



BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
IRVING AND SYLVIA GOLDBLATT)

Appearances:

For Appellants: Irving Goldblatt
in -pro. per.

. 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 protests to proposed assessments of additional personal income tax in the amounts of \$3,920.26, \$6,225.66, \$7,551.49 and \$9,598.25 assessed against Irving and Sylvia Goldblatt jointly for the years 1952, 1953, 1954 and 1955, respectively, and in the amounts of \$5,151.67 and \$5,167.67 assessed against Irving and Sylvia Goldblatt, respectively, for the year 1956.

During the years in question, appellant Irving Goldblatt (hereinafter called appellant) conducted a coin machine business in San Francisco under the name of Hirschfeld Sales Company. Appellant owned multiple odd bingo pinball machines, music machines, shuffle alleys and some miscellaneous amusement machines. 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 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, phonograph records and other business expenses. Respondent determined that appellant was renting space in the locations where his machines were placed and

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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 the operating arrangements between appellant and each location owner were the same as those considered by this board in Appeal of C. B. Hail, Sr. Cal. St. Bd. of Equal., Dec. 29, 1958. Our conclusion in Hail that the machine owner and each location owner were engaged in a joint venture in the operation of these machines is, accordingly, applicable here. Thus, only one-half of the amounts deposited in the machines operated under the arrangements was includible in appellant's gross income.

In Appeal of Advance Automatic Sales Co., Cal. St. Ed. of Equal., Oct. 9, 1962, 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 things of value were paid to players for unplayed free games, and we also held bingo pinball machines to be predominantly games of chance.

At the hearing of this matter, respondent's auditor testified that at the time of the audit in 1959 he requested to see the collection slips but appellant refused. In addition, the auditor testified that during interviews at the time of the audit he was told by two location owners that they paid cash to winning players of appellant's bingo pinball machines for unplayed free games.

One of the location owners appeared as a witness at the hearing of this matter and declined to answer questions relating to the making of payouts for unplayed free games on the basis of the privilege against self-incrimination. This location owner did testify that "most of the time" he told appellant the exact nature of the expenses incurred.

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Appellant testified that he reimbursed the location owners for all expenses claimed by them and that these expenses would be from eight to fifteen dollars at each location, I-ie characterized these expenses as the cost of drinks given to stimulate play, disclaiming any knowledge that the expenses included cash payouts for free games.

Considering the evidence as a whole, the auditor's testimony that two location owners admitted that they paid cash for free games, the refusal of one location owner to testify on that point, appellant's refusal to make the collection slips available and his admission that he paid substantial expenses claimed by location owners, it may reasonably be inferred that it was the general practice to make payouts to players of bingo pinball machines for free games won and not played. If drinks were given to "stimulate play," as appellant indicated, the logical inference is that they were given in lieu of free games won by the players. Whether the payouts were in the form of cash or merchandise, the effect is the same.

We conclude that the bingo pinball 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 17297.

There were no records of amounts paid to winning players of the bingo pinball machines and respondent estimated these unrecorded amounts as equal to .50 percent of the total amounts deposited in such machines. Respondent's auditor testified that the .50 percent payout estimate was based on investigation of other pinball operations in the San Francisco area. Appellant would not venture an estimate of the percentage of payouts.

As we also held in Hall, supra, respondent's computation of gross income is presumptively correct. There is no evidence either from appellant's own testimony, or otherwise, which would indicate that the 50 percent payout estimate was excessive and it appears to be consistent with results obtained from other pinball operators. Under the circumstances, the 50 percent payout estimate must be sustained.

In connection with the computation of the unrecorded payouts, it is necessary to determine the amount of appellant's recorded gross income which was attributable to bingo pinball machines. Appellant's records did not segregate income between the bingo pinball machines and the other amusement

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machines and apparently respondent' treated all the income from games as attributable to bingo pinball machines.

Appellant testified that only about 25 percent of his machines were bingo pinball machines. Purchase invoices submitted by appellant establish that he did have a substantial number of machines other than the bingo pinball machines. Beginning in 1956, he segregated the machines on his tax returns for depreciation purposes and those segregations support his estimate.

Accordingly, we believe some segregation of the game income must be made. Recognizing the superior earning power of bingo pinball machines, we conclude that 50 percent of appellant's recorded gross income from games was attributable to bingo pinball machines during each of the years in question.

Respondent disallowed all of the business expenses attributable to the coin machine business for each of the years under appeal. We are of the opinion that under a reasonable interpretation of section 17297 the overall operation of the coin machines did tend to promote or further, and was connected or associated with, the illegal activities. The entire business was conducted as one, integrated operation, and the illegal phase of the business was substantial. Respondent was, therefore, correct in disallowing all the expenses of the business.

We find this matter distinguishable from the Appeal of A. D. and Harriet Wickstrom, Cal. St. Bd. of Equal., Dec. 13, 1961, to which appellant attempts to draw a parallel. In Wickstrom, we found it reasonable to disallow only those expenses directly related to the illegal operation. There, 'the taxpayer's business consisted almost entirely of the legitimate operation of music machines. To meet the demand of a few location owners he acquired six pinball machines. Those machines were not circulated among other locations. The bingo pinball machines owned by appellant, on the other hand, were a substantial source of his income from an integrated business. We cannot find on the evidence before us that the illegal activities in his case were an insignificant and separable part of his operations.

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,

