BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Platter of the Appeal of)
)
RAYMOND J, AND CRYSTAL I, ANDERSON)

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 Raymond J. and Crystal I. Anderson to proposed assessments of additional personal income tax in the amounts of $3,783.00, $6,412.42, $5,852.50 $6,626.10 and $472.06 for the years 1952, 1953, 1954, 1955 and 1956, respectively,

Appellant Raymond J. Anderson -(hereafter referred to as appellant) conducted a coin machine business in the Bakersfield area. Be owned music machines, multiple-odd bingo pinball machines, other types of pinball machines, and a few miscellaneous amusement machines which he placed in bars, restaurants 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 appellant and the location owner,

There were about 20 locations. A music machine was in every location and most of the locations also had one or more pinball machines,

Appellant devoted little of his time to the coin machine business. It was operated primarily by two employees.

The gross income reported in appellant's returns was the total of amounts retained by appellant from locations, Deductions were taken for depreciation, cost of phonograph records, salaries 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 appellant, 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.

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 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.

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. _____, we concluded that the ownership or possession of a pinball machine is illegal under Penal Code sections 330b, 330.1 and 330.5 if the machine is predominantly a game of chance or if cash is paid to players for unplayed free games, and we held bingo pinball machines to be predominantly games of chance,

Respondent's auditor interviewed appellant in 1958, and at that time appellant stated that location owners were reimbursed from the money in the bingo pinball machines for cash payouts to players in lieu of free games. Appellant also stated that while he had no records of the amount of such payouts, he estimated that they equaled 60 percent of the total coins deposited in the machines,

Two location owners who had bingo pinball machines owned by appellant testified that players were paid cash for unplayed free games. Appellant's brother was the collector on the route for most of the period in question, and he testified that pinball machines had been drilled by players to permit manipulation of the machines and also that the location owners claimed expenses prior to the equal division of the proceeds.

The ownership and possession of the bingo pinball machines was thus illegal not only because they were predominantly games of chance but also because cash was paid to winning players, Inasmuch as there was illegal activity, respondent was correct in applying section 17297.

The bingo pinball machines contributed about 60 percent of the recorded gross income of the coin machine business* A single collector collected from all types of machines and a single mechanic repaired all types of machines. Most of the locations had both a music machine and a pinball machine. We conclude that the legal operation of music machines and other amusement machines was associated or connected with the illegal operation of bingo pinball machines and respondent was correct in disallowing the expenses of the entire business.

There were no records of amounts paid. to winning players and other expenses initially paid by the location owners. Respondent therefore estimated the unrecorded amounts on the basis of the estimate of appellant that the payouts equaled 60 percent of the total coins deposited in the bingo pinball machines.

hs we held in Hall, supra, respondent's computation of gross income is presumptively correct. We find appellant's estimate given to respondent's auditor the most reliable evidence presented and sustain respondent's method of computing the unrecorded gross income.

Appellant has raised a question as to whether the notices of proposed assessment were timely. The notices of proposed assessment were issued by respondent on March 19, 1959, The returns for the years 1952, 1953, 1954, 1955 and 1956 were due on April 15, 1953, 1954, 1955, 1956 and 1957, respectively, (Rev, & Tax, Code, Par, 18432,) The notices of proposed assessment for 1954, 1955 and 1956 were issued less than four years after the due date of the returns. The notices of proposed assessment for 1952 and 1953 were issued more than four years and less than six years after the due date of the returns.

Section 18586 of the Revenue and Taxation Code provides a general four-year period for respondent to issue a notice of proposed assessment . Section 18586.1 extends the period to six years if the taxpayer omits from gross income an amount in excess of 25 percent of the gross income stated in the return. Under either section, the time starts to run upon the filing of a return, except that if the return is filed prior to the final date for filing, the time starts to run on such final date, (Rev, & Tax, Code, Par. 18588,)

The notices of proposed assessment were timely for the years 1954, 1955 and 1956 under the general four-year limitation, The amount of *gross* income not reported amounted to approximately $21,000 for 1952 and $31,000 for 1953. The gross income reported was approximately $50,000 for 1952 and $74,000 for 1953, The gross income omitted for 1952 and 1953 was well in excess of 25

percent of the gross income reported for each year and the not ices of proposed assessment for these years were, therefore, timely.

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 protest of Raymond J. and Crystal I, Anderson to proposed assessments of additional personal income tax in the amounts of $3,783.00, $6,412.42, $5,852.50, $6,626.10 and $472.06 for the years 1952, 1953, 1954, 1955 and 1956, 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,

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

George R. Reilly, Chairman

Richard Nevins, Member

John W. Lynch, Member

_____, Member

_____, Member

ATTEST: Dixwell L. Pierce, Secretary