63-SBE-077

BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeals of)
)
HAROLD N. AND ZOE COOK and)
HARRY H. AND VEVA RUSSO)

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 Harold N. and Zoe Cook in the amounts of $223.79, $419.06, $574.27 and $845.65 for the years 1951, 1952, 1953 and 1954, respectively, against Harry H. Russo in the amounts of $308.58 and $816.34 for the years 1951 and 1952, respectively, and against Harry H. and Veva Russo in the amounts of $613.40 and $917.74 for the years 1953 and 1954, respectively.

Appellants Harold N. Cook and Harry H. Russo were partners in Tri-Cities Amusement Company (hereinafter referred to as Tri-Cities) which operated a coin machine business in and near the cities of Concord, Martinez and Port Chicago. The business owned multiple-odd bingo pinball machines, flipper pinball machines, music machines and some miscellaneous amusement machines. The equipment was placed in numerous locations such as bars and restaurants. At weekly intervals the proceeds from each machine, after exclusion of expenses claimed by the location owner in connection with the operation of the machine, and after Tri-Cities received a $3 guaranteed amount relative to each music machine, were divided equally between the partnership and the location owner.

The gross income reported in the partnership returns of Tri-Cities was the total of amounts retained from locations. Deductions were taken for depreciation, cost of phonograph records and other business expenses.

Respondent determined that Tri-Cities was renting space in the locations where its machines were placed and that all of the

coins deposited in the machines constituted gross income to it. 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 except for the $3 minimum guaranteed to Tri-Cities from each music machine, the operating arrangements between Tri-Cities 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, in our opinion, applicable here. A joint venture may exist regardless of whether one party is to receive a minimum return. (Elias v. Erwin, 129 Cal. App. 2d 313 [276 P. 2d 848].)

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.

Appellant Harry H. Russo testified that he assumed that location *owners* were paying cash to players of Tri-Cities' bingo pinball machines for unplayed free games. He also testified that on the average the expenses claimed by the location owners relative to the bingo pinball machines were higher than those claimed with respect to the flipper pinball machines. We conclude that it was the general practice to pay cash to winning players for unplayed free games. Accordingly, the business of Tri-Cities 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 bingo pinball machines and music machines. A repairman serviced all types of machines.

Consequently, the coin-machine business was highly integrated and we believe that there was a substantial connection between the illegal activity of operating bingo pinball machines and the legal operation of the music machines, flipper pinball machines and miscellaneous amusement machines. Accordingly, Respondent was correct in disallowing all expenses of the coin machine business.

There were no records of amounts paid to winning players of the bingo pinball machines and Respondent estimated these unrecorded amounts as equal to 25 percent of the total amounts deposited in those machines. Respondent's auditor testified that the 25 percent payout figure was the estimate given by Appellant Harry H. Russo when he was interviewed in 1954.

As we also held in Hall, supra, Respondent's computation of gross income is presumptively correct. Since there is no evidence to the contrary, we sustain the 25 percent payout figure.

In connection with the computation of the unrecorded payouts it was necessary for Respondent's auditor to estimate the percentage of Tri-Cities' recorded gross income arising from the bingo pinball machines since the records of Tri-Cities lumped all game receipts together. The auditor's segregation of bingo pinball income was based directly on information supplied by and estimates made by Appellant Harry H. Russo. There being no evidence to indicate that Respondent's segregation was unreasonable, we shall not disturb it.

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 protests to proposed assessments of additional personal income tax against Harold N. and Zoe Cook in the amounts of $223.79, $419.06, $574.27 and $845.65 for the years 1951, 1952, 1953 and 1954, respectively, against harry H. Russo in the amounts of $308.58 and $816.34 for the

years 1951 and 1952, respectively, and against Harry H. and Veva Russo in the amounts of ~613.40 and $917.74 for the years 1953 and 1954, respectively, be modified in that the gross income is to be recomputed in accordance with the opinion of the Hoard. 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