



BEFORE THE STATE BOARD OF EQUALIZATION  
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of }  
NATHAN AND JEANNE MOORE }

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 Nathan and Jeanne Moore to proposed assessments of additional personal income tax in the amounts of \$993.91, \$1,843.19 and \$3,119.73 for the years 1953, 1954 and 1955, respectively.

Appellant Nathan Moore (hereinafter called appellant) conducted a coin machine business in San Francisco. During the years in question, appellant had multiple odd bingo pinball machines, flipper pinball machines, shuffle alleys and shuffle-boards. He owned some of the equipment and, in addition, he rented some equipment from Advance Automatic Sales Co. The equipment was placed in several 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 and, in some instances, after appellant received a guaranteed amount, were divided equally between appellant and the location owner.

The gross income reported in tax returns was the total of amounts retained from locations. Deductions were taken for depreciation and other business expenses. Respondent determined that appellant was renting space in the locations where his

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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 17297 (17359 prior to June 6, 1955) of the Revenue and Taxation Code which 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 except for the minimum returns guaranteed to appellant with respect to certain machines 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, 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, in our opinion, applicable here. A joint venture may exist regardless of whether one party is to receive a minimum return. (Elias v. Erwin, 129 Cal. App. 2d 313 [276 P.2d 848].)

In Appeal of Advance Automatic Sales CO., Cal. St. Bd. of Equal., Oct. 9, 1962, CCH Cal. Tax Rep. Par. 201-984, 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, appellant denied having actual knowledge of any cash payouts to winning players of his bingo pinball machines for unplayed free games. One location owner testified that he made such payouts at times, while another testified that he never did. Respondent's auditor testified that during an interview in 1957 a third location owner stated that he made payouts.

From the evidence before us we conclude that the pinball phase of appellant's business was illegal, both on the ground of possession of bingo pinball machines which were predominantly games of chance and on the ground that cash was paid to winning players of bingo pinball machines in some, if not all, cases. Respondent was therefore correct in applying section 17297.

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There were no records of amounts paid to winning' players of appellant's bingo pinball machines and respondent estimated these unrecorded amounts as equal to 50 percent of the total amount deposited in the machines. Respondent's auditor testified that the location owner who **admitted payouts** at a prior interview gave no estimate but stated that **an** estimate of 43 percent was 'too high. The record does not show why the 43 percent figure was introduced. Appellant testified that the expenses claimed by the location owners in connection with the operation of the machines were very small, not over 10 percent, and the location owner who testified at the hearing that **payouts were** made, said that the free games were usually played off.

As we held in Hall, supra, **respondent's** computation of gross income carries a presumption of correctness. Considering all the evidence, however, we conclude that the payout figure should be reduced to 20 percent.

In connection with the computation of unrecorded payouts, respondent determined that all of appellant's recorded income was derived from bingo pinball machines. However, appellant submitted a schedule showing a segregation of income and testified that he had only two bingo pinball machines in 1953, five in 1954 and twelve in 1955, while having machines of all types totaling 23, 20 and 19 for those respective years. The schedule submitted by appellant indicates that his income from all machines, including certain **guaranteed** sums, amounted to \$11,128.01 in 1953, \$15,704.95 in 1954 and \$20,624.50 in 1955. The same schedule indicates that appellant's share from the bingo pinball machines, exclusive of guaranteed sums, amounted to \$1,075.17 in 1953, \$3,120.45 in 1954 and \$11,232 in 1955. With respect to the guaranteed sums which were received relative to various machines at a few locations and which amounted to \$3,948.50 in 1953, \$3,898 in 1954 and \$4,681 in 1955, appellant has made no attempt to segregate amounts which are attributable to **bingo pinball** machines.

In the absence of actual figures and in view of the increase of bingo pinball machines during the years in question, we estimate that \$1,000 of the guaranteed return from various machines was attributable to the bingo pinball machines in 1953, \$2,000 in 1954 and \$3,000 in 1955. Accordingly, we conclude that appellant's recorded income from bingo pinball machines amounted to \$2,075.17 in 1953, \$5,120.45 in 1954 and \$14,232 in 1955.

Respondent disallowed all of the business expenses attributable to the coin machine route **for** each of the years under appeal. We are of the opinion that there was a **sub-**stantial connection between the illegal activity of Operating

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bingo pinball machines and the legal operation of various amusement devices during 1954 and 1955 and respondent was correct in disallowing all business expenses relative to the coin machine business in those years. However, in view of the relatively small number of bingo pinball machines placed on location in 1953, we believe that under a reasonable interpretation of section 17297 the overall operation of the coin machines did not tend to promote or further, and was not connected or associated with, the illegal activities in 1953. We believe, however, that the operation of amusement machines in the same locations with bingo pinball machines in 1953 did tend to promote or further and was connected or associated with the illegal activity of operating bingo pinball machines. The evidence indicates that there were two locations, having a total of nine machines, which had amusement machines together with bingo machines.

Accordingly, the expenses to be disallowed are all expenses of the two bingo machines and all the expenses of the seven amusement machines in the same location with the bingo pinball machines during 1953. In the absence of evidence of the exact amount of expenses, we find that 36 percent of the total expenses of the coin machine route during 1953 would reasonably reflect the expenses of the bingo pinball machines and the expenses of amusement machines placed in the same locations with the bingo machines.

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

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action of the Franchise Tax Board on the protest of Nathan and Jeanne Moore to proposed assessments of additional personal income tax in the amounts of \$993.91, \$1,843.19 and \$3,119.73 for the years 1953, 1954 and 1955, respectively, be modified in that the gross income and expenses are 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 18th day of February, 1964, by the State Board of Equalization.

Paul R. Leake, Chairman  
John W. Lynch, Member.  
Richard J. [unclear], Member  
Robert Sperry, Member  
[unclear], Member

Attest:

[Signature], Secretary