



BEFORE THE STATE BOARD OF EQUALIZATION  
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of )  
COIN MACHINE SERVICE COMPANY )

Appearances:

For Appellant: Dale I. Stoops  
Attorney at Law

For Respondent: Wilbur F. Lavelle  
Counsel

O P I N I O N

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This appeal is made pursuant to section 25667 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Coin Machine Service Company against proposed assessments of additional franchise tax in the amounts of \$6,724.06, \$12,452.68, \$16,324.63, \$14,846.02, and \$15,354.43 for the income years ended August 31, 1952, 1953, 1954, 1955, and 1956, respectively.

Appellant corporation was engaged in the coin machine business during the years in question. This business included sales, **leasing, and a route operation.** The sales and leasing operations were located in the San Francisco Bay area with headquarters in Santa Rosa. The sales included automatic music machines, for which appellant had a manufacturer's distributorship, and new and used coin machines, including the so-called multiple odd bingo pinball machines. Appellant also leased bingo type pinball machines. Both the sales and leasing were integrated operations in that they were both under the same management, and the same repair and service personnel were used for both operations.

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Appellant's route operation was centered in Eureka. It was totally separate from the Santa Rosa operations in that separate equipment, personnel, and management were provided. The coin machine route involved the placing of machines by the operator in various locations such as bars and restaurants. The net proceeds of such machines were divided equally between the route operator and each location owner after excluding the location owner's claimed out-of-pocket expenses, such as taxes and cash payouts, if any. Appellant's Eureka route consisted of approximately 50 music machines, 80 bingo pinball machines, 20 flipper pinball machines, and 15 to 30 miscellaneous amusement machines. This route was itself integrated in that different types of machines would often be placed at one location, the same personnel would make collections from and repairs to all types of machines, and the entire route was operated by a single manager;-

Appellant reported its gross income from the route operation as its half of the net proceeds of the machines after the exclusion of the location owners' claimed expenses. Appellant took deductions for depreciation, salaries, cost of phonograph records, and other business expenses.

Respondent determined that appellant was renting space from the location owners on its route and that all coins deposited in its machines constituted gross income to it. Respondent also disallowed all deductions (both of the Eureka and of the Santa Rosa operations) on the basis of section 24436 (24203 prior to June 6, 1955) of the Revenue and Taxation Code which reads:-,

In computing net income, no deductions shall be allowed to any taxpayer on any of its 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 deduction be allowed to any taxpayer on any of its gross income derived from any other activities which tend to promote or to further, or are connected or associated with such illegal activities..

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The chapters of the Penal Code referred to in the above section prohibit various forms of gaming and the possession, ownership, sale, repair, lease, etc., of certain gaming devices. We have previously held that the mere possession of a coin machine which is predominantly a game of chance comes within this prohibition and thus renders applicable section 24436 of the Revenue and Taxation Code. (Appeal of Advance Automatic Sales Co., Cal. St. Bd. of Equal., Oct. 9, 1962.) That same case held that multiple odd bingo pinball machines were predominantly games of chance.

The evidence, especially the direct testimony of appellant's president and sole stockholder, Mr. Speer, clearly indicates that appellant owned, sold, leased, and made repairs upon multiple odd bingo pinball machines in its sales and leasing operations. It is also clear from the evidence that the entire Santa Rosa operation was conducted as an integrated unit. Consequently, on the authority of Appeal of Advance Automatic Sales Co., supra, we must sustain respondent's application of section 24436 to disallow any deductions for appellant's sales and leasing operations.

Concerning appellant's Eureka route operation, since the filing of this appeal we decided the case of Appeal of C. B. Hall, Sr., Cal. St. Bd. of Equal., Dec. 29, 1958, in which the operating arrangements between appellant and each location owner, the same as those here, were held to constitute a joint venture. That holding, insofar as it deals with the joint venture, is controlling here. A supplemental memorandum filed by respondent with this board reflects adjustments in the proposed assessments on this basis.

The evidence also clearly indicates that many of the coin machines on the Eureka route were multiple odd bingo pinball machines. As stated above, this is sufficient to render applicable section 24436. Furthermore, the making of cash payments in lieu of free games likewise comes within the prohibition of the indicated sections of the Penal Code and thus renders applicable section 24436. (See Appeal of C. B. Hall, Sr., supra.) There is evidence in the record that cash payments in lieu of free games were made by-location owners on the route. Such evidence includes both direct testimony by one location owner at the oral hearing on this case, and also

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statements made to respondent's auditor by several location owners during the course of its audit of appellant. Mr. Speer also testified that location owners were reimbursed for such cash payouts if any were claimed. On the basis of this and other evidence in the record we find that cash payouts were made and consequently we must sustain respondent's application of section 24436 to disallow any deductions for appellant's Eureka route operation.

Appellant has challenged respondent's disallowance of deductions for the non-illegal machines operated by it on its route operation. Section 24436 mandates such disallowance if such "other activities . . . tend to promote or to further, or are connected or associated with such illegal activities." The application of this section has been oftentimes upheld where it appeared that all of the machines owned by taxpayer were operated as an integrated business. (Hall v. Franchise Tax Board, (1966) 244 Cal. . . App. 2d 843 [53 Cal. Rptr. 597]; Anneal of George and Ruby Young, Cal. St. Bd. of Equal., April 20, 1964.) The evidence shows the Eureka route to be such an integrated business so this determination by respondent must also be upheld.

Respondent's supplemental memorandum, in addition to making adjustments on the basis of the joint venture issue, also made other adjustments. These adjustments being favorable to the taxpayer, no challenge has been raised as to them, and they will be upheld. The revised assessments based upon these adjustments are \$1,228.40, \$3,184.57, \$6,040.76, \$4,519.00, and \$4,516.39 for the income years ended August 31, 1952, 1953, 1954, 1955, and 1956, respectively.,

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 25667 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of Coin Machine Service Company to proposed assessments of additional franchise tax in the amounts of \$6,724.06, \$12,452.68, \$16,324.63, \$14,846.02, and \$15,354.43 for the income years ended. August 31, 1952,

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1953, 1954, 1955, and 1956, respectively, be and the same is hereby modified to reflect the revised assessments of the Franchise Tax Board. In all other respects the action of the Franchise Tax Board is sustained.

Done at Sacramento, California this 24th day of October, 1972, by the State Board of Equalization.

Joseph W. Lynch, Chairman

Robert J. [unclear], Member

Robert [unclear], Member

William B. [unclear], Member

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ATTEST: W. W. [unclear], Secretary