BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
LeROY AND MARGARET PARKS)

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 LeRoy and Margaret Parks to proposed assessments of additional personal income tax in the amounts of $3,671.41, $8,179.76, $6,252.20, $6,263.56 and $6,385.94 for the years 1953, 1954, 1955, 1956 and 1957, respectively.

Appellant LeRoy Parks (hereinafter called Appellant) conducted a coin machine business in the Palo Alto - San Jose area. During the years under appeal, Appellant owned about one hundred pinball machines with the multiple-odd bingo-type predominating. Appellant also owned 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 equally between Appellant and the location owner.

The gross income reported in tax returns was the total amount retained from locations. Deductions were taken for depreciation 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 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 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 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. Thus, only one-half of the amounts deposited in the machines operated under these arrangements was includible in Appellant's gross income.

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.

At the hearing of this matter, three location owners testified that they paid cash to players of Appellant's bingo pinball machines for unplayed free games while one witness declined to answer all questions asked him on the basis of the privilege against self-incrimination. Appellant testified the location owners had told him that they were making payouts to winning players of his bingo pinball machines for unplayed free games. We conclude that it was the general practice to pay cash to winning players for unplayed free games. Accordingly, 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 was paid to winning players. Respondent was therefore correct in applying Section 17297.

Appellant and his employee collected from and serviced all types of machines. Appellant's 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 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 50 percent of the total amounts deposited in those machines. The only evidence presented which

would tend to qualify Respondent's presumptively correct computation is the testimony of one location owner that he imagined payouts amounted to around 20 percent and Appellant's estimate that expenses claimed by the location owners ran as much as 20 percent, Based on our experience, the 20 percent payout figure appears unusually low. We note that the aforementioned location owner was but one of many and that Appellant's estimate was that of an interested party. We conclude that the unrecorded payouts on bingo pinball machines equalled 30 percent of the total amounts deposited in the machines.

In connection with the computation of the unrecorded payouts, Respondent attributed 50 percent of Appellant's reported gross income to bingo pinball machines on the basis of Appellant's representation that this was a correct allocation. Under the circumstances, we have no reason to disturb the allocation.

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 LeRoy and Margaret Parks to proposed assessments of additional personal income tax in the amounts of $3,671.41, $8,179.76, $6,252.20, $6,263.56 and $6,385.94 for the years 1953, 1954, 1955, 1556 and 1957, 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 7th day of August, 1963, by the State Board of Equalization.

John W. Lynch, Chairman

Paul R. Leake, Member

Geo. R. Reilly, Member

Richard Nevins, Member

_____, Member

ATTEST: H. F. Freeman Secretary