



BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeals of)
PETER AND JOY M. PERINATI and)
LOUIS AND LENA PELETTA)

Appearances:

For Appellants: Archibald M. Mull, Jr., Attorney at Law
For Respondent: A. Ben Jacobson, Associate Tax Counsel;
James T. Philbin, 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 as follows:

<u>APPELLANTS</u>	<u>YEAR</u>	<u>AMOUNTS</u>
Peter Perinati	1951	\$2,611.48
Joy M. Perinati	1951	2,611.48
Peter Perinati and Joy M. Perinati	1952	
	1953	13,706.97 19,250.22
	1954	9,984.66
Louis Peletta and Lena Peletta	1951	1,909.92
	1952	3,285.28
	1953	4,106.32
	1954	715.54

Appellants Peter Perinati and Louis Peletta were partners in conducting a business. The business consisted of operating a route of pinball machines and a few claw machines. In addition, Peter Perinati individually operated a route of pinball machines, music machines and few shuffle alleys. Both businesses operated from the same location and, except for the distribution of profits, the method of operating the partnership business and the individual business was the same. Appellants owned the machines and placed them in various locations such as restaurants and bars. The arrangement with each location owner was that Appellants were required to maintain the machine in proper working order, had the key to the coin box in the machine and visited the location periodically to open the machine and count and wrap the coins. The location owner furnished the electricity for the machine and determined who would be permitted to play the machine.

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At the time the coins were removed from the machine and counted, an amount would be set aside for the location owner equal to the amount of the expenses which the location owner asserted he had incurred in connection with the machine and the balance was divided equally between Appellants and the location owner. Generally, however, the location owner would "buy the nickels" to which Appellants were entitled. Thereby the location owner would have the coins which he needed to make change for persons desiring to play the machine and Appellants would acquire paper money and large coins equal in value to their share of the coins in the machine.

The expenses which a location owner incurred in connection with the machine might include cash payouts to players, refunds to players for mechanical malfunction or taxes and licenses assessed against the machine.

Appellants reported the amounts which they retained as their gross income. As stated above, this amount was the total in the machine less the expenses paid by the location owner and the latter's 50% share of the balance. From the reported gross income, Appellants deducted depreciation on the machines, cost of repairing the machines, cost of phonograph records for the music machines, and other business expenses.

The assessments in question result from Respondent's revision of gross income to include all amounts deposited in the machines by patrons and disallowance of all expenses. The expenses were disallowed on the basis that Appellants were engaged in illegal activities as defined in Section 17359 (now 17297) of the Revenue and Taxation Code and that pursuant to that section no expenses may be deducted from the gross income from such illegal activities.

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 is in Chapter 10 of Title 9 of Part 1 of the Penal Code and makes it a crime to possess or control a "mechanical device, upon the result of action of which

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money . . . is . . . hazarded, and which is operated . . . by . . .
depositing therein any coins . . . and by means whereof . . . any
merchandise, money, representative or articles of value, checks,
or tokens, redeemable in, or exchangeable for money or any other
thing of value, is won or lost . . . when the result of action . . .
of such machine . . . is dependent on hazard or chance...."

As to the claw machines, the Supreme Court of Arizona in
the case of Boies v. Bartell, 310 P. 2d 834, found claw machines
to be illegal gambling machines under the applicable Arizona
statutes in that **they were** operated by depositing a coin, the
successful operation of the machines depended primarily on chance,
and a successful player obtained a figurine from the machine
which was redeemable for one dollar.

In Tooley v. United States, 134 F. Supp. 162, the United
States District Court for the District of Nevada held that the
successful operation of a claw machine depended primarily on
chance. Noteworthy is the following language from the opinion
at page 167:

"The operator has complete control over the
placement of the figures and in our opinion
this alone would nullify, if not eliminate, the
element of skill. Certainly, if the mechanical
operation of the machine was always identical,
and if the figures were similar in size and
shape, and if they contained the same holds, and
the holds were in each instance in the same
places, and the cord or cable suspending the
claws from the boom were always the same length,
then it would appear that the average player
might within a reasonable period of time, by
assiduous application to the problem, become
more proficient as time went on. But such is
not the case here. A variation in any one of
these conditions would, and does, create a new
hazard with which the player must cope, The
chance element preponderates over the element
of skill."

We accordingly hold that the claw machines are games of
chance. Since they are operated by depositing coins in the
machines and since successful players obtain merchandise from the
machines, the operation of claw machines violates Section 330a of
the Penal Code and it is immaterial whether the successful players
may obtain cash in redemption of the merchandise. Therefore,
Respondent was correct in disallowing deductions from the gross
income of the claw machines.

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As to the pinball machines, their mechanical operation is described as follows:

The insertion of a coin into a slot in the machine releases the balls 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 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.

The description of these machines is identical to that in the Appeal of C. B. Hall, Sr., et al., Calif. St. Bd. of Equal., December 29, 1958 (2 CCH Cal. Tax Cas. Rep. Par. 201-197), (3 P-H State & Local Tax Serv., Cal. Par. 58,145). Here, as in that case, the machines were games of chance.

Four location owners testified that they had machines owned by Appellant Perinati or by the partnership of Appellants Perinati and Peletta. All of these location owners stated that whenever requested by the players they paid cash to those who had won free games.

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A man who worked for the partnership as a collector testified that he visited the various locations on his route, opened the machines and counted the money, and divided the money with the location owner. He stated that the location owner received whatever he claimed for payouts and other expenses plus 50% of the balance. He further testified that location owners invariably claimed to have made cash payouts to players in lieu of free games.

It clearly appears that the pinball machines were used for gambling in violation of Section 330a of the Penal Code in that the machines were operated by depositing coins in the machines, the winning of free games was determined primarily by chance, and winning players converted free games into cash. Therefore Respondent was correct in disallowing deductions from the gross income of the pinball machines.

Since the relationship between Appellant and the location owners is identical to that considered by us in Appeal of C. B. Hall, Sr., supra, our conclusion in Hall that the machine owner and each location owner were engaged in a joint venture for the operation of the machines is applicable here. Accordingly, Respondent's assessment must be revised to reduce Appellants' gross income from 100% of the coins deposited in the machines to 50% of the coins deposited in the machines.

Respondent's auditor examined Appellants' records and interviewed persons connected with Appellants' operations, including 10 of the location owners who had pinball machines in their places of business. The records showed only the amounts which Appellants themselves retained.

As the first step in computing the gross income of the Appellants, Respondent accepted their records as accurate for the purpose of determining the amounts retained by them. Respondent then determined the total amount deposited in the machines on the route of Appellant Perinati by first estimating that one-third of the reported amount came from music machines and shuffle alleys and that two-thirds came from pinball machines. This division was based on an estimate given to Respondent's auditor by Perinati. To the reported income from music machines and shuffle alleys Respondent added an equal amount as the location owners' share.

To the reported income from the pinball machines on the Perinati route and from all the machines on the partnership route, Respondent added an equal amount as the location owners' share and an amount estimated to have been paid out to winning players. Based upon the interviews with location owners, the

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payouts to winning players were estimated to equal 50% of the amounts deposited in the machines.

As we held in Appeal of C. B. Hall, Sr., supra, Respondent's computation of gross income is presumptively correct. Appellants did not testify at all and have offered no evidence whatever to show that the computation was inaccurate. Under these circumstances, except for the reduction due to our conclusion that Appellants and each location owner were engaged in a joint venture, Respondent's computation of gross income is sustained.

The deductions disallowed by Respondent included expenses incurred in connection with the music machines and shuffle alleys owned by Perinati. The entire business was conducted from one location, income from different types of machines was not segregated in the records, and the same person and the same shop was used to repair the music machines, shuffle alleys and pinball machines. We think it may be concluded from these facts that the operation of the music machines and shuffle alleys was associated or connected with the operation of the pinball machines. Accordingly, Respondent did not err in disallowing these expenses.

Respondent's assessments included penalties for the years 1951, 1952 and 1953. Respondent has agreed to withdraw these penalties and we are, accordingly, not called upon to determine whether they were properly imposed.

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 CRDERED, ADJUDGED AND DECREED, pursuant to Section 18595 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protests to proposed assessments

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of additional personal income tax against Peter Perinati in the amount of \$2,611.48 for the year 1951; against Joy M. Perinati in the amount of \$2,611.48 for the year 1951; against Peter Perinati and Joy M. Perinati in the amounts of \$13,706.97, \$19,250.22 and \$9,984.66 for the years 1952, 1953 and 1954, respectively; and against Louis Peletta and Lena Peletta in the amounts of \$1,909.92, \$3,285.28, \$4,106.32 and \$715.54 for the years 1951 through 1954, 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 and the penalties are to be deleted. In all other respects, the action of the Franchise Tax Board is sustained.

Done at Sacramento, California, this 6th day of April, 1961, by the State Board of Equalization.

John W. Lynch, Chairman

Geo. R. Reilly, Member

Alan Cranston, Member

Paul R. Leake M e m b e r

Richard Nevins, Member

ATTEST: - Dixwell L. Pierce, Secretary