

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
RICHARD E. HUMMEL AND BELLE)
HUMMEL, FORMERLY BELLE McLANE)

For Appellants: Ralph Irby White
Attorney at Law

For Respondent: Crawford H. Thomas
Chief Counsel

A. Ben Jacobson
Counsel

OPINION

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 Richard E. and Belle Hummel, formerly Belle McLane, against proposed assessments of additional personal income tax and penalties against Richard E. Hummel,

Appeal of Richard E. I-lummel and Belle
I lummel, formerly Belle McLane

individually, in the total amounts of \$24.29, \$441. 60, and \$508.84 for the years 1963, 1964, and 1965, respectively, and against Belle I-lummel, formerly Belle McLane, individually, in .the total amounts of \$18.10, \$463.68, and \$553.26 for the years 1963, 1964, and 1965, respectively.

During the years in question appellants, as partners, operated the Golden Bay News Center in San Francisco. In addition to the sale of tobacco, food items, magazines, books, newspapers, and sundries usually sold in smoke shops, appellants operated five pinball machines on the premises. Respondent was unable to determine whether appellants rented the machines from their owner or operated them jointly with him. Respondent stated in its brief, however, that the machines were "...of the illegal bingo type" and that "... appellants or employees of their business made illegal cash payouts to players of the machines for games won. "

Based upon its conclusion that appellants' pinball machine activities were illegal, respondent disallowed certain of their claimed business deductions pursuant to Revenue and Taxation **Code section 17297, which provided:**

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. 1/

1/ Amendments to this section in 1965 do not affect the determinations contained in this opinion.

Appeal of Richard E. Hummel and Belle
I-Iummel. formerly Belle McLane

Additionally, respondent estimated amounts allegedly paid out illegally but not reported by appellants as gross income during the years in question, and added these amounts to appellants' reported gross income for those years. The proposed assessments now in issue followed.

Appellants deny the illegality of their activities and contend that it is incumbent upon respondent to establish such illegality in order to prevail. We agree that in cases of this type respondent must make at least an initial showing that appellants' activities were within the purview of section 17297 and the provisions of the Penal Code referred to therein. In considering a case involving the application of section 17359 of the Revenue and Taxation Code (now section 17297), the California District Court of Appeal concluded that respondent had adequately carried its burden of proof through a prima facie showing of illegal activity by the taxpayers. (Hall v. Franchise Tax Board, 244 Cal. App. 2d 843.)

In the case at hand, respondent offered no evidence to prove that appellants possessed or operated machines which were "...of the illegal bingo type," nor did respondent submit any evidence to indicate that "... appellants or employees of their business made illegal cash payouts to players of the machines for games won." Normally, a presumption of correctness attaches to respondent's deficiency assessments and the burden to prove the incorrectness of those assessments is on the taxpayer; however, where the burden is upon respondent to establish the very facts upon which its assessments are based, it cannot rely on the presumption of correctness or mere assertions to evade or shift this burden. (See C. A. Reis, 1 T. C. 9.)

Where, as here, respondent seeks to apply a statute as harsh in effect as section 17297 of the Revenue and Taxation Code, we believe it is of particular importance that respondent make an initial showing of illegality. In this case, respondent has failed to submit any evidence regarding the nature of appellants' pinball machine activities or the machines themselves, and has therefore failed to sustain its burden of establishing the prima

