



BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeals of)
)
WILLIAM H. REMINGTON, JR., AND)
RUTH REMINGTON, T. F. AND PHYLLIS T.)
TOWER, WAYNE R. AND BLANCHE O. HARDIN,)
and HUB AMUSEMENT COMPANY, INC.)

Appearances: '

For Appellants: Ray Manwell, Attorney at Law

For Respondent: A. Ben Jacobson, Associate Tax Counsel

O P I N I O N

These appeals are made pursuant to Sections 18594 and 25667 of the Revenue and Taxation Code from the action of the Franchise Tax Board on protests against proposed assessments of additional tax as follows:

<u>Appellant</u>	<u>Type of tax</u>	<u>Taxable Year</u>	<u>Amount</u>
William H. Remington, Jr., and Ruth Remington	Personal Income Tax	1952	\$ 4,362.51
		1953	16,118.55
		1954	14,969.55
		1955	16,002.90
		1956	13,279.49
		1957	7,146.17
T. F. and Phyllis T. Tower		1952	2,865.12
		1953	16,216.92
		1954	14,958.63
		1955	15,443.38
		1956	8,169.74
Wayne R. and Blanche O. Hardin	"	1954	497.58
		1955	1,117.31
		1956	10,181.84
Hub Amusement Company, Inc.	Franchise Tax	1957	827.41
		1958	827.41

Prior to and during a portion of 1952, Appellant William H. Remington, Jr., operated a single proprietorship in Sutter and Yuba Counties under the name Twin Cities Music Company, and

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Appellant T. F. Tower operated a single proprietorship in the same counties under the name Tower Music Company. Some time in 1952, the two individuals formed a partnership and amalgamated their two businesses. Thereafter the partnership conducted a business under the name Hub Amusement Company. Appellant Wayne R. Hardin conducted a single proprietorship in Sutter and Yuba Counties under the name Wayne's Amusement Company from February 2, 1954, to April 7, 1956, on which date he became a member of the Hub Amusement Company partnership. On October 1, 1957, the business of the Hub Amusement Company partnership was taken over by a corporation called Hub Amusement Company, Inc.

Each of the businesses in question owned pinball machines, music machines and miscellaneous amusement machines. Most of the pinball machines were of the bingo variety. In addition, Wayne's Amusement Company and Hub Amusement Company had cigarette machines.

Cigarette machines were first acquired by Hub Amusement Company in 1954. Initially, they were furnished to location owners without charge for the purpose of allowing location owners to make sales of cigarettes. At some later time, this practice was abandoned and Hub started selling cigarettes in the machines. One employee collected exclusively on these machines, but the same warehouse and repair facilities were used for all machines. Commencing in 1956, Hub's cigarette machines, together with certain "bumper pool" games were operated by Hub's partners, at least on the books, under the name E & A Vending Company.

The equipment of these various businesses was placed in more than one hundred locations and the proceeds from each machine, other than cigarette machines, were divided between the location owner and the machine owner. Prior to the division, however, the location owner received from the proceeds the amount he claimed for expenses. The division was usually an equal division, but in some situations with respect to music machines, the location owner would receive only 40 percent or only 30 percent. In the case of cigarette machines wherein the machine owner was selling cigarettes, the location owner received a commission on cigarettes sold. Typically, this amount would be 3¢ per pack.

The gross income reported in tax returns was, except as to cigarette machines, the total of amounts retained from the locations. In the case of cigarette machines where one of the businesses in question was selling cigarettes in such machines, the gross income reported in tax returns was the total amount of coins deposited in the machines less the cost of the cigarettes. Deductions were taken on returns for depreciation, salaries, cost of phonograph records, commissions and other business expenses.

Respondent determined that each of the businesses in question was renting space in the locations where the machines were

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placed and that all the coins deposited in the machines other than cigarette machines constituted gross income to the business. The gross income from the cigarette machines was considered to be as reported in the tax returns. Respondent also disallowed all expenses pursuant to Sections 17297(17359 prior to June 6, 1955) and 24436 of the Revenue and Taxation Code. Sections 17297 and 24436 are substantially identical, the former applying to individuals and the latter to corporations. Section 17297 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 each of the businesses here in question and each location owner were, except as to cigarette machines, 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, 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.

In Appeal of Carl P. Reinert, Cal. St. Bd. of Equal., March 22, 1962, CCH Cal. Tax Rep. Par. 201-913, 3 P-H State & Local Tax Serv. Cal. Par. 58232, we held that a cigarette vending machine owner who furnished the cigarettes and serviced the machine was renting space in the location and that the gross income of the machine was attributable entirely to the machine owner. The conclusion in Reinert is applicable here.

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.

From the testimony of the three principals above mentioned and of five of the location owners, it is clear that it was the general practice to pay cash to players of the pinball machines for unplayed free games. Accordingly, the pinball machine phase of each of the businesses here in question was illegal, both on the ground of ownership and possession of bingo pinball machines

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which were predominantly games of chance and on the ground that cash was paid to winning players. Respondent was therefore correct in applying Sections 17297 and 24436.

As to each of the businesses here in question, the pinball machines produced more than half of the income. For the most part, the individuals who made collections or repairs made such as to all types of equipment handled by a particular business. Most of the locations had both a music machine and a pinball machine.

It appears that the cigarette machines of Hub were initially used to promote the rest of the business by accommodating location owners. Presumably they were placed in locations where other types of machines were located, Although one collector handled these machines exclusively after Hub began to sell cigarettes in them and the partners of Hub eventually placed the cigarette and bumper pool portion of the business under the name E & A Vending Company, the same warehouse and repair facilities were used for all machines. Appellants have not attempted to establish any real separation of E & A from Hub. In this operation, as in all of the enterprises here involved, the ownership of each type of equipment aided the entire business by permitting the offering of a full line of coin machine devices.

We conclude that the illegal operation of pinball machines was associated or connected with the legal operation of music machines, miscellaneous amusement machines and cigarette machines, and Respondent was therefore correct in disallowing all the expenses of the businesses here in question.

There were no records of amounts paid to winning players for unplayed free games on the pinball machines and Respondent estimated such amounts to be equal to 50 percent of the total deposited in those machines. This figure was based upon interviews with a number of location owners. Appellants presented no evidence that the 50 percent estimate was excessive. It appears reasonable under the circumstances and is sustained.

With the exception of the Hub Amusement Company records, the records of these various businesses contained no breakdown of the income as between pinball machines and other types of equipment. Respondent's auditor made an estimate of the breakdown based on the number of pieces of each type of equipment, attributing equal amounts of income to each piece of equipment. Again Appellants have presented no evidence that this resulted in an excessive allocation of income to the pinball machines. In view of the usual tendency of pinball machines to produce higher amounts of income per machine than other types, Respondent's estimate appears to be conservative and 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 Sections 18595 and 25667 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on protests against proposed assessments of additional tax as set forth below be and the same is hereby modified in that the gross income is to be recomputed in accordance with the opinion of the Board:

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		1958	827.41

Done at Sacramento, California, this 19th day of March, 1963, by the State Board of Equalization.

John W. Lynch, Chairman

Geo. R. Reilly Member

Richard Devins, Member

_____, Member

_____, Member

ATTEST: Dixwell L. Pierce, Secretary