



BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
JOHN F. AND BERTHELLE L. PATRICK)

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 John F. and Berthelle L. Patrick to proposed assessments of additional personal income tax in the amounts of \$1,590.84, \$2,267.75, \$7,793.39 and \$7,173.80 for the years 1951, 1952, 1953 and 1954, respectively,

Appellant John F. Patrick (hereafter referred to as Appellant) conducted a coin machine business in and near Eureka under the name of Patrick Music Company. He owned music machines, bingo pinball machines, other types of pinball machines, bowlers and miscellaneous amusement machines. The equipment was placed in bars, restaurants and other locations. The proceeds from each machine, after exclusion of *expenses* claimed by the location owner in connection with the operation of the machine, were divided between Appellant and the location owner.

The division as to pinball machines was 50 percent to Appellant and 50 percent to the location owner. The division as to music machines, bowlers and miscellaneous amusement machines was sometimes 50 percent, sometimes 60 percent and sometimes 66-2/3 percent to Appellant and the balance to the location owner.

Appellant owned approximately 70 music machines. There was a music machine in virtually all of the locations and one or more pinball machines in most of the locations.

The gross income reported in Appellant's tax returns was the total of amounts retained from locations. Deductions were taken for depreciation, salaries, 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.

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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 the machines is, accordingly, applicable here,

In Appeal of Advance Automatic Sales Co., Cal. St. Bd. of Equal., 3ct. 9, 1962, 3 CCH Cal. Tax Cas. 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 is predominantly a game of chance or if cash is paid to players for unplayed free games, and we also held bingo pinball machines to be predominantly games of chance.

Three location owners who had pinball machines from Appellant testified that they paid cash to players for unplayed free games. Appellant testified that on occasions when he collected from pinball machines, the location owners claimed certain amounts from the proceeds for expenses. A total of 50 reports of pinball machine collections were placed in evidence by Respondent. These reports all show the total in the machine, an amount deducted from the total and the balance divided equally between Appellant and the location owner. The deductions from the totals are variously labeled "Expense," "P. out Refund," "P. out," "P. off," "Refd," "Ref," "P. O.," "P," and "Refund."

We conclude that it was the general practice to pay cash to players for free games not played off. Therefore, the pinball machine phase of Appellant's business was illegal and Respondent was correct in applying Section 17359. It also appears that most of the pinball machines owned by Appellant were bingo pinball machines, the ownership or possession of which is illegal.

Most of Appellant's locations had both a music machine and one or more pinball machines. Appellant's collectors collected

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from all types of machines and his mechanics repaired all types of machines. We conclude that the legal operation of music machines, bowlers and miscellaneous amusement machines was associated or connected with the illegal operation of pinball machines. Respondent was, therefore, correct in disallowing all the expenses of the Patrick Music Company business.

Starting with Appellant's reported share of the net proceeds and adding to that the shares of the location owners, Respondent computed the gross income from the pinball machines based on an estimate that the payouts to winning players were equal to 50 percent of the coins deposited in the machines, The estimate of the payouts was derived from interviews with five location owners.

While the 50 collection reports in evidence before us are only a small sample of all of Appellant's collection reports for the period in question, they are the best available evidence of the amounts deposited in the pinball machines. When added together they show a total deposited in pinball machines of \$7,226.50 and a total of deductions for payouts of \$2,598.40. The latter is 36 percent of the former. Accordingly, we conclude that the unreported part of Appellant's gross income should be recomputed on the basis that 36 percent of the total deposited in pinball machines was deducted prior to the division between Appellant and the location owners.

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 John F. and Berthelle L. Patrick to proposed assessments of additional personal income tax in the amounts of \$1,590.84, \$2,267.75, \$7,793.39 and \$7,173.80 for the years 1951, 1952, 1953 and 1954, respectively, be 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 19th day of December, 1962, by the State Board of Equalization.

- Geo. R. Reilly , Chairman
 John W. Lynch , Member
 Paul R. Leake , Member
 Richard Nevins , Member
 _____ , Member

ATTEST : Lixwell I. Pierce , Secretary