



BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeals of)
FRANK CORSETTI, LOREN AND AGNES)
CROWELL, AND THOMAS AND DOLLY F.)
MALLOY

Appearances:

For Appellants: Archibald M. Mull, Jr., Attorney at Law

For Respondent: Wilbur F. Lavelle, Associate Tax 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 to proposed assessments of additional personal income tax against Frank Corsetti in the amounts of \$3,298.01, \$8,320.77, \$10,205.47 and \$11,572.53 for the years 1951, 1952, 1953 and 1954, respectively, against Loren and Agnes Crowell in the amount of \$1,027.55 for the year 1951, against Loren Crowell in the amount of \$1,642.95 for the year 1952, against Agnes Crowell in the amount of \$1,658.95 for the year 1952, against Loren and Agnes Crowell in the amounts of \$4,065.88 and \$4,472.00 for the years 1953 and 1954, respectively, and against Thomas and Dolly F. Malloy in the amounts of \$1,661.07, \$3,015.02, \$4,294.94 and \$5,310.46 for the years 1951, 1952, 1953 and 1954, respectively.

Appellants Frank Corsetti and Loren Crowell were partners in the Modern Vending Service which operated a coin machine business in eastern Solano County with headquarters in Fairfield. The business owned multiple-odd bingo pinball machines, flipper pinball machines, music machines and some miscellaneous amusement machines. The equipment was placed in some 40 or 50 locations, and the proceeds from each machine, after exclusion of expenses claimed by the location owner in connection with the operation of the machines, were divided equally between Modern Vending Service and the location owner.

Appellants Frank Corsetti and Thomas Malloy were partners in Modern Vending Service Napa which conducted a coin machine business in Napa County. The business owned multiple-odd bingo pinball machines, non-multiple-odd bingo pinball machines, flipper pinball machines, music machines and miscellaneous amusement machines. The equipment was placed in some 90

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locations, and, subject to the exceptions discussed below, 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 Modern Vending Service Napa and the location owner.

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

The evidence indicates that the operating arrangements between the partnerships and each location owner were, with one exception, the same as those considered by us in Appeal of C. B. Hall, Sr., 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. The basic financial arrangement in Hall was that out of the proceeds of the machine the location owner received the amount he claimed for expenses, and the balance was divided equally between the location owner and the machine owner. As to some of the pinball and music machines owned by the Corsetti-Malloy partnership, the machine owner received \$8 per week out of the proceeds prior to the equal division. This \$8 payment was called "guaranteed rental" and was applicable on new machines for a period up to perhaps one year. The guaranteed rental charge was used primarily in 1952.

In Hall we held that the machine owner and each location owner were engaged in a joint venture in the operation of the machines. The arrangements in the case before us were the same as in Hall except for the guaranteed rental charge that existed in some instances. A joint venture may exist even though one of the parties is to receive a minimum return on his investment. (Elias v. Erwin, 129 Cal. App. 2d 313 [276 P.2d 848]). We conclude that all of the arrangements here were joint ventures.

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In Appeal of Advance Automatic Sales Co., Cal. St. Bd of Equal., Oct. 9, 1962, 3 CCH Cal. Tax Cas. Par. 201-984, 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.

As to the **Corsetti-Crowell** partnership, one location owner testified that he had two or three of the pinball machines at a time and paid cash to players for unplayed free games. He estimated that the expenses on the pinball machines averaged 50 percent of the total amounts deposited in the machines* Another location owner testified that he did not pay cash to players for unplayed free games, but in 1956 he told Respondent's auditor that the "expenses" averaged 50 percent of the total amount deposited in the pinball machines. A former mechanic employed in the business testified that he, on rare occasions, would make collections and that at such times the location owner generally claimed expenses in connection with the pinball machines and that the expenses averaged from 25 percent to 30 percent. Appellant Loren Crowell testified that he did much of the collecting on the route, that it "was more or less understood" that the expenses claimed by the location owners included amounts for payouts for unplayed free games, and in 1956 he told Respondent's auditor that the payouts on the bingo pinball machines were 25 percent of the amounts deposited in the machines. There were introduced into evidence copies of two collection reports from one location serviced by the partnership, which collection reports contained notations indicating that payouts were made on the pinball machines **or** that expenses were taken out prior to the equal division,

As to the **Corsetti-Malloy** partnership, one location owner testified that one of its pinball machines was in his location, that he paid cash to players of the pinball machine for unplayed free games, and that the expenses averaged between 20 and 30 percent of the total amount deposited in the machine. Another location owner having the partnership's pinball machines stated that he paid cash to players for unplayed free games and that the expenses on the pinball machine averaged between 30 and 50 percent of the total amounts deposited in the machines. In further testimony he stated as to the same subject that the expenses averaged between 30 and 35 percent. A third location owner having one of the **partnership's** pinball machines testified that he paid cash to players for unplayed free games. Appellant Thomas Malloy testified that he made many of the collections from the pinball machines; that the location owners claimed expenses from the proceeds and that such expenses would, in the case of some location owners, include refunds to players for free games,

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and in the case of other location owners would not include such refunds; and that the average amount of expenses claimed by the location owners as to bingo pinball machines varied with respect to different locations, but all within the range of 10 to 50 percent of the total proceeds of such machines. Respondent's auditor testified that he interviewed nine location owners in 1956 and that one told him that payouts were not made, another told him that he didn't know whether payouts were made, and seven stated that payouts were made. Of the seven, three estimated that the payouts averaged 50 percent of the total proceeds of the machine, one estimated 60 percent, one estimated 20 percent, and the other two could give no estimates.

We find that as to each partnership it was the general practice to pay cash to players of the bingo pinball machine for unplayed free games. Accordingly, the bingo pinball machine phase of the business of each partnership 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. Respondent was therefore correct in applying Section 17359.

In the case of the Corsetti-Crowell partnership, most of the locations had both a music machine and a bingo pinball machine. Appellant Loren Crowell testified that he made most of the collections and did some of the repairs. The mechanics employed repaired all types of equipment used in the business.

In the case of the Corsetti-Malloy partnership more than half of the locations had both a music machine and a bingo pinball machine. During the period under review, Appellants Frank Corsetti and Thomas Malloy personally did most of the collecting on bingo pinball machines. The business had one employee who spent full time making collections from music machines. The business had one or two other employees who were mechanics and repaired all types of equipment.

There was a substantial connection between the illegal operation of bingo pinball machines and the legal operation of music machines and miscellaneous amusement machines as to each of the partnerships, and Respondent was therefore correct in disallowing all expenses of the businesses.

There were no records of amounts paid to winning players of the bingo pinball machines for unplayed free games. Respondent estimated these unrecorded amounts as equal to 50 percent of the total amounts deposited in such machines. In the case of the Corsetti-Crowell partnership the 50 percent payout estimate was based on interviews of three location owners and the employee of another. Of these four, one stated that payouts were

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not made, one stated that payouts were made and estimated the average amount of payouts as equal to 50 percent of the total deposited in the bingo pinball machines, another estimated that "expenses" averaged 50 percent of the total deposited, and the employee who was interviewed said that payouts were made but could give no estimate. The statement by the employee cannot be considered reliable because she was not employed in the particular location during the period under review. In the case of the Corsetti-Malloy partnership the 50 percent payout estimate was based on the interviews of nine location owners, as recited previously in this opinion.

The records of the two partnerships did not segregate the income from the bingo pinball machines, and in order to compute the unrecorded amount of payouts on bingo pinball machines, it was first necessary to determine the portion of the recorded income which was derived from such machines. Each partnership kept a separate record of its music machine collections but collections from all of its other machines were aggregated and not separately identified. Respondent estimated that of the recorded income other than music income 95 percent was derived from bingo pinball machines and 5 percent from other types of equipment, except that these figures were 90 percent and 10 percent for the years 1951 and 1952 in the case of the Corsetti-Crowell partnership. These percentages were based on the fact that a large proportion of the non-music equipment in each partnership consisted of bingo pinball machines, and on the experience of Respondent's auditors that the bingo pinball machines produced a significantly larger income than flipper pinball machines and miscellaneous amusement machines.

As we also held in Hall, supra, Respondent's computation of gross income is presumed correct. There were no records of the payments to winning players and the evidence can be construed to support Respondent's estimate. Under the circumstances Respondent's computation of gross income is sustained, subject to the adjustment required by our finding that the Appellants were engaged in joint ventures with the location owners.

