82-SBE-239

BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeals of)
)
MICHAEL A. DEBENEDETTI AND)
FRANCIS, JR., AND JOY PURCELL)

Appearances:

For Appellants: Gregg M. Anderson
Attorney at Law

For Respondent: John R. Akin
Counsel

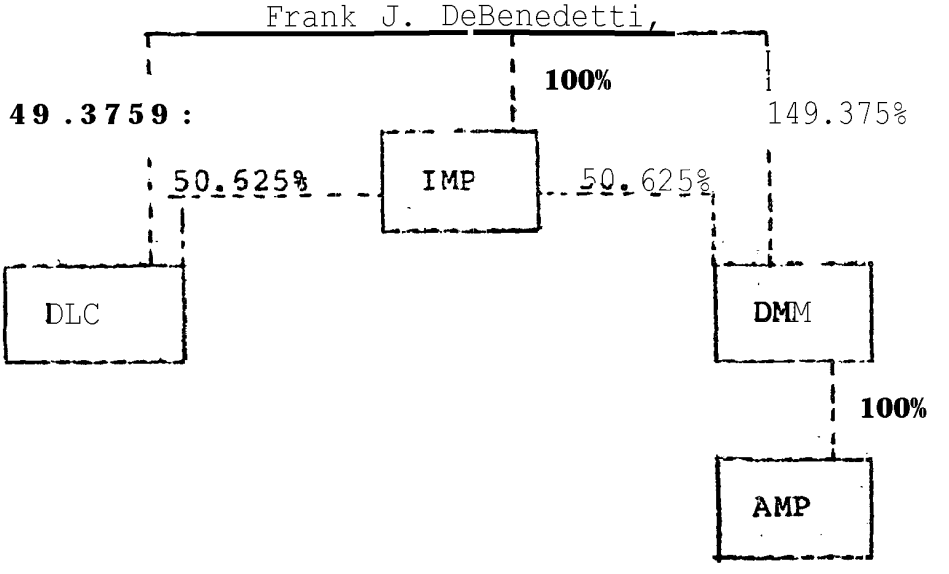
O P I N IO N

These appeals are made pursuant to section 18593 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protests of Michael A. DeBenedetti and Francis, Jr., and Joy Purcell against proposed assessments of additional personal income tax in the amounts and for the years as follows:

Appeal of Michael A. DeBenedetti and Francis, Jr., and Joy Purcell

Appellant	Year	Amount
Michael A. DeBenedetti	1973	$1,019.06
	1974	$ 951.08
	1976	$1,488.78
Francis, Jr., and Joy Purcell	1973	$1,245.83

.The factual background for this case goes back to 1966 when one Frank J. DeBenedetti indirectly owned Associated Meat Packers, Inc. (AMP), an Oregon corporation. He had this ownership by virtue of his 100 percent interest in Idaho Meat Packers (IMP), his 49.375 percent interest in Del Monte Meat Packers (DMM), and IMP's 50.625 percent interest in DMM. DMM was the parent of AMP. (See chart below.)



In 1966; a loan for $650,000.00 was made to IMP by First National Bank of Oregon, and the stock of AMP, DMM, and IMP was pledged as collateral for the loan. In 1968, AMP was sold to Frank J. DeBenedetti's children, among whom were appellants Michael DeBenedetti and Joy Purcell. IMP extended the credit necessary for the children to purchase AMP, as, apparently, the children would not have been able to obtain the required credit elsewhere. Even so, the purchase could only be made if First National Bank of Oregon would temporarily release the AMP stock from the 1966 pledge. The bank consented to such release on the condition that the stock would immediately thereafter be pledged again to secure the balance of the 1966 loan. The purchase was accomplished under these terms, and after the sale the stock was re-pledged to the bank. The original $650,000.00 loan to IMP was repaid

in 1975, but an additional line of credit was extended at the time and the bank still holds the AMP stock.

During the years 1973, 1974, and 1976, the shareholders of AMP elected taxation as a subchapter S corporation for federal income tax purposes. Appellants reported their distributive shares of AMP income on their Oregon returns, as is required by Oregon law. However, appellants are, and were during those same years, California residents. Under California law, which does not recognize subchapter S status for corporations, appellants were required to report the amount of income AMP actually distributed to them as dividends. Appellants did so, and each claimed a credit for the tax paid to Oregon on these dividends. Respondent denied their respective claims, and issued proposed assessments accordingly. Appellants protested but respondent denied the protests, leading to this appeal.

Under section 18001 of the Revenue and Taxation Code, a resident is allowed a credit for income taxes paid another state on income from sources within that other state. In the usual case, this has no application to dividend income, such as that under review herein, because California adheres to the rule that "intangibles (moveables) follow the person" ("mobilia sequuntur personam"). An intangible, such as stock, follows and is "domiciled" in the same state as its owner. Dividends from stock owned by a California resident thus normally have California as their source.

There is an exception to this general rule and it applies if the intangible has acquired a "business situs" in some other state. With regard to this exception, respondent views it as applying to intangibles employed in conjunction with, or as an integral part of, a foreign business of the owner of the intangible. Since the stock at issue had been pledged to the bank for the benefit of IMP, .a company not owned by appellants, respondent disagrees that the stock qualified for a business situs in Oregon. Appellants, on the other hand, assert that there is no authority to limit the business situs exception to cases where intangibles are connected with a foreign business of the owner of the intangibles. It is contended instead that the exception applies as long as intangibles are an integral part of any foreign business. Appellants further contend that even if the type of connection specified by respondent is a requisite of the business situs exception, such requirement is satisfied by virtue of the "family business" arrangement that exists between AMP and IMP. For the reasons indicated below, we do not

believe that the stock in question acquired a business situs in Oregon by virtue of the pledge.

We initially take note of two items that the parties appear to stipulate are not in issue. We perceive the parties to concede that California law, and not Oregon law, is controlling in this appeal. This is based on the holding to that effect in Christman v. Franchise Tax Board, 64 Cal.App.3d 751 [134 Cal.Rptr. 725](1976). They also appear to agree that the mere fact that stock is present in a foreign state or that it is pledged as security,, without more, is not controlling over the question of whether a business situs has been acquired., With these two particulars aside, we can proceed to the central issue.

The specific question of whether the business situs exception is restricted to intangibles connected with a foreign business of their owner does not appear to have been addressed heretofore by either the courts or this board. However, in each of the cases where a business situs question was before the court and the determination was made that the exception applied, the economic connection forming the basis of the exception involved a business of the taxpayer. In addition, the business situs rule has been stated in several of those cases as applying to instances where intangibles are related directly to foreign businesses of their owner. The following passages are representative of such statements:

> It is well recognized that intangibles may be so employed by a nonresident in conjunction with his business that they acquire their own domicile,, separate and distinct from that of the owner. (Christman v. Franchise Tax Board, supra, 64 Cal.App.3d at p. 759.)
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> In all the business situs cases it was held that the intangibles were so tied in with the activities of their owner carried on in the foreign state and under the protection of the law and government provided by the foreign state, that they had acquired a taxable situs, described as a "business situs" in the foreign state. (Southern Pacific Co. v. McColgan, 68 Cal.App.2d 48, 71 [156 P.2d 81] (1945).)
>
> The distinction we have pointed out is further emphasized in Stanford v. San Francisco, 131 Cal. 34 [63 Pac. 145], where the court . . . . says: "But it will be observed that the

> exception to the general rule assumes that the securities 'are held by the agent for management in the permanent business of the owner,' at the place where they are held ...." (Westinghouse Co. v. Los Angeles, 188 Cal. 491, 495-496 [205 P. 1076] (1922).)
>
> There is an exception which has gained extensive recognition--where the paper evidences of debt are in the possession and control of an agent of the owner in a state foreign to the domicile of the latter, and are held by the agent for management in the course of the permanent business of the owner, as for example, to collect the money to become due thereon and to reinvest it, the securities are deemed to be taxable at the domicile of such agent. (Estate of Fair, 128 Cal. 607, 614 [61 P. 184] (1900); also see Mackay v. San Francisco, 128 Cal. 678, 686-687 [61 P. 382] (1900).)

On the basis of the above, it seems that the question should be answered in the affirmative. Appellants, nonetheless, take a contrary position. They argue that the requisite foreign connection does not have to be between the intangible and a business of the owner. A connection with "related businesses or affiliated businesses or a family of businesses" would also satisfy the business situs test according to appellants. This latter proposition is said to be based principally on Southern Pacific Co. v. McColgan, supra. We have reviewed that case and find that it does not support the proposition advanced by appellants.

The central question in the Southern Pacific case was whether California could tax the dividend income of a foreign corporation which operated a unitary railroad transportation business in California and several other states. The court held'that it could, on the ground that the commercial domicile of the railroad business was in California and the stockholdings in question were integrally connected with that business. Although the court discussed the business situs concept, its holding was based on the conclusion that the taxpayer's stockholdings had their situs at the taxpayer's commercial domicile.

Since appellants have not been able to cite any authority which supports their contention that a business' situs may exist where an intangible is connected only with

a local business not owned and conducted by its owner, we must conclude that respondent correctly determined that the situs of appellants' stock was in California and that the source of appellants' dividend income was, therefore, in this state. Accordingly, respondent properly denied the tax credits claimed for the income taxes appellants paid to the State of Oregon.

Appeal of Michael A. DeBenedetti and Francis, Jr., and Joy Purcell

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 action of the Franchise Tax Board on the protest of Michael A. DeBenedetti and Francis, Jr., and Joy Purcell against proposed assessments of additional personal income tax in the amounts and for the years below, be and the same is hereby sustained.

Appellant	Year	Amount
Michael A. DeBenedetti	1973	$1,019.06
	1974	$ 951.08
	1976	$1,488.78
Francis, Jr., and Joy Purcell	1973	$1,245.83

Done at Sacramento, California, this 14th day of October, 1982, by the State Board of Equalization, with Board Members Mr. Bennett, Mr. Collis, Mr. Dronenburg and Mr. Nevins present.

William M. Bennett, Chairman

Conway H. Collis, Member

Ernest J. Dronenburg, Jr., Member

Richard Nevins, Member

_____, Member