BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
THOMAS AND LAURA WORKMAN)

Appearances:

For Appellants: George A. Kasem, Attorney at Law

For Respondent: F. Edward Caine, Senior 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 Thomas and Laura Workman to proposed assessments of additional personal income tax in the amounts of $1,537.28, $3,387.24 and $5,289.15 for the years 1951, 1952 and 1953, respectively.

During the years in question, Appellants Thomas and Laura Workman (hereinafter referred to as Appellants) operated a coin machine business in Los Angeles County. Appellants had multiple-odd bingo pinball machines, music machines and some miscellaneous amusement machines. The equipment was placed in various locations such a's 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 Appellants and the location owner.

Appellants did not file state tax returns for the years under appeal and Respondent used the gross income reported in federal tax returns as a basis for its adjustments. Respondent determined that Appellants were renting space in the locations where their machines were placed and that all the coins deposited in the'machines constituted gross income to them. Pursuant to Section 17359 (now 17297) of the Revenue and Taxation Code, Respondent allowed no deductions for business expenses. Section 17359 read as follows:

> 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 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 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 Fames, and we also held bingo pinball machines to be predominantly games of chance,

Respondent's auditor testified that during interviews in 1955 three location owners, two of whom were joint owners of one location, had told him that they paid cash to winning players of Appellants' pinball machines for unplayed free games. Two other location owners signed affidavits stating that they made cash payouts to players for unplayed free games and that Appellant Thomas Workman reimbursed them for such payouts from the proceeds in the respective pinball machines. One of these location owners later disaffirmed his sworn statement by testifying at the hearing in this appeal that he did not pay cash to players but would only put money in the machine to allow them to play the number of free games that had been cancelled through tilts and mechanical malfunctions. The other affiant, consistent with his sworn statement, testified that he first had a multiple-odd bingo pinball machine late in 1953 and that he made no cash payouts to winning players for unplayed free games until late in 1954. Two additional location owners who had Appellants' multiple-odd bingo pinball machines testified that during the period in question it was their general practice to pay cash to winning players for unplayed free games. Appellant Thomas Workman neither chose nor was called to testify in this matter. He had previously relied on the privilege against self-incrimination in refusing to answer questions concerning payouts posed in a questionnaire sent to him by Respondent in 1955.

Based on the evidence before us, we find that it was the general practice to pay cash to players of the bingo pinball machines for unplayed free games, Accordingly, this phase of Appellants' 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 17359.

It appears that some, if not 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. In our opinion there was a substantial connection between the illegal operation of the multiple-odd bingo pinball machines and the legal operation of music machines and miscellaneous machines. Respondent was correct in not allowing the deduction of any business expenses relative to the coin machine business.

There were no records of amounts paid to winning players on Appellants* pinball machines and Respondent estimated these unrecorded amounts as equal to 50 percent of the total amount deposited in the machines. The auditor testified that the 50 percent payout figure was an average of the estimates given by the three location owners whom he interviewed in 1955. At the hearing, two location owners gave payout estimates in the range of $10 to $25 a week without making clear the weekly amounts deposited in the pinball machines. Correlating these figures with Respondent% own estimate of the revenue produced by a multiple-odd pinball machine, as indicated in the following paragraph, the payouts by these two location owners would be around 25 percent. Considering all the evidence, we conclude that the payout figure should be reduced to 33-1/3 percent.

Appellants made no records available to Respondent's auditor 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 indicated by the Federal tax returns which was derived from such machines. Respondent's auditor testified that on the basis of interviews with three location owners and after checking with the city clerk's office in the city of El Monte with respect to licensing, he concluded that Appellants had 12 multiple-odd bingo pinball machines in 1951, 14 in 1952 and 16 in 1953. The auditor further testified that he estimated that Appellants retained $1,000 per year from collections from each multiple-odd pinball machine. He stated that experience had shown the aforesaid amount to be a conservative figure for multiple-odd type games. At the hearing of this matter, Appellants were given the opportunity to file additional factual information and, since they have not chosen to do so, we can see no reason to disturb the segregation proposed by Respondent.

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 Thomas and Laura Workman to proposed assessments of additional personal income tax in the amounts of $1,537.28, $3,387.24 and $5,289.15 for the years 1951, 1952 and 1953, 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 18th day of June, 1963, by the State Board of Equalization.

John W. Lynch, Chairman

Paul R. Leake, Member

Richard Nevins, Member

_____, Member

_____, Member

ATTEST: Dixwell L. Pierce, Secretary