



BEFORE THE STATE BOARD OF EQUALIZATION  
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of  
WILLIAM A. AND ZELLA DAVIDSON

Appearances:

For Appellants: Archibald M. Mull, Jr. , Attorney at Law

For Respondent: F. Edward Caine, Senior 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 William A. and Zella Davidson to proposed assessments of additional personal income tax in the amounts of \$1,224.90, \$2,941.54, \$3,729.84 and \$3,649.56 for the years 1952, 1953, 1954 and 1955, respectively.

During the period in question, Appellant William A. Davidson owned and operated a coin machine business in the Crescent City area under the name of ABC Music Company. ABC had multiple-odd bingo pinball machines, flipper pinball machines, music machines and some other types of amusement machines. The equipment was placed in restaurants, bars and other locations. The proceeds from each machine, after the allowance of expenses claimed by the location owner in connection with the machine, were divided equally between ABC and the location owner. Equipment was placed in approximately fifteen locations.

The gross income reported by Appellants from ABC was the **total of the amounts retained by ABC** from locations. Deductions were taken for depreciation, cost of phonograph records and other business expenses.

Respondent determined that ABC was renting space in the locations where its machines were placed and that all the coins deposited in the machines constituted gross income to ABC. Respondent also disallowed all expenses pursuant to Section 17359 (now 17297) of the Revenue and Taxation Code which read:

In computing net income, no deduction 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

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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 ABC and each location owner were the same as those considered by us in Appeal of C. B. Hall, Sr., Cal. Bd. of Equal., Dec. 29, 1958, 2 CCH Cal. Tax Cas. Par. 201-197; 3 P-H State & Local Tax Serv. Cal. Par. 58,145. Our conclusion in Hall that the machine owner and each location owner were engaged a joint venture in the operation of the machines is, accordingly, applicable here.

As we held in the Hall appeal, if a coin machine is a game of chance and cash is paid to winning players, the operator is engaged in an illegal activity within the meaning of Section 17359. The multiple-odd bingo pinball machines here involved are substantially identical to the machines which we held to be games of chance in Hall. The evidence as to cash payouts is not without conflict but two location owners testified that cash payouts were made, Appellant William A. Davidson testified that he assumed that locations with "bingos" were "paying off on them" and the machines were equipped to record free games not played off. From the evidence before us we conclude that it was the general practice to make cash payouts to players of these machines for free games not played off. Accordingly, these machines were operated illegally and Respondent was correct in applying Section 17359.

Appellant William A. Davidson personally operated the entire business by himself. He made collections and repairs, solicited new locations and purchased new equipment. Occasionally, he hired someone to help him. There was a music machine in virtually every location and there were multiple-odd bingo pinball machines in about one-third of the locations. We thus find that there was a substantial connection between the illegal activity of operating multiple-odd bingo pinball machines and the legal activity of operating music and amusement machines. Respondent was, therefore, correct in disallowing all deductions for expenses of the entire business.

We next consider whether Respondent's computation of gross income was correct. Appellant William A. Davidson prepared a collection report at the time of each collection and left a copy with the location owner. The amounts included on the reports were the net proceeds after exclusion of the amounts claimed by the location owners for expenses. Since there were no complete records of amounts paid to winning players and other expenses initially paid by the location owners, Respondent made an estimate of the unrecorded amounts.

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At the time of making the audit of 1956, Respondent's auditor interviewed several owners of locations in which multiple-odd bingo pinball machines acquired from ABC were operated during the years in question. Only one location owner stated that cash payouts were made for free games not played off and he estimated that the cash payouts totaled 50% of the amounts deposited in the machine. Based on this information, Respondent estimated the cash payouts to have been equal to 50% of the total amounts deposited in all of the multiple-odd bingo pinball machines,

Since ABC's records did not indicate income by type of machine except as discussed below, Respondent's auditor made an estimate of the percentage of total recorded gross income which was derived from such machines. For the year 1953, the collection reports showed the receipts from each machine where more than one machine was in the same location. From an analysis of these reports for September through December of 1953, Respondent's auditor determined that 54-1/2% of the recorded gross income was from multiple-odd bingo pinball machines, 33-1/2% from music machines and 12% from other types of equipment. He applied these percentages to the income of the entire year of 1953.

For the last eight months of 1952 (the business having been started in May of 1952) and for the years 1954 and 1955, Respondent's auditor made the estimates by reference to the percentages for 1953 and also by reference to the payments ABC made to suppliers for the purchase or rental of the various types of machines. On this basis, he estimated that of the total recorded gross income for 1952, 45% was derived from multiple-odd bingo pinball machines, 35% from music machines and 20% from other types of equipment. His estimates for 1954 and 1955 were 60% from multiple-odd bingo pinball machines, 30% from music machines and 10% from other types of equipment.

Respondent derived its estimate of unrecorded payouts by combining the 50% payout estimate with its estimates of the percentages of income attributable to the multiple-odd bingo pinball machines. As we also held in Hall, supra, Respondent's computation of gross income is presumptively correct. Appellants have not offered any evidence to establish a more accurate computation. Respondent's method of estimation was reasonable under the circumstances and therefore, except for the reduction due to our conclusion that ABC and each location owner were engaged in a joint venture, Respondent's computation of gross income is sustained.

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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 William A. and Zella Davidson to proposed assessments of additional personal income tax in the amounts of \$1,224.90, \$2,941.54, \$3,729.84 and \$3,649.56 for the years 1952, 1953, 1954 and 1955, respectively, be and the same is hereby 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 6th day of November, 1961, by the State Board of Equalization.

John W. Lynch, Chairman  
Paul R. Leake, Member  
Geo. R. Reilly, Member  
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ATTEST: Dixwell L. Pierce, Secretary