



BEFORE THE STATE BOARD OF EQUALIZATION  
OF THE STATE OF CALIFORNIA

In the Matter of the Appeals of )  
ELDRLD E. AND SHIRLEY J. SHIPLEY )  
and PAUL T. AND EVELYN SPEER )

Appearances:

For Appellants: Dale I. Stoops, 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 Eldred E. Shipley in the amount of \$1,647.25 for the year 1952, against Shirley J. Shipley in the amount of \$1,647.25 for the year 1952, against Eldred E. and Shirley J. Shipley in the amounts of \$8,039.82, \$13,732.72 and \$17,870.24 for the years 1953, 1954, and 1955, respectively, and against Paul T. and Evelyn Speer in the amounts of \$3,253.22, \$7,841.28, \$13,501.88 and \$18,013.75 for the years 1952, 1953, 1954, and 1955, respectively.

Paul Speer and Eldred Shipley, hereafter referred to as Appellants, were partners in the Sonoma Amusement Company which operated a coin machine business in the Santa Rosa area. The company owned music machines, multiple-odd bingo pinball machines, flipper pinball machines and miscellaneous amusement machines. The equipment was placed in restaurants, bars 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 Sonoma Amusement 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 Appellants were renting space in the location where their machines were placed and that all the coins deposited in the machines constituted gross income to them. 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

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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 Appellants and each location owner were 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. 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. 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.

Two location owners testified that they had multiple-odd bingo pinball machines from Sonoma Amusement and paid cash to winning players for unplayed free games. One of them said that he discussed such payments with Appellant Eldred Shipley and that "I was to keep track of them and put them down." Appellant Paul Speer testified that "To the best of my knowledge" the expenses claimed by the location owners prior to the equal division of the net proceeds included cash payouts to players for unplayed free games. (Appellant Paul Speer did not participate in management of the business but had some knowledge of the business. Appellant Eldred Shipley managed the business but a serious prolonged illness prevented him from being a witness at the hearing.) We conclude that it was the general practice to pay cash to players of Sonoma Amusement multiple-odd bingo pinball machines for free games not played off. Accordingly, the pinball machine phase of the 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. Respondent was therefore correct in applying Section 17297.

The total number of locations in which equipment was placed gradually increased through the period in question and apparently the total reached approximately 100 locations at the

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maximum. There was a music machine in virtually every location. There were bingo pinball machines in about 50 percent of the locations, There were no bingo pinball machines in any location within the city limits of Santa Rosa. The business had about four employees. The collectors collected from all types of machines except that during the latter part of the period under review one person was hired for the sole purpose of collecting from music machines. The mechanic repaired all types of machines. There was therefore a substantial connection between the illegal operation of bingo pinball machines and the legal operation of music machines and miscellaneous amusement machines, and Respondent was correct in disallowing all the expenses of the business.

There were no records of amounts paid to winning players on the bingo pinball machines, and Respondent estimated these unrecorded amounts as equal to 50 percent of the total amounts deposited in such machines. The records did not contain a segregation of the source of income by type of machine and Respondent estimated that of the total recorded gross income, the proportion arising from bingo pinball machines was 40 percent in 1952, 50 percent in 1953, 65 percent in 1954 and 70 percent in 1955.

The record contains no indication of the basis upon which Respondent arrived at the 50 percent payout estimate but there is no evidence in the record indicating that it is wrong. The various percentages used to segregate income between bingo pinball machines and other sources were based on the relative number of such machines at the end of 1952 and the substantial purchases of such machines subsequent thereto. At the time of the audit in 1957 Appellant Eldred Shipley made a breakdown of the 1956 receipts based on his knowledge of the type of equipment in the various locations and passed this on to Sonoma Amusement Company's accountant who in turn passed it on to Respondent's auditor. Shipley was requested to be present at an interview with Respondent's auditor but his attorney informed the auditor that Shipley would decline to answer any questions on the basis of possible self-incrimination and the interview was never held.

We think that Respondent's payout percentage and percentages used to segregate income as between bingo pinball machines and other types of equipment should be sustained. The estimates do not appear to be unreasonable, there is no evidence which would indicate that they are excessive and Appellants declined an opportunity in 1957 to present any meaningful material to Respondent's auditor by the decision not to answer any questions.

