



BEFORE THE STATE BOARD OF EQUALIZATION  
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of )  
MICHAEL AND NELLY GOMEZ )

Appearances:

For Appellants: James Vizzard, Attorney at Law

For Respondent: A. Ben Jacobson, Associate Tax 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 Michael and Nelly Gomez to proposed assessments of additional personal income tax in the amounts of \$1,080.26, \$989.28, \$883.42 and \$646.76 for the years 1953, 1954, 1955 and 1956, respectively.

Appellant Michael Gomez was a partner with Dallas E. McPherson and Harry E. Banister in the MGB Amusement Co, MGB conducted a coin machine business in the Bakersfield area, It owned music machines, multiple-odd bingo pinball machines, flipper pinball machines, claw machines and miscellaneous amusement machines. The equipment was placed in some 50 locations such as bars and restaurants, and 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 MGB and the location owner.

The gross income reported in the MGB tax returns was the total of amounts retained from locations, Deductions were taken for depreciation, repair parts, phonograph records, and other business expenses. Respondent determined that MGB was renting space in the locations where its machines were placed and that all the coins deposited in the machines constituted gross income to MGB. Respondent also disallowed all expenses 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,

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The **evidence** indicates that the operating arrangements between MGB and each location owner were the same as those considered by us in Appeal of Hall, 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 these machines is, accordingly, applicable **here**.

In Appeal of Advance Automatic Sales Co., Cal. St. Bd. of Equal., Oct. 9, 1962, 3 CCH Cal., Tax Cas. Par. \_\_\_\_\_, 2 P-H State & Local Tax Serv, Cal. Par. 13288, we held **the ownership** or possession of a pinball machine to be illegal under Penal Code sections **330b**, **330.1**, and **330.5** if the machine was predominantly a game of chance or if cash was paid to players for unplayed free games, and we also held bingo **pinball** machines to be predominantly games of chance,

From the testimony of appellant **Michael Gomez**, **Harry Banister** and three location **owners**, together with statements by two Locations made to respondent's auditor in 1958, it appears that it was the general practice to pay cash to players of **MGB's** multiple-odd bingo pinball machines for unplayed free games, Accordingly, this phase of **MGB's** business was illegal, both on the ground of ownership **and** possession of bingo pinball machines<sup>9</sup> which were predominantly **games of chance**, and on the ground that cash was paid to winning players.

We have previously held the operation of a claw machine to be illegal whether **or no-t** a successful player is permitted to redeem the merchandise for cash, (Appeal of Perinati, Cal. St. Bd. of Equal., April 69 1961, 3 CCH Cal. Tax Cas. Par. 201-733, 3 P-H State & Local Tax Serv, Cal. Par. 58191; Appeal of Seeman, Cal. St. Bd. of Equal., July 19, 1961, 3 CCH Cal. Tax Cas. Par. 201-825, 3 P-H State & Local Tax Serv, Cal. Par. 58028.) Inasmuch as there was illegal activity, respondent was correct in applying section 17297,

Almost every one of **MGB's** locations had a music **machine**. About 10 to 15 of the locations had multiple-odd bingo pinball machines= The maximum number of claw machines operated by **MGB** was about 10. The partners personally managed the entire route, **McPherson** made most of the collections and solicitations of new locations while Banister did most of the repair work,, Gomez had a regular job elsewhere and devoted only a small portion of his time to the **MGB business**.

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The making available of pinball, claw, music or other machines as **desired** by location owners, the volume of business which permitted specialization between the primary working partners, and the centralized operation of the over-all business indicate that the legal **activity** of operating music machines and amusement machines was associated with the illegal activity of operating multiple-odd bingo pinball machines and claw machines\* Respondent was therefore correct in disallowing the expenses of the entire business.

There were not complete records of amounts paid to winning players on the multiple-odd bingo pinball machines and the claw machines, and respondent estimated these unrecorded amounts as equal to 50 percent of the total amounts deposited in such machines, The basis for the 50 percent estimate was primarily the experience of **respondent's** auditor in auditing other pinball machine **operators**. Respondent's auditor interviewed the **MGB** partners and also a few location owners, In the course of these interviews, he received statements that payouts were made but no one was able to give an estimate of what percentage the payouts were of the total amounts deposited in the machines,,

As we also held in **Hall**, supra, respondent's computation of gross income is **presumptively correct**. There is no evidence either from **appellant's** own testimony, or otherwise, which would indicate that the 50 percent payout estimate was excessive and it appears to be consistent with results obtained from other pinball **operators**. Under the **circumstances**, the 50 percent payout estimate must be **sustained**.

**MGB's** records did not segregate the pinball and claw machine income from the music and amusement machine income. Respondent's auditor was unable to obtain an estimate from any of the partners as to the basis for a proper breakdown and, upon examination of the inventory of equipment, he completed his audit on the basis that 50 percent of the recorded gross income arose from multiple-odd bingo pinball machines and claw machines and 50 percent from music machines and **amusement** machines,

Appellant has sorted through many of the individual collection reports and with his knowledge of the types of equipment in many of the locations has estimated that **only** 25 percent of the recorded gross income was derived from multiple-odd bingo pinball machines and claw machines,

Appellant was in a good position to make a reasonable estimate because of his knowiedga of the **business**. In all of

