



BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
SAM AND CONCETTA MIANO)

Appearances:

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

For Respondent: Burl D. Lack, Chief 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 Sam and Concetta Miano to proposed assessments of additional personal income tax in the amounts of \$13,236.92 and \$18,165.74 for the years 1952 and 1953, respectively.

During the years in question, appellant Sam Miano (hereinafter referred to as appellant) operated a coin machine business in the Santa Cruz area. Appellant had multiple-odd bingo pinball machines, flipper pinball machines, music machines and some miscellaneous amusement machines. The equipment was placed in about 100 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, except as to most of the music machines, divided equally between appellant and the location owner. Appellant usually received 60 percent of the music machine proceeds.

The gross income reported in tax returns was the total of amounts retained from locations. Deductions were taken for salaries, depreciation, phonograph records and other business expenses. Respondent determined that appellant was renting space in the locations where his machines were placed and that all the coins deposited in the machines constituted gross income to him. Respondent also disallowed all expenses pursuant to section 17359 (now 17297) of the Revenue and Taxation Code which 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.

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The evidence indicates that the operating arrangements between appellant 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, 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 the 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, 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.

At the hearing in this matter, four location owners testified that they paid cash to players of appellant's bingo pinball machines for unplayed free games and no witness testified to the contrary. We conclude that it was **the** general practice to pay cash to winning players for unplayed free games. Accordingly, this phase of appellant's business 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 17359.

Appellant's entire business was operated as a unit. The same individual made collections from all machines and two mechanics repaired all types of machines on the route. There was thus a substantial connection between the illegal operation of bingo pinball machines and the legal operation of music machines and miscellaneous amusement devices and it was proper to disallow all the expenses of the coin machine business.

There were no records of amounts paid to winning players of appellant's pinball machines and respondent estimated these unrecorded amounts as equal to 40 percent of the total amount deposited in the machines. At the time of the audit in 1955, respondent's auditor interviewed 10 location owners. While one was unable to give an estimate and two said no payouts were made, the remaining location owners were able to give him estimates of the percentages which the payouts bore to the total amounts in the machines. These estimates ranged from 20 to 70 percent and the figure used by respondent was based on these estimates. At the hearing, four of the location owners testified, with three of them giving estimates which were consistent with those given when interviewed in 1955, and one of them giving a somewhat lower estimate. With respect to the latter, it is noted that the estimate given to respondent's auditor in 1955 was made at a time much closer to the events to which it related than was the one made at the hearing. On the basis of the evidence before us, we believe that the payout percentage used by respondent in computing unrecorded gross income was reasonable and, therefore, it is approved,

Appellant's records did not segregate the income from the bingo pinball machines, and in order to compute the unrecorded amount of payouts on bingo pinball machines, it was necessary to determine the portion of the recorded income which was derived from such machines. Respondent estimated that **80** percent of the recorded income from coin machine games and music machines was

