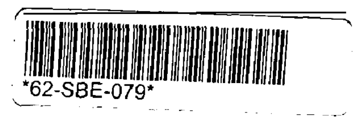

BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
FRED AND MARION ALLEN)

Appellants:
For Appellants: James Gizzard, 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 Fred and Marion Allen to proposed assessments of additional personal income tax in the amounts of $626.78, $543.26, $1,647.96, $2,180.59 and $3,634.89 fur the years 1952, 1953, 1954, 1955 and 1956, respectively,

Appellant Fred Allen (hereinafter referred to as appellant) conducted a coin machine business in the Bakersfield area under the name of Allen's Music. He owned music machines, flipper pinball machines, multiple-odd bingo pinball machines and miscellaneous amusement machines* The equipment was placed in some 35 locations such as bars and restaurants, 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, 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 to further, or are connected or associated with, such illegal activities.

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The evidence indicates that the operating arrangements between appellant and each location owner were the same as those considered by us in <u>Appeal of Hall</u>, 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 <u>Hall</u> 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 <u>Appeal of Advance Automatic Sales Co</u>,, 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 machinewas 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 two location owners and prior admissions of appellant, it is clear that it was the general practice to pay cash to players of appellant's multiple-odd bingo pinball machines for unplayed free games. Accordingly, the multiple-odd bingo pinball machine 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 to winning players, Inasmuch as there was illegal activity, respondent was correct in applying section 17297.

Appellant had no employees and personally operated the entire business,, He had music machines in every location and during 1954, 1955, and 1956 had multiple-odd bingo pinball machines in 30 or 40 percent of the locations. The operation of what was essentially a single business of providing various types of coin-operated machines as requested by location owners and the substantial income from the multiple-odd bingo pinball games lead us to the conclusion that the legal operation of music and amusement machines was connected or associated in a substantial way with the illegal operation of multiple-odd bingo pinball machines* Respondent was therefore correct in disallowing the expenses of the entire business.

There were no records of amounts paid to winning players on the pinball machines. Appellant's records, furthermore, did not segregate the pinball machine income from the music machine and amusement machine income, At the time of the audit in 1958, respondent's auditor asked appellant for an estimate of the average percentage which the payouts on multiple-odd bingo pinball machines bore to the total amount in the machines. Appellant's estimate was 30 percent and respondent's auditor used this

in computing the unrecorded gross income, Appellant also estimated for respondent's auditor that in 1952 and 1953 10 percent of the recorded gross income was from multiple-odd bingo machines and that in 1954, 1955 and 1956, 33-1/3 percent of the recorded gross income was from multipie-odd bingo pin-ball machines. Respondent's auditor used these estimates also in computing the unrecorded gross income.

There was no testimony of appellant or other evidence presented to us which would indicate that the estimate used by respondent's auditor was erroneous or should be adjusted, The percentages used by respondent in computing unrecorded gross income are, therefore, sustained.

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 11, 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 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 period . For the years 1952 and 1953, appellant's unreported gross income computed in accordance with the earlier part of this opinion was less than 25 percent of the gross income reported in his returns and the assessments for these years are therefore barred .

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 Fred and Marion Allen

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to proposed assessments of additional personal income tax in the amounts of $626.78, $543.26, $1,647.96, $2,180.59 and $3,634.89 for the years 1952, 1953, 1954, 1955 and 1956, respectively, be modified for the years 1954, 1955 and 1956 in that the gross income is to be recomputed in accordance with the opinion of the board and that the action for the years 1952 and 1953 be reversed. 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

Paul R. Leake, Member

John W. Lynch, Member

__________, Member

ATTEST: Dixwell L. Pierce, Secretary