BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
WILLIAM J. AND GRACE M. SCHNACKEL)

Appearances:

For Appellants: Archibald M. Mull, Jr., and Bernard J. Favaro, Attorneys at Law

For Respondents: Wilbur F. Lavelle, 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 William J. and Grace M. Schnackel to proposed assessments of additional personal income tax in the amounts of $2,277.54, $3,664.48, $3,637.65, $6,597.03, and $7,360.40 for the years 1951, 1952, 1953, 1954, and 1955, respectively.

Appellant husband William J. Schnackel (hereinafter called appellant) was engaged in the coin machine business in the Vallejo area. He owned multiple-odd bingo pinball machines, flipper pinball machines, music machines, and miscellaneous amusement machines. The number of multiple-odd bingo pinball machines averaged about 45 to 50 and the number of music machines averaged about 20 during the years in question. The equipment was placed in bars, restaurants and other locations, 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 appellant and the location owner.

The gross income reported in tax returns was the total of amounts retained from locations. Deductions were taken for depreciation, salaries, cost of phonograph records and other business expenses. Respondent determined that appellant was renting space in the locations where his machines were placed and that all the coins deposited in the machines constituted gross income to him. 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 further, or are connected or associated with, such illegal activities,

The evidence indicates that the operating arrangements between appellant 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 St. & 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 and of four location owners who had appellant's machines sometime during the years in question, it is apparent that it was the general practice to pay cash to players of appellant's multiple-odd bingo pinball machines for free games not played off, Accordingly, this phase of appellant's business was illegal, both on the ground of ownership and possession of bingo pinball machines which were predominantly games of chance and on the ground that cash was paid towinning players. Respondent was therefore correct in applying section 17297,

All or virtually all of the locations had multiple-odd bingo pinball machines. Most of the locations also had music machines. Appellant personally made all collections and repairs in the early par.t of the period in question. Later he hired one or two employees but he continued to personally make collections and repairs on a portion of the equipment. Appellant's records did not segregate the income from pinball machines and from other types of machines, There was therefore a substantial connection between the illegal operation of multiple-odd bingo pinball. machines and the legal operation of the other

equipment and respondent was correct in disallowing all expenses of the business,,

There were no records of amounts paid to winning players on the multiple-odd bingo pinball machines and respondent estimated these unrecorded amounts as equal to 50 percent of the total amount deposited in such machines.

At the time of the audit in 1957 respondent's auditor interviewed appellant and four location owners,, Appellant estimated the expenses on the multiple-odd bingo pinball machines at 35 percent of the total deposited in the machines* Of the four location owners one stated payouts were not made and the other three gave payout percentage estimates of 33-1/3, 40 and 47, respectively. At the hearing in this matter, two location owners estimated the payouts at 30 percent and another gave an estimate of from 25 to 30 percent, We conclude that the payouts averaged 35 percent of the amounts deposited in the machines,

In connection with the computation of the unrecorded payouts it was necessary for respondent's auditor to estimate the percentage of appellant's recorded gross income arising from multiple-odd bingo pinball machines. Appellant's records did not segregate this income from the income from other types of machines. Respondent's auditor estimated this at 70 percent. At the hearing in this appeal, appellant made an estimate of 65 percent, but we do not consider this single, unsupported estimate sufficient to justify reducing respondent's figure,

ORDER

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 protest of William J. and Grace M. Schnackel to proposed assessments of additional personal income tax in the amounts of $2,277.54, $3,664.48, $3,637.65, $6,597.03 and $7,360.40 for the years 1951, 1952, 1953, 1954, and 1955, respectively, be 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.

Appeal of William J. and Grace M. Schnackel

Done at Pasadena, California, this 27th day of November, 1962, by the State Board of Equalization.

George R. Reilly Chairman

Richard Nevins, Member

Paul R. Leake, Member

John W. Lynch, Member

_____, Member

ATTEST: Dixwell L. Pierce, secretary