BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
JOE AND DOROTHY TESSLER)

Appearances:

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

For Respondent: Burl D. Lack, Chief 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 Joe and Dorothy Tessler to proposed assessments of additional personal income tax in the amounts of $9,392.88, $12,018.44, $12,255.32 and $10,887.56 for the years 1951, 1952, 1953 and 1954, respectively.

Appellant Joe Tessler (hereinafter called appellant) conducted a coin machine business in the Oakland area under the name of United Music Company. Appellant owned music machines, bingo pinball machines, flipper pinball machines, and miscellaneous amusement machines. The equipment was placed in various locations, such as bars and restaurants, 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 froin locations. Deductions were taken for depreciation, salaries, 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 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 Fart 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 C. B. hall, Sr., Cal. St. Bd. of Equal., Dec. 29, 1958, 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, CCH Cal. Tax Rep. 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 or other things of value were paid to players for unplayed free games, and we also held bingo pinball machines to be predominantly games of chance.

Three location owners appeared as witnesses at the hearing. One stated that he had Appellant's pinball machines and that he paid cash to players for unplayed free games. A second location owner testified that he had Appellant's pinball machines and that he allowed players to take beer or mixed drinks for unplayed free games. A third location owner testified that he never paid cash or merchandise to players for unplayed free games.

A collector for Appellant testified that it was the general practice for location owners having pinball machines to claim expenses at the time of the collections, and that the location owners having bingo pinball machines generally claimed higher amounts for expenses than location owners having flipper pinball machines.

We conclude that it was the general practice to pay cash or merchandise to players of Appellant's bingo pinball machines for free games not played off. Accordingly, the 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 or other things of value were paid to winning players. Respondent was therefore correct in applying Section 17359.

Appellant had equipment in approximately 100 locations. All but one or two of these locations had music machines. Approximately half of the locations had pinball machines. Apparently, at least three-fourths of Appellant's pinball machines were of the bingo variety rather than of the flipper variety. Appellant's

collectors collected from all types of machines and his repairmen made repairs to all types of machines. Thus, there was a substantial connection between the illegal operation of 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 and Respondent estimated them as equal to 50 percent of the amounts deposited in the pinball machines. The estimate was based on results of audits of other pinball machine operators, primarily in the Sacramento area, and also on results of interviews of two location owners who had pinball machines from Appellant. One of these location owners estimated the payouts to be about 51 percent or 52 percent and the other gave an estimate in terms of dollars which came out to a payout percentage of from 29 percent to 41 percent. The location owner who testified at the hearing that he paid cash to players for unplayed free games stated that the expenses were in the neighborhood of 10 percent of the total amount deposited in the machines. The location owner who testified that he gave merchandise for free games stated that such payouts were "nominal." We conclude that the unrecorded payouts should be computed on the basis that they were equal to 30 percent of the total amounts deposited in the bingo pinball machines.

Appellant's records did not segregate income by type of machine, and Respondent's auditor segregated the income into two categories, music and pinball, based on the number of pinball machines as compared with the total number of pinball and music machines in each year. He disregarded the miscellaneous amusement machines such as bowlers and shuffleboards. On this basis Respondent's auditor computed the percentage of the total recorded gross income for each year derived from pinball machines as 68.6 percent for 1951, 50 percent for 1952, and 44.1 percent for 1953 and 1954.

After examining Appellant's depreciation schedules, we conclude that a more accurate segregation would be to consider that of the total recorded gross income for each year, the percentage derived from bingo pinball machines was 70 percent in 1951, 60 percent in 1952, 35 percent in 1953 and 35 percent in 1954. Gross income should then be reconstructed on the basis that payouts were made only on bingo pinball machines.

Appeal of Joe and Dorothy Tessler

O R D E R

Pursusnt 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 Joe and Dorothy Tessler to proposed assessments of additional personal income tax in the amounts of $9,392.88, $12,018.44, $12,255.32 and $10,887.56 for the years 1951, 19.52, 1953 and 1954, 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 Sacramento, California, this 19th day of March, 1963, by the State Board of Equalization.

John W. Lynch, Chairman

Geo. R. Reilly, Member

Richard Nevins, Member

_____, Member

_____, Member

ATTEST: Dixwell L. Pierce, Secretary