inc., v. City of Santa Monica, 47 Cal. 2d 11.) The Supreme Court **held** that the **only** issue before the superior court was the validity of the city license, that the city council exercised a quasi-judicial function in the licensing procedure and

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therefore the superior court could not receive evidence on the issue of chance but must confine itself to a review of the record before the city council to determine whether there was substantial evidence to sustain the city council's determination. In the course of its opinion the court also stated, "It should also be observed that whether licenses are or are not issued the criminal law is still open to Schur."

The parties to the proceeding never brought the matter to a retrial in the superior court because in the meantime the Santa Monica City Council had passed an ordinance prohibiting the conduct of games of the type in question,

Appellants contend that the Santa Monica City Council had jurisdiction to consider the legality of the games, that it exercised a quasi-judicial function, that it held a hearing and received evidence, that it made its decision and that the decision is now final and determinative of the issue before us.

Appellants' contentions are refuted by the above-quoted portion of the opinion in the Schur case to the effect that the criminal law is still open. As we read the Schur opinion, the reasoning is that the city council had jurisdiction to determine whether a city license should issue and its decision was final in the absence of an error of law. The city council, however, had no criminal jurisdiction and therefore its determination would have no effect on a criminal proceeding even though an identical issue might have to be decided in both the licensing and the criminal proceedings. To the same effect is People v. Settles, 29 Cal. App. 2d Supp, 781, which held that the possession of a city license to conduct a game of skill did not constitute a binding determination that the game was in fact a game of skill so as to be a defense in a criminal prosecution for operating an illegal lottery.

Similarly, the determination of the amount of taxes owed is independent of the city licensing procedure. The fact that there might be a common issue in both types of proceedings as applied to specific individuals is merely a coincidence and does not alter our duty to decide these appeals on the record before us.

The game in each business establishment was played by a maximum of 50 players, each of whom paid a fee to play. A merchandise prize was awarded to the winner. A seat at a counter was provided for each player. In front of each player was a receptacle divided into 75 compartments each 1-7/8" square and numbered from 1 to 75. In the center of the receptacle there was an unnumbered hole 3-1/2" square painted red. Each player was provided with rubber balls 1-1/2" in diameter,

Each player was also provided with a card containing 75 numbers arranged in 5 columns of 15 numbers each. The first column contained the numbers 1 to 15 but arranged out of numerical sequence, the second

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column contained the numbers 16 to 30, similarly arranged, and so on as to the remaining columns, A player could play more than one card but paid an extra fee for additional cards. Out of all the cards used in the game no two cards had the numbers arranged in the same order.

The play began by the operator designating eight of the players to throw one ball in his receptacle in turn. Thereby eight numbers were selected and all persons playing covered the corresponding numbers on their cards with white markers, The receptacles of the eight players throwing the "set up" balls were cleared and thereupon all players began to throw "skill" balls into their respective receptacles and covered the corresponding numbers on their cards with black markers.

The winner was the player having five markers in a row horizontally, vertically or diagonally on his card with the lowest number of black markers. Speed was not a factor in winning, It was possible for two or more players to tie and ties regularly occurred.

Of the five markers in the winning combination, at least one was required to be a black marker, That is, if the numbers covered as a result of the eight "set up" balls gave a particular player five in a row he would not be declared the winner until he had thrown at least one "skill" ball in a receptacle with one of these numbers thereby replacing his white marker with a black marker.

There were introduced in evidence reports of the winning results in some 7,000 games played at one of the locations. These reports were compiled by recording as to the winner of each game the number of black markers in his winning combination and the number of black markers on his card, These reports showed a pattern of very few of the winners having less than 5 black markers on the card, a few of the winners having 10 or more black markers on the card (ranging up to 15) and the great bulk of the winners having from 5 to 9 black markers on the card. More than 30 percent of the winners had 5 black markers on the card.

As stated above, of the three elements of a lottery, consideration, prize and chance, the first two are clearly present in this case and it is only the chance element which is in issue. The test to be applied is stated in People v. Settles, supra, as follows:

A game is not to be regarded as one of skill merely because that element enters into the result in some degree, or as one of chance solely because chance is a factor in producing the result, The test of the character of a game or scheme as one of chance or skill is, which of these factors is dominant in determining the result?

Respondent presented an engineer as an expert witness. He stated that in his opinion both chance and skill were present but that chance predominated over skill in determining the winners of the games, He never

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observed the playing of the games but based his opinion on a description of the games furnished to him and on the reports of the winning results of some 7,000 games described above.

His reasoning proceeded along several alternative lines. The relative position of a player as a result of the eight "set up" balls was determined by chance. The reports of the winning results indicated that the winner averaged 7.12 black markers on his card and 2.98 black markers in his winning combination. From this he reasoned that chance predominated over skill because the winner was unable to get a ball in a particular hole as often as half the time. He also suggested an economic analysis to the effect that if it were possible to develop some substantial skill, some players would have done so and they would win most of the time and thereby discourage the ordinary player from playing.

Appellants presented a mathematician as an expert witness. He never observed the playing of the game and based his analysis on the same data as Respondent's expert, namely, a description of the game and the reports of the winning results of over 7,000 games.

The mathematician's method was to assume that the winner was determined solely by chance and to construct a mathematical model of this hypothesis. From the model he derived certain conclusions and tested them against the results of actual games. When the actual results were substantially different from the results to be expected if the winner was determined solely by chance, he concluded that the probability was 1 in 100,000,000 that the actual results had occurred solely by chance.

Appellants' expert stated his opinion that the game was not one in which the winner was determined solely by chance. Based on his opinion that the chance probability was extremely small, he concluded that the game was predominantly one of skill. He defined "skill" as any factor which enables a player to improve the performance over chance performance.

There are two California cases (Einzig v. Board of Police Commissioners, 138 Cal. App. 664; and People v. Babdaty, 139 Cal. Supp. 791) which hold tango games to be games of chance. The tango games were almost identical to the "set up" ball phase of Appellants' games except that they did not stop at eight "set up" balls but continued until there was a winner.

In Brown v. Board of Police Commissioners, 58 Cal. App. 2d 473, the trial court ordered a city permit to be issued for the conduct of a game virtually identical to Appellants' games except that it had no "set up" ball feature. The balls used were "of such density that when tossed into a hole they will remain and not bounce out." The trial court had found the game to be one predominantly of skill. The trial court had watched a demonstration of the game. On appeal it was held that there was substantial evidence to sustain the finding that skill predominated.

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On February 19, 1951, the Attorney General issued an opinion that a game virtually identical to Appellants' games was a game in which chance predominated. (17 Ops. Cal. Atty. Gen. 63.) The Attorney General stressed the chance basis for the selection of the first eight numbers and also said,

Considering the factors that undoubtedly would be present, such as variance in the weight and size of the rubber ball, slight differences in the size of the slots, etc., it would appear that direct hits in selected slots would be predominantly the result of chance and not skill,

We have found two cases from New Jersey, involving games similar to the one in question, except that they did not entail the use of "set up" balls. In O'Brien v. Scott, 89 A.2d 280 (N. J. Sup'r Ct.), the court concluded that skill was the dominant factor. On the other hand, it was held in Ruben v. Keuper, 127 A.2d 906 (N. J. Sup'r Ct.), that the game was one of-chance,

We were particularly impressed by the opinion in Ruben v. Keuper, where the court received the testimony of a statistician as to the results of a series of games in which two experts played against two novices and the experts won about 70 percent of the games. The court said (127 A.2d 906, at 909j):

There is no denial of the factual premise that a player can develop an expertness in either of the games presently under examination sufficient to enable him to compete successfully in a contest with a novice. But plaintiffs' operations do not consist of the conduct of contests of that kind. Plaintiffs' case must be judged by what they actually do, not by a theoretical analysis of an experiment that does not characterize what occurs in their establishments. The average game they run is one in which a score or more of casual boardwalk passersby of various degrees of inexpertness try their hand in competition with others of the same ilk, and against the house. These are games in which comparative novices can win an occasional prize and thus titillate themselves and others into continued participation. To them the lure is chance and not an opportunity to match skills. Whatever one may say as to the expert, there can be no question but that the average or novice player is risking his dime against the lucky contingency that his balls will fall into a winning combination sooner than those of any other contestant; . . .

In the games with which we are concerned it is clear that from the point of view of any given player the eight numbers selected as a result of the "set up" balls were selected wholly at random. The only

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exception was where the player had thrown one of the "set up" balls, in which case, as to that player, the other seven numbers selected as a result of the "set up" balls were selected wholly at random.

The reports of the results of actual games showed that, on the average, of the winner's winning combination of five numbers two were the result of "set up" balls. Thus, about 40 percent of the winning result was wholly by chance on this ground alone.

As to the portion of the play following the throwing of the "set up" balls, it is inevitable that in almost all instances the rubber ball bounced around considerably before it settled in one of the compartments. It would indeed be an amazing feat of skill to be able to control the direction of rebound of the ball after it struck one of the partitions in the receptacle.

We find therefore as to the games conducted by Appellants that the winners were determined predominantly by chance and that the games were illegal lotteries.

We think this conclusion is not inconsistent with the opinion expressed by Appellants' expert witness. The reason for the difference between our conclusion and his conclusion lies in his definition of chance and skill. We believe that primarily what he has measured and labelled as "skill" was merely ordinary manual dexterity by which a player was usually able to keep the ball within a particular area of the box, thus increasing his probability of having the ball land in a given hole. For example, his probability for a given hole might have been 1 in 20 instead of the blindfolded or pure chance probability of 1 in 75.

While a person who, for one reason or another, lacked ordinary manual dexterity or was blind, would no doubt have been under a handicap in competing with the other players, possession of such ordinary manual dexterity together with the ability to see for a least a short distance was not skill. This merely qualified the player for the competition and among the qualifying players the result was determined primarily by chance,

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 protests of the following Appellants to proposed assessments of additional personal income tax for the years and in the amounts indicated be sustained:

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<u>Appellant</u>	<u>Year</u>	<u>Amount</u>
Stuart B. Aronoff	1951	\$\$\$ 34.19
	1952	2,177.66
	1953	6,143.31
	1954	4,269.78
Jason H. and Ileyne Bernie	1951	33.76
	1952	941.76
	1953	2,396.98
	1954	2,264.55
Gloria Boyd	1951	12.96
	1952	930.94
	1953	2,739.85
	1954	2,489.45
Leon Brown	1951	13.05
Irma Brown	1951	19.58
Leon and Irma Brown	1952	1,252.75
	1953	3,935.14
	1954	3,086.06
Richard Brown	1951	4.83
Richard L. and Sandra Brown	1952	187.46
	1953	610.37
	1954	500.88
Althea G. Case	1951	17.76
	1952	214.88
	1953	891.89
	1954	590.90
Ralph Davis	1951	93.97
Ray Davis	1951	62.65
Ralph and Ray Davis	1952	5,249.08
	1953	10,871.27
	1954	9,586.48
Ralph Davis, Jr.	1951	17.59
Marjorie Davis	1951	6.52
Ralph, Jr., and Marjorie Ann Davis	1952	1,080.05
	1953	3,604.61
	1954	3,045.91
Allen S. and Barbara B. Feder	1951	5.21
	1952	171.34
	1953	599.13
	1954	512.47

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<u>Appellant</u>	<u>Year</u>	<u>Amount</u>
Nathan and Ida Franklin	1951	\$12,839.70
	1952	23,409.14
	1953	23,406.16
	1954	54,099.66
Clifford R, Gans	1951	6,039.25
	1952	18,536.18
	1953	28,795.06
	1954	6,139.43
Bud Charles and Phyllis Gore	1951	11.67
	1952	477.63
	1953	1,910.05
	1954	2,319.26
Max and Tura Kleiger	1951	5,986.25
	1952	18,395.84
	1953	28,724.78
	1954	17,588.60
Samual and Anna Robinson	1952	8,273.24
	1953	13,502.32
	1954	3,732-U
Martin and Kathryn Sirody	1952	5,008.78
	1953	10,070.03
	1954	5,230.25
Hymen and Severt Smith	1951	1,602.11
	1952	28,762.48
	1953	35,148.16
	1954	19,213.06
Max and Fay Stein	1953	327.04
	1954	1,166.60
Harry M. and Mary Sugarman	1951	17.79
	1952	992.60
	1953	2,552.13
	1954	3,024.77
Roy C. Troeger	1951	71.14
Virginia Ruff Troeger	1951	20.11
Roy C. and Virginia Ruff Troeger	1952	3,957.19
Roy C. Troeger	1953	6,658.20
Virginia Ruff Troeger	1953	2,588.31
Roy C. and Virginia Ruff Troeger	1954	8,317.39

