

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeals of
CLARENCE E. AND MARGUERITE STANDISH,
ROBERT M. MCCOY AND BERNICE THOMAS,
INDIVIDUALLY AND AS ADMINISTRATRIX OF
THE ESTATE OF HENRY THOMAS, DECEASED.

Appearances:

For Appellants: Leo J. Gleason, Archibald M. Mull, Jr.,
and John B. Lounibos, Attorneys at Law

For Respondent: Israel Rogers, Assistant 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 Clarence E. and Marguerite Standish in the amounts of \$906.36, \$10,173.59 and \$16,316.16 for the years 1952, 1953 and 1954, respectively, against Robert M. McCoy in the amounts of \$45.14, \$44.01, \$1,980.73 and \$8,015.88 for the years 1951, 1953, 1954 and 1955, respectively, and against Bernice Thomas, individually and as Administratrix of the Estate of Henry Thomas, Deceased, in the amount of \$7,467.77 for the year 1953.

During the years 1951 through 1955, a partnership made up of Messrs. Cedric Ayers and George Markarian and appellants Clarence E. Standish and Robert M. McCoy operated a business establishment in Guerneville which featured a variation of the game commonly known as bingo. During 1951 and part of 1952 the partnership was known as McCoy & Standish and thereafter it was known as Markarian & Standish. Partnership tax returns were filed for the period in question. Respondent disallowed expenses attributable to this business 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.

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The question thus presented is whether the operation of the above mentioned game constituted an illegal activity as defined in the chapters of the Penal Code specified in section 17359.

The game was played by a maximum of 40 players, each of whom paid a fee of at least 10 cents. A winning player had the choice of receiving a merchandise prize or scrip worth about \$2.00 which was redeemable in merchandise at local stores. A seat at a horseshoe-shaped counter was provided for each player. In front of the player was a wooden receptacle divided into 75 compartments, each slightly larger than a baseball and numbered from 1 to 75. The player was provided with a typical bingo card, marked with 24 squares bearing numbers selected from the numerals 1 to 75, and having a blank square in the center. A player could play more than one card but paid an extra fee of 10 cents for each additional card. Out of all the cards used in the game no two cards were alike in their sequences of numbers in the squares, Starting with the person seated at one end, each player in turn would throw a baseball into the receptacle and the number covered by the ball was the number called. The winner was the player having five markers in a row horizontally, vertically or diagonally on his card.

This game clearly constituted a lottery as defined in section 319, chapter 9, title 9, part 1 of the Penal Code. (Einzig v. Board of Police Com'rs 138 Cal. App. 664 (32 P.2d 1103); People v. Babdaty, 139 Cal. App. Supp. 791 (30 P.2d 634).) Section 17359 of the Revenue and Taxation Code was therefore properly applied by respondent.

In addition to his interest in the above game, appellant Robert M. McCoy, as a sole proprietor, operated a coin machine business during 1954 and 1955 under the name Modern Music Co. He owned multiple-odd bingo pinball machines, music machines and some miscellaneous amusement machines. The equipment was placed in various 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, generally equally, between appellant and the location owner.

Appellant Clarence E. Standish, besides his connection with the ball-throwing game, was a partner with appellant Henry Thomas in T & S Amusement Company, which conducted a coin machine business in Sonoma County. The business owned multiple-odd bingo pinball machines, music machines and some miscellaneous amusement machines. The equipment was placed in various locations and the proceeds from each pinball and novelty machine, after exclusion of expenses claimed by the location owner in connection with the operation of the machine, were divided equally between appellants and the location owner; however, proceeds from music machines were split 45-55, with the appellants receiving 55 percent. The partnership commenced on March 1, or May 1, 1952, and terminated with the death of Mr. Thomas on November 5, 1953. Thereafter, Mr. Standish continued the business under the same name but as a sole proprietorship,

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The gross income reported in tax returns by the partnership and individuals was the aggregate of amounts retained from locations. Deductions were taken for depreciation, salaries, cost of phonograph records and other business expenses. Respondent determined that the partnership and individuals 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 owners. Respondent also disallowed **all** expenses pursuant to section 17359 (now 17297) of the Revenue and Taxation Code.

The evidence indicates that the operating arrangements between the partnership and individuals 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 the 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 was paid to players for unplayed free games, and we also held bingo pinball machines to be predominantly games of chance,

Robert McCoy admitted at the hearing in this matter that cash was paid to winning players at locations where his pinball machines were placed and two of the location owners so testified. Clarence Standish had previously denied to **respondent's** auditor that such payouts were made in locations where T & S Amusement Company placed its pinball machines, but three of the location owners testified that they made such payouts and one of them testified that **"everybody paid off"** and that both Standish and Thomas knew it.

We conclude that it was the general practice to pay cash to players of appellants' pinball machines for free games not played off. Accordingly, the pinball machine phase of appellants' businesses 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.

Most of the locations had both pinball machines and music machines. The collectors collected from **all** types of machines and the repairmen serviced all types of machines. There was therefore a substantial connection between the illegal operation of pinball machines and the legal operation of the music machines and miscellaneous amusement machines and respondent was correct in disallowing all expenses. We note that appellant Robert M. McCoy objected particularly to the disallowance of a \$2,000 casualty loss relative to a music machine which was destroyed by fire and a \$722.52 business expense deduction relative to a boat used in part to entertain business customers, including various location owners having appellant's pinball machines. However, the

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music machine and the cabin cruiser appear to have been connected with the illegal operation of the pinball machines and we conclude that these deductions were properly disallowed,

In the case of the McCoy route, respondent estimated that payouts to winning players of the bingo pinball machines for unplayed free games averaged 50 percent of the total proceeds of the machines. Respondent's auditor testified that he interviewed four location owners and that one told him that payouts were not made, another estimated that the payouts averaged 50 percent, another estimated 20 to 50 percent, and another said the percentage varied. At the hearing in this matter one location owner testified that the payouts on McCoy's pinball machines averaged 40 to 45 percent and McCoy's collector estimated that the payouts averaged not more than $33\frac{1}{3}$ percent. Appellant Robert M. McCoy made a two-week test check during 1956 which indicated that payouts amounted to 32 percent of the total proceeds of the machines. The 32 percent figure is compatible with the other evidence and has a reasonably sound basis. Considering all the evidence, we conclude that the payout figure should be reduced to 32 percent,

In the case of the T & S Amusement Company, respondent computed the cash payouts on the basis that they averaged 57 percent of the coins deposited in the bingo pinball machines. Respondent's auditor testified that he interviewed four location owners and that two estimated payouts averaged 60 percent, another estimated 50 percent, and another said the percentage of payouts varied. Three location owners testified that payouts were made and one estimated that they averaged 60 percent, another estimated 40 percent, and the other that payouts varied from 10 to 50 percent, with the weekly percentage never exceeding 50 percent. Our conclusion is that the payout figure should be reduced to 50 percent.

The records relating to the McCoy route segregated the income from the music machines, but the remaining income derived from amusement machines was not segregated. Respondent's auditor testified that all of the later was considered bingo-type pinball receipts in setting up the assessment. He further stated that it was subsequently ascertained that there was some income derived from certain pool tables and shuffle alleys where no payouts were made, with the result that \$450 was erroneously included in the assessment as payouts. The deficiency assessment should be adjusted to exclude the aforesaid measure,

The records relating to T & S Amusement Company 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. Respondent's auditor testified that appellant Clarence E. Standish had estimated that bingo pinball receipts represented 15 to 25 percent of the recorded gross receipts in 1952, 35 to 40 percent in 1953, and 50 to 60 percent in 1954. The facts indicate that there was a sizeable increase in the number of each type of equipment during these years. The auditor pointed out that reported gross receipts stood at \$14,500 in 1951 and that they had gone up to \$72,000 in 1954.

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He stated the belief that nearly the entire increase in gross receipts from 1951 through 1954 was due to the bingo pinball machines and that on this basis respondent allocated 60 percent to pinball receipts in 1952, 75 percent in 1953, and 80 percent in 1954. The auditor also testified that the usual practice was to have two bingo-type pinball machines and a music box per location and that appellant Clarence E. Standish had told him in 1956 that he had around 25 to 30 locations in 1952 and about 40 to 50 in 1956. The auditor stated that on November 5, 1953, when the T & S partnership was dissolved, there were 50 bingo-type machines, 44 music machines and 16 novelty games. The percentages used by respondent were based, in part, on the experience of its auditor that the bingo pinball machines produced significantly larger income than the music machines and other amusement machines.

In view of the fact that many legal music machines and amusement machines in addition to the pinball machines were acquired during the years in question, we cannot accept respondent's premise that virtually the entire increase in gross receipts was attributable to the pinball machines. Under the circumstances, we conclude that 40 percent, 55 percent and 65 percent of the recorded gross receipts constituted pinball receipts for the years 1952, 1953 and 1954, respectively.

As to the T & S Amusement Company, it has been urged on behalf of appellants that the aforesaid company did not commence as a partnership until May 1, 1952, as evidenced by the written partnership agreement, while the deficiency assessment covers a period beginning March 1, 1952, with the result that there may be amounts erroneously included in the assessment. Respondent's auditor testified that the partnership returns filed by T & S Amusement Company and signed by C. E. Standish report income for a period starting March 1, 1952, and state that the date of organization was March 1, 1952. The auditor further testified that the assessment was based on the amount reported as partnership income. In view of this use of reported partnership income in computing the deficiency, the actual starting date of the partnership appears immaterial,

It is contended on behalf of appellant Bernice Thomas that she is not responsible for any tax on her deceased husband's share of the partnership income for 1952 since Henry Thomas filed a separate return for that year, and that income which he received from the T & S Amusement Company was not community income and therefore section 18555 of the Revenue and Taxation Code is not applicable to the joint return filed for 1953.

Since 1952 is not one of the years under appeal, we shall only consider the contention relating to 1953. Section 18555 provides:

The spouse who controls the disposition of or who receives or spends community income as well as the spouse who is taxable on such income is liable for the payment of the taxes imposed by this part on such income. Where a joint return is filed by a husband and wife, the liability for the tax on the aggregate income is joint and several.

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We believe that the aforesaid code section is clearly applicable. Even if we were to make the unsupported assumption that the income from the T & S Amusement Company was not community income, we would still be forced to conclude that the filing of a joint return for 1953 would subject appellant Bernice Thomas to tax liability on the income in question under the second sentence of section 18555.

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 therefore,

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 protests to proposed assessments of additional personal income tax against Clarence E. and Marguerite Standish in the amounts of \$906.36, \$10,173.59 and \$16,316.16 for the years 1952, 1953 and 1954, respectively, against Robert M. McCoy in the amounts of \$45.14, \$44.01, \$1,980.73 and \$8,015.88 for the years 1951, 1953, 1954 and 1955, respectively, and against Bernice Thomas, individually and as Administratrix of the Estate of Henry Thomas, Deceased, in the amount of \$7,467.77 for the year 1953, be modified by recomputing gross income 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 17th day of April, 1963, by the State Board of Equalization.

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| <u>Paul R. Leake</u> | , Acting Chairman |
| <u>Richard Nevin</u> | , Member |
| <u>Geo. R. Reilly</u> | , Member |
| <u>Alan Cranston</u> | , Member |
| <u> </u> | , Member |

ATTEST: Dixwell L. Pierce, Secretary