



BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeals of)
FRANK MARTY, JR., DOROTHY B. MARTY)
AND HEDY MARTY)

Appearances:

For Appellants: Archibald M. Mull, Jr., Attorney at Law
For Respondent: Israel Rogers, Assistant Counsel

O P I N I O N

These appeals are made pursuant to Section 18594 of the Revenue and Taxation Code from the action of the Franchise Tax Board on protests to proposed assessments of additional personal income tax against Frank Marty, Jr., and Dorothy B. Marty in the amounts of \$6,257.52 and \$9,759.91 for the years 1951 and 1952, respectively, and against Frank Marty, Jr., and Hedy Marty in the amounts of \$10,931.98 and \$12,377.63 for the years 1953 and 1954, respectively.

Appellant Frank Marty, Jr., (hereafter referred to as Appellant) conducted a coin machine business in the San Jose area which was known as Acme Lovelty Company. Appellant owned multiple-odd bingo pinball machines, flipper pinball machines, slot machines, one or two claw machines, shuffle alleys, music machines and some miscellaneous amusement machines. Appellant also rented similar equipment from Advance Automatic Sales Company. The slot machines were not used after some date in 1951 but were kept until 1953. The remainder of the equipment was placed in various 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 the music machines, divided equally between Appellant and the location owner. After exclusion of expenses, Appellant on the average retained 56 percent of the proceeds from each music machine,

The gross income reported in Appellant's tax returns was the total of amounts retained from locations. Deductions were taken for depreciation, salaries, cost of phonograph records and other business expenses.

Respondent determined that Appellant was renting space in the locations where his machines were placed and that all of the coins deposited in the machines constituted gross income to him.

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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.

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 these 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 or other thing of value was paid to players for unplayed free games and we also held bingo pinball machines to be predominantly games of chance.

Respondent's auditor testified that during interviews in 1955 he was told by six location owners that they paid cash to winning players of Appellant's bingo pinball machines for unplayed free games while one location owner denied making payouts. One location owner testified that he gave cigarettes, beer and various restaurant items to winning players for unplayed free games; a manager at one of the locations admitted making payouts; and a person employed as a mechanic and collector by Appellant during the years under appeal testified he "imagined" that part of the expenses claimed by the location owners constituted reimbursement for cash payouts to winning players of Appellant's bingo pinball machines for unplayed free games. We conclude that it was the general practice to pay cash or other things of value to players of Appellant's bingo pinball machines for free games not played off. 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 or other things of value were paid to winning players. Respondent was therefore correct in applying section 17359. In view of our conclusion that there was illegal

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activity with respect to the bingo pinball machines, we find it unnecessary to consider the possible illegality of possessing certain slot machines or operating one or two claw machines.

The employee who collected from game machines did not collect from music machines. The music machine income was reflected on separate collection slips but was not segregated on Appellant's ledgers. Appellant's entire coin machine business was conducted from one shop and all types of machines were serviced by the same repairman. In placing machines in various locations Appellant tried to get as many types of equipment in a single location as possible. There was, in our opinion, a substantial connection between the illegal operation of bingo pinball machines and the legal operation of the music machines and other amusement devices and Respondent was thus correct in disallowing all the expenses of the business.

There were no records of amounts paid to winning players of bingo pinball machines, and Respondent estimated these unrecorded amounts as equal to 58 percent of the total amounts deposited in those machines. Respondent's auditor testified that the 58 percent payout figure was an average of the estimates given by four location owners when interviewed in 1955. Two other location owners when interviewed had also admitted making cash payouts for unplayed free games but were either unable or unwilling to make an estimate and one location owner denied making payouts. Of the four persons who made estimates when interviewed in 1955, one who had estimated that payouts averaged $33\frac{1}{3}$ percent stated in a declaration under penalty of perjury on February 6, 1962, that payouts averaged 20 percent. Another person who had estimated payouts at $66\frac{2}{3}$ percent later testified at the hearing in this matter and estimated payouts for unplayed free games at 25 percent. A collector employed by Appellant estimated at the hearing that the payouts averaged about 20 percent. Respondent's auditor testified that Appellant had told him in 1955 that about 25 percent of the total receipts were given to the location owner for expenses other than taxes and licenses.

As we held in Hall, supra, Respondent's computation of gross income carries a presumption of correctness. Considering all of the evidence, however, together with the time between the events and the estimates given and the possibility of bias in the estimates of Appellant and his employee, we conclude that the payout figure should be reduced to 40 percent.

In connection with the computation of the unrecorded payouts it was necessary for Respondent's auditor to estimate the percentage of Appellant's recorded gross income arising from the multiple-odd bingo pinball machines since Appellant's records did not segregate the income from the various kinds of coin machines. On the basis of test checks of collection slips for one month

