

1953 and until  
June 30, 1954. The partnership was then dissolved and a new  
partnership was immediately formed between Victor Paganucci and  
Mike Paganucci, The new partnership continued to operate the same  
business as the old partnership. The new partnership was known as  
Capitol Music Company and operated from July 1 throughout the  
balance of 1954.

Hereinafter the word "Appellants" will be used to mean Mike  
Paganucci, Victor Paganucci, and Frank L. Giordano.as to the

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~~and Victor Paganucci, 1954, through~~ June 30, 1954, and Mike Paganucci  
December 31, 1954. period July 1, 1954, through

Appellants operated an establishment in downtown Sacramento known as Funland. At Funland were a number of coin-operated machines. These machines were of several varieties, including baseball machines, motion picture machines, music machines, a claw machine, flipper-type pinball machines, and multiple-odds bingo-type pinball machines. A multiple-odds bingo-type pinball machine will hereinafter be called a bingo pinball machine.

A bingo pinball machine is one in which a coin is inserted and five balls are thereupon released for play. The player propels each ball by means of a spring-activated plunger to the top of an inclined playing field. In the playing field are arranged bumpers, pins and scoring holes. This arrangement is such that the ball cannot drop into any hole without first striking one or more bumpers or pins. When a ball drops into a hole, the event is recorded on a scoring panel by lighted indicators. To win the game, balls must be placed in a certain combination of holes.

Additional coins may usually be deposited in the machine. The deposit of such additional coins activates the machinery under the playing field and scoring panel which, in turn, may increase 'the scoring odds, alter the winning combinations, or provide additional balls' to be played. The player, however, has no control over the effects which the deposit of additional coins will have.

There are controls inside the machine which can be adjusted in order to change the odds. These adjustments range from liberal to conservative, but the state of adjustment is not evident to the player. The machines are also equipped with anti-tilt controls. If the player jars or tilts the machine beyond a very limited degree, this control is activated and voids the player's score. The sensitivity of this control may also be adjusted, but again the state of adjustment is not evident to the player.

A counter in the scoring panel shows the number of free games won by the player. The free plays and the reading on the counter in the scoring panel may be removed by pushing a button set into the case of the machine. Inside the machine is another counter or meter which records the number of free plays which are removed by pushing the button, rather than by playing them. It may be inferred that the purpose of the removal button is to enable the person controlling the operation of the machine to make a cash payment to a player in lieu of his playing off the free games.

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Appellants also owned about 13 coin-operated music machines which were placed in business establishments not operated by Appellants. In 1953 Appellants acquired 6 bingo pinball machines and placed these in business establishments not operated by Appellants. Appellants' agreements with the location owners were that Appellants would service the music and pinball machines and that there would be an equal division of the proceeds after deduction of payouts, if any, and other amounts expended by the location owner in connection with the operation of the music and pinball machines.

A witness who played the bingo pinball machines at Funland about once a month throughout 1951, 1952, and 1953 and until February of 1954 testified that he would request and receive a cash payment from the management for free games not played off. The cash payment was at the rate of 5 cents for each free game. He further testified that he witnessed other patrons receiving cash payments in lieu of free games. He also testified as to his net winnings and losses but did not indicate the total amount which he deposited in the machines nor the total amount which he received back as cash payouts.

An auditor for Respondent testified that in 1954 he audited the records of the business and talked to Victor Paganucci and to Mr. Larsen, a public accountant who maintained the records of the business. The auditor stated that the receipts from Funland were not segregated according to individual machine or type of machine. The receipts from pinball machines and music machines on the route were commingled with receipts from Funland. Collection slips were not available. He stated that Victor Paganucci had estimated that about half of the reported gross income was from bingo pinball machines and about half from other types of machines. The auditor further stated that Victor Paganucci denied that cash payouts in lieu of free games were ever made to patrons at Funland.

Respondent's auditor stated that the assessment was based on Section 17359 (now 17297) of the Revenue and Taxation Code. He stated that from his audit he concluded that Appellants' business violated the Penal Code in that the bingo pinball machines were operated for gambling. He stated that Appellants' gross income had been understated by excluding cash payouts made in lieu of free games.

He determined the amount of the cash payouts in lieu of free games by first assuming that half the reported income was from bingo pinball machines and half from other machines and by then assuming that cash payouts on bingo pinball machines equaled 50 percent of the total amount of cash deposited in these machines.

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Thus, for every \$20 appearing in the records as gross income, an additional \$10 was considered as paid out to winning players.

The 50 percent figure used as the percentage of payouts to total amounts deposited in the machines was based on audits of other owners of bingo pinball machines in the same area. This 50 percent figure was the one most frequently found in such audits.

The auditor stated that he disallowed all deductions claimed on the return for expenses of operating the business and also disallowed as expenses the estimated cash payouts. For the year 1951, no adjustments of gross income or disallowance of expenses were made for the portion of the year preceding May 3, 1951, the effective date of Section 17359.

Section 17359 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."

Section 330a of the Penal Code makes it a crime to possess or control a "mechanical device, upon the result of action of which money . . . is . . . hazarded, and which is operated . . . by . . . depositing therein any coins . . . and by means whereof . . . money . . . is won or lost . . . when the result of action of such machine . . . is dependent upon hazard or chance." Section 330a is a part of Chapter 10 of Title 9 of Part 1 of the Penal Code of California.

Respondent contends that the bingo pinball machines in question are primarily games of chance and that money may be won or lost on the result of action of the machines. Respondent concludes, therefore, that Section 17359 of the Revenue and Taxation Code is applicable. It is of the opinion that it made a reasonable estimate of Appellants' gross income, and that in accordance with Section 17359 it was proper to disallow all expenses of the business, including expenses not directly attributable to the operation of bingo pinball machines.

Respondent has presented evidence which establishes that in conducting the business at Funland cash payments were made to players of bingo pinball machines in lieu of free games. The description of these machines is identical to that in the Appeals

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of C. B. Hall, Sr., et al., Cal. St. Bd. of Equal., December 29, 1958 (CCH, 2 Cal. Tax Cases, Par. 201-197), (P-H, St. & Loc. Tax Serv., Cal., Par. 58,145). Here, as in that case, the machines were games of chance, Section 17359 of the Revenue and Taxation Code is, accordingly, applicable.

In the Hall appeal, it was held that, the illegal operation of pinball machines having been established by the evidence presented, the action of the tax administering agency is presumptively correct as to the amount of gross income and as to the allowable deductions.

Respondent's method of computing the cash payouts on bingo pinball machines by taking Victor Paganucci's estimate that half of the business income was from such machines and combining it with the payout percentage most commonly found in other audits in the same area was reasonable since Appellants' records did not include this information or afford any basis from which this information could be computed or reasonably estimated. No evidence has been presented to show that Respondent's computation, of gross income was excessive.

In accord with Section 17359, no deductions may be allowed to Appellants on any of their gross income derived from any illegal activity nor may any deductions be allowed on any of their gross income derived from any other activity which tends to promote or further or is connected or associated with such illegal activity. Cash payouts in lieu of free games, depreciation, and costs of collection and repair are, of course, deductions from gross income of the illegal operation of the bingo pinball machines and are therefore not allowable. Depreciation and costs of repair on other types of machines at Funland and the general overhead expenses at Funland are also nonallowable deductions because the operating of machines other than bingo pinball machines clearly tends to further or promote the operation of the bingo pinball-machines.

Depreciation and costs of collection and repair on machines on the route (music machines only in 1951 and 1952 and music machines and pinball machines in 1953 and 1954) are likewise nonallowable if the operation of machines on the route tends to further or promote or is associated or connected with the illegal operation of bingo pinball machines at Funland. On the record before us it may be inferred that the operation of machines on the route tended to promote or further or was connected or associated with the operation of bingo pinball machines at Funland. Appellants have offered no evidence on this subject: Appellants know their own operations well and it would have been easy for one of them to testify as to their business practices so as to

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establish the necessary independence of the two types of operation, if they were in fact independent. None of the Appellants appeared as a witness. Accordingly, Respondent's action as to this phase of the matter must also be sustained.

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 actions of the Franchise Tax Board on the protests to proposed assessments of additional personal income tax against Mike and Rose Paganucci in the amounts of \$152.69, \$211.52, \$208.22, and \$185.27 for the years 1951 through 1954, respectively; against Victor and Tomasina Paganucci in the amounts of \$114.82, \$225.78, \$226.12, and \$206.44 for the years 1951 through 1954, respectively; against Frank L. Giordano in the amount of \$194.72 for the year 1951; against Mary Giordano in the amount of \$194.72 for the year 1951; and against Frank L. and Mary Giordano in the amount of \$398.34 for the year 1953 be, and the same are hereby, sustained.

Done at Sacramento, California, this 15th day of December, 1960, by the State Board of Equalization.

John W. Lynch, Chairman

George R. Reilly, Member

Paul R. Leake, Member

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ATTEST: Dixwell L. Pierce, Secretary