

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
JOHN K. AND PATRICIA J. WITHERS)

For Appellants: Walter G. Schwartz,
Attorney at Law

For Bespondent: Lawrence C. Counts,
Junior Counsel

O P I N I O N

This appeal is made pursuant to section 1859^{1/4} of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of John K. and Patricia J. Withers, against a proposed assessment of additional personal income tax in the amount of \$1,867 . 57 for the year 1962.

Appellants, who are husband and wife, are residents of California. John K. Withers, hereafter alone referred to as appellant, received dividends from stock owned in the Post Bulletin Company, a Minnesota corporation which published a newspaper in Rochester, Minnesota. The stock of the corporation was owned equally by appellant, his two brothers, and the estate of his late father. In addition to the dividends, appellant received a salary as a vice president and director of the corporation. During the year in question, the corporation and its stockholders elected under Minnesota law to have the corporation taxed as a partnership.

Appellant paid taxes on the dividend income to the State of Minnesota and claimed a credit for those taxes in the California income tax return filed by him and his wife for the year 1962. Section 18001 allows a credit against the California tax "for taxes paid to the other state on income derived from sources within that state. "

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Respondent disallowed the claimed tax credit on the basis that the income was derived from a source within California because the dividends were received from stock having a California situs for tax purposes.

It is appellants' position that this income was equivalent to partnership earnings because the Post Bulletin Company and its shareholders had elected to have the corporation taxed as a partnership by the State of Minnesota. It is reasoned that the source of partnership earnings is fixed at the location of the partnership's business. Section 290.972 of the Minnesota Statutes Annotated provides:

... any small business corporation and its shareholders may, in accordance with the provisions of this section, elect to have said corporation and its shareholders taxed as though said corporation were a partnership.

In the alternative, it is contended that the stock had acquired a business situs in Minnesota by reason of appellant's employment as vice president and director of the corporation so as to establish the source of the dividends in Minnesota.

It is clear that the election to be taxed as a partnership under Minnesota law was solely for tax purposes. The election did not effect any change in the corporate status of the business or in appellant's legal relationship as a stockholder of the corporation.

The question is presented, nevertheless, whether the corporation should be treated as a partnership in determining the source of the income within the meaning of California's tax credit statute because the corporation was so treated under Minnesota law for purposes of applying Minnesota's tax. A comparable issue has previously been considered by the California Supreme Court in Miller v. McColgan, 17 Cal 2d 432 [110 P.2d 419]. There the court ruled that a California resident who received dividends from a corporation doing business in the Philippine Islands was not entitled to a tax credit under section 25(a) of the California Personal Income Tax Act (predecessor to section 18001) even though the Philippine income tax act provided that dividends paid by a domestic corporation constituted income derived from sources in the Philippine Islands. In holding that the dividends were received from a source in California for California income tax purposes, the court stated:

That the Philippines may impose such a tax does not mean that under our theories and our act such income is derived from the Philippines. Rather it simply

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indicates that the Philippines have adopted a theory and philosophy of taxation different from that adopted by California, which has uniformly applied the well-recognized principle of mobilia sequuntur personam in determining the situs of intangibles for purposes of taxation.

Correspondingly, the fact that Minnesota taxed the income in question as if the corporation were a partnership does not affect the determination of the source of the income and the concomitant right to a tax credit under California law. That determination must rest on the fact that the income constituted dividends from stock in a corporation.

In the Miller case, the court concluded that the source of dividends on corporate stock is the stock itself. Under the doctrine of mobilia sequuntur personam (movables follow the person), the court held that the situs of the stock and therefore the source of the dividends is in the state or country where the owner resides unless the stock has acquired a business situs elsewhere.

The business situs exception applies where possession and control of the intangibles are localized in a state other than that of the owner's domicile and where the intangibles are used in connection with a local business activity, (Westinghouse Co. v. Los Angeles, 188 Cal. 491 [205 P. 1076].) To overcome the presumption of domiciliary location, the proof of business situs must definitely connect the intangibles as an integral part of the local activity, (Newark Fire Insurance Co. v. State Board of Tax Appeals, 307 313 [83 L. Ed. 1312].).

We have not been referred to any case nor has our research disclosed any in which stock has been held to acquire a business situs by virtue of the shareholder's employment by the issuing corporation. While employment is sufficient to connect a stockholder with a corporation's business, it does not follow from this that his stock is localized at the place of the business activity. A review of the entire record does not reveal that appellant's stock was utilized in the business activity carried on by the Post Bulletin Company.

Appellants rely on Henley v. Franchise Tax Board, 122 Cal. App. 2d 1 [264 P.2d 179], as authority that appellant's stock had acquired a situs in Minnesota. In Appeal of R. H. and Mary M. Scanlon, Cal. St. Bd. of Equal., Apr. 20, 1955, we compared the Miller and Henley cases and concluded there was no material distinction in the facts involved and that the Miller case, as a decision of our highest state court, was controlling. Subsequently we followed Miller in deciding

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Appeal of John and Catherine Burnham, Cal. St. Bd. of Equal.,
Nov. 1, 1955; Appeal of Anne Bachrach, Cal. St. Bd. of Equal.,
July 22, 1958; and Appeal of Hugh S. and Nina J. Livie, et al.,
Cal. St. Bd. of Equal., Oct. 28, 1964.

Appeal of C. H. Wilcox, Cal. St. Bd. of Equal.,
Nov. 15, 1939, also relied on by appellants, is distinguished
from this appeal by reason of the fact that the taxpayer there
was the beneficiary of a trust and not a stockholder of a
corporation.

For the reasons set forth above we conclude that
in accordance with California law appellant's stock had a
situs in California and that dividends received therefrom
constituted income from a source within California. No credit
is allowable, therefore, for the taxes paid to Minnesota.

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,

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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 K. and Patricia J. Withers against a proposed assessment of additional personal income tax in the amount of \$1,867.57 for the income year 1962, be and the same is hereby sustained.

Done at Sacramento, California, this 1st day of September, 1966, by the State Board of Equalization.

Charles R. Jones, Chairman
John W. Lynch, Member
Robert R. Jones, Member
John C. Jones, Member
 , Member

ATTEST: , Secretary