

Appeal of Paul A. Laymon, Inc.

<u>Income Year</u>	<u>Amount</u>
2-28-58	\$4,352.51
2-28-59	4,479.34
2-29-60	6,443.22
2-28-61	5,707.49
2-28-62	5,784.59
2-28-63	6,157.99
2-29-64	6,148.68
2-28-65	6,989.27
2-28-66	6,037.08
2-28-67	7,155.86
2-29-68	8,191.65

The only issue presented by this appeal is a procedural one, whether the "Notices of Additional Tax Proposed to Be Assessed" issued by respondent complied with the requirements of section 25662. Appellant has not contested the merits of respondent's assessments.

Appellant, a California corporation, is a distributor of new and used coin operated machines in southern California. In addition to other types of machines, appellant distributes pinball machines for United Manufacturing Company and Bally Manufacturing Corporation,

These companies manufacture machines commonly known as multiple coin, bingo type pinball machines. Respondent determined that bingo type pinball machines are illegal gaming devices under section 330.1 of the California Penal Code. According to section 24436, no deductions are allowable from gross income derived from such illegal machines.

Although it suspected appellant had derived income from the sale of such machines, respondent deferred auditing appellant's returns because the constitutionality of section 17297, the Personal Income **Tax** Law counterpart of section 24436, was being litigated. Instead, respondent sought, and received, waivers of the statute of **limitations** from appellant, explaining that it wished to await "the outcome of C. B. Hall v. Franchise Tax Board" before taking further action regarding appellant's returns.

Appeal of Paul A. Laymon, Inc.

The final decision reached in Hall v. Franchise Tax Board, 244 Cal. App. 2d 843 [53 Cal. Rptr. 597], upheld the constitutionality of section 17297 (and section 24436) and endorsed the denial of deductions to one engaged in illegal pinball activities. On February 7, 1968, respondent sent a letter to appellant discussing the Hall decision. In the letter respondent requested that appellant report the amount of income, if any, it had received from the sale, ownership or operation of bingo type pinball machines during the years in question. Respondent also requested that appellant provide an inventory of the machines, of all types, it had owned during that period. Appellant's counsel confirmed receipt of this **letter** on February 20, 1968.

Respondent then audited appellant's books and records, and confirmed its suspicion that appellant was selling illegal machines. Appellant never received any written report of the audit findings. However, the auditor did discuss those findings with appellant's counsel by telephone, when an attempt was made to convince the auditor that the pinball machines in question were legal.

After the audit, appellant and its counsel **denied** ever having received respondent's letter of February 7, 1968 (even though they had confirmed receipt of it on February 20, 1968) and requested another copy of it. Respondent sent each a copy on **March 11, 1970**. Less than two months later, respondent issued the notices of proposed assessment for the years in question.

All the notices had the same format. Each set out the computation of the proposed assessment, and each contained the following statement as the basis for the assessment:

Revised in accordance with the provisions of
Section 24436 of the Bank and Corporation
Tax Law.

The notices contained no other information relevant to the issue on appeal,

Appeal of Paul A. Laymon, Inc.

This appeal centers on the adequacy of those notices, as measured by the standards set in section 25662. Section 25662 provides:

...Each notice [of proposed assessment] shall **set** forth the reasons for the proposed additional assessment and the details of the computation thereof. (Emphasis added.)

Prior to its amendment in 1951, section 25662 (**formerly** section 25 of. the Bank and Corporation Franchise Tax **Act**) read:

...Each notice shall set forth the details of the proposed additional assessment and of computing said tax.

Appellant maintains that by amending the statute to **require** "reasons" as well as "details", the Legislature intended that a more specific notice be given to the taxpayer, and that respondent failed to provide such notice.

Turning specifically to the notices in question, appellant insists that their simple reference to section 24436 was meaningless. At the time the notices were issued, section 24436 provided:

...[N]o deductions shall be allowed to any taxpayer on any of its 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 deduction be allowed to any taxpayer on any of its gross income derived from any other activities which tend to promote or to further, or are connected or associated with, such illegal activities.

Since the three **chapters of** the Penal Code referred to in section 24436 cover lotteries, gaming and **horseracing**, and contain 46 separate sections, appellant claims the simple reference to section 24436 in respondent's notices

Appeal of Paul A. Laymon, Inc.

was too vague. Appellant contends the notices did not give any reasons or details and failed to apprise it of the specific activity that required the disallowance of its deductions.

Respondent's position is that, by its terms, the only details required by section 25662 -are "details of the computation." We agree and are convinced that the computations in the notices, which showed that all deductions were disallowed, gave the proper details.

In order to determine whether the notices "set forth the reasons" for the proposed assessments, we believe the word "reasons" should be given its ordinary and familiar meaning. The primary meaning given for the word "reason" in Webster's Third New International Dictionary (Unabridged, 1971) is:

1. a: an expression or statement offered as an explanation...or as a justification of an act or procedure....

The statement on each of the notices in question, ("Revised in accordance with...section **24436....**"), is clearly a "statement offered as...justification of an act." Respondent thereby gave a reason for its assessment, as required by section 25662.

The real issue, **then**, is whether the reason respondent gave was sufficient to prevent any prejudice to appellant. In construing the similar notice requirement in the Personal Income Tax Law, we stated:

The purpose of [the notice **requirement**]...is to inform the taxpayer of the basis of the assessment so that he can intelligently protest the matter. (Appeal of The First National Bank of Chicago, Trustee for Virginia Kirk Cord Trust, et al., Cal. St. Bd. of Equal., June 23, 1964.)

Appeal of Paul A. Laymon, Inc.

In the instant case, the notices indicated all deductions were being disallowed due to receipt of income from illegal activities; prior communications between the parties, detailed above, centered on appellant's receipt of income from illegal pinball machine activities; the last such communication was less than two months before the issuance of the notices. Under these circumstances, we are sure that appellant was aware of the specific activity which required the disallowance of its deductions and an intelligent protest was therefore possible. Indeed, appellant's protest specifically denied that it had ever engaged in illegal pinball activities.

In accordance with the views herein expressed, we find that respondent's **notices** of proposed assessment complied with section **25662** in every respect. Therefore, we must sustain respondent's assessments.

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,

Appeal of Paul A. Laymon, Inc.

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section 25667 of the Revenue and Taxation Code, that the action of the Franchise Tax Board in denying the protest of Paul A. Laymon, Inc., against proposed assessments of additional franchise tax in the amounts and for the income years below, be and the same is hereby sustained.

<u>Income Year</u>	<u>Amount</u>
2-28-58	\$4,352.51
2-28-59	4,479.34
2-29-60	6,443.22
2-28-61	5,707.49
2-28-62	5,784.59
2-28-63	6,157.99
2-29-64	6,148.68
2-28-65	6,989.27
2-28-66	6,037.08
2-28-67	7,155.86
2-29-68	8,191.65

Done at Sacramento, California, this 6th day of October, 1976, by the State Board of Equalization.

William B. Burnett, Chairman
George J. J. J. J., Member
Paul A. Laymon, Member
_____, Member
_____, Member

ATTEST: *Will Hunter*, Executive Secretary