BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeals of)
KENNETH K. TVETE and PARILEE J. CHASE)

Appearances:

For Appellants: William J. Kempenich, Attorney at Law

For Respondent: Israel Rogers, Associate Tax Counsel

OPINION

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 Kenneth K. Tvete and Parllee J. Chase (formerly Parllee J. Tvete) jointly In the amounts of $1,364.37 and $2,185.04 for the years 1951 and 1952, respectively, against Kenneth K. Tvete In the amounts of $2,341.89, $3,750.68, $5,107.00 and $3,952.91 for the years 1953, 1954, 1955 and 1956, respectively, and against Parllee J. Chase In the amounts of $824.53, $1,361.97, $1,082.76, $769.60 and $855.09 for the years 1953, 1954, 1955, 1956 and 1957, respectively.

Prior to May 1, 1953, and the initiation of divorce proceedings, appellants Kenneth K. Tvete and Parllee J. Chase, who was then Mrs. Tvete, operated a coin machine business In San Francisco as a partnership. The partnership had multiple odd bingo pinball machines, music machines, shuffle alleys and some miscellaneous amusement machines. Some of the equipment was owned while much of It was rented from Advance Automatic Sales Co.

The coin machine 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, usually equally, between appellants and the particular loca'tlon owner.

After May 1, 1953, Kenneth K. Tvete continued the business as a sole proprietorship except that his ex-wife, Parilee J. Chase, took over that part of the business connected with one location in which two bingo pinball machines were placed.

The gross income reported In tax returns was the total of amounts retained from locations. Deductions were taken for depreciation and other business expenses. 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. 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 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, 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, 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.

Two location employees and two location owners testified at the hearing of this matter. One location owner readily admitted regularly making payouts for free games while the other location owner, the one having pinball machines owned by appellant Parilee J. Chase, although admitting that he was arrested and fined for making payouts shortly thereafter, denied making cash payouts during the years under appeal. The aforesaid employees denied any knowledge of payouts. However, respondent's

auditor testified that during interviews in 1958 each of these same four persons had admitted that cash payouts were made during the period under consideration. Appellant Kenneth K. Tvete testified that the locations were reimbursed for whatever expenses were claimed. We find this 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 17297.

In accordance with section 17297, all expenses related with the bingo pinball machines were properly disallowed. This Includes, of course, all expenses of the separate operation by appellant Parilee J. Chase, since she had only such machines. With respect to the rest of the operations involved, appellant Kenneth K. Tvete did the collecting from the various machines. A single place of business was used to service and store all types of equipment. Several of the locations which had a bingo pinball machine also had a music machine or some miscellaneous amusement machine. There was, in our opinion, a substantial connection between the illegal activity of operating bingo pinball machines and the legal activity of operating music machines, shuf'fle alleys and miscellaneous amusement machines. Respondent was therefore correct in disallowing all the expenses of the coin machine businesses of appellants.

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 such machines. Respondent's auditor testified that the 50 percent payout estimate was based on Investigation of other pinball operations in the San Francisco area. The auditor further testified, however, that a location owner and a location employee Interviewed at the time of the audit had estimated payouts at 50 percent while one location owner had estimated payouts at 30 percent.

As we held In the Hall appeal, supra, respondent's computation of gross income -presumptively correct. The 50 percent payout figure seems reasonable and under the clrcumstances will not be disturbed.

In connection with the computation of the unrecorded payouts relative to the business of the'partnershlp and later that of appellant Kenneth K. Tvete, the latter's records showed the pinball receipts separately for only 1952, 1953 and 1954. For the years of 1951, 1955 and 1956, when the pinball income was not segregated in the records, respondent estimated such Income on the basis of the average percentage of total gross Income derived from pinball machines during the years 1952, 1953 and 1954. Respondent recomputed the unrecorded payouts relative to the pinball Income of appellant Parilee J.

Chase for the years 1953 through 1957 on the basis of the amounts she reported in tax returns. Respondent considered all of the pinball income as being attributable to bingo pinball machines. Appellant Kenneth K. Tvete testified that he also has some flipper pinball machines, but he has not established that the income therefrom was significant. Under the circumstances we have no reason to disturb respondent's 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 protests to proposed assessments of additional personal income tax against Kenneth K. Tvete and Parilee J. Chase (formerly Parilee J. Tvete) jointly in the amounts of $1,364.37 and $2,185.04 for the years 1951 and 1952, respectively, against Kenneth K. Tvete in the amounts of $2[illegible]1.89 $3,750.68, $5,107.00 and $3,952.91 for the years 1953, 1954, 1955 and 1956, respectively, and against Parilee J. Chase in the amounts of $824.53, $1,361.97, $1,082.76, $769.60 and $855.09 for the years 1953, 1954, 1955, 1956 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 San Francisco, California, this 17th day of March, 1964, by the State Board of Equalization.

Paul R. Leake, Chairman

[signature], Member

[signature], Member

[signature], Member

[signature], Member

Attest: [signature], Secretary