

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
MIDWAY HOMES)

For Appellant: David Margulieux
Controller

For Respondent: Donald C. McKenzie
Counsel

O P I N I O N

This appeal is made pursuant to section 25666 of the Revenue and Taxation Code from the action of the Franchise **Tax Board** on the protest of Midway Homes against a proposed assessment of additional franchise tax in the amount of **\$115,193.56** for the income year 1979.

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The sole issue presented for our decision is whether appellant is entitled to deduct its share of the loss incurred by a **partnership** doing business outside this state.

Appellant is a California corporation engaged in the business of real estate development. During or before the year in question, appellant invested in a partnership engaged in the mining of precious minerals and metal ore in Canada. By apparently making a cash downpayment and executing a promissory note for the remainder of the purchase price, appellant was able to buy an interest in land located in Canada. The extraction and processing of metal ore from this property was thereafter conducted by the operators of the mining venture. After making its initial investment, appellant received annual **reports from** the partnership but did not participate in the actual mining operations.

For the year under review, the partnership apparently incurred a substantial loss from the mining enterprise. In filing its 1979 return for franchise tax **purposes**, appellant claimed as a deduction its distributive share of this business loss of the partnership. Respondent disallowed the deduction on the basis that the loss originated from a source outside California. In this appeal, appellant contends that the loss should be deductible because the mining venture was a legitimate investment which, it entered into for purposes of making a profit.

A taxpayer which derives income from sources both within and without this state is required to measure its franchise tax liability by its net income derived from or attributable to sources within this state. (Rev. & Tax. Code, § 25101.) Income from California sources includes income from tangible or intangible property located or having a **situs** in this state, and any income from activities carried on in this state. (Rev. & Tax. Code, S-23040.) Conversely, any losses from California sources are deductible (Appeal of H. F. Ahmanson & Company, Cal; St. Bd. of Equal., April 5, 1965), while **losses** attributable to out-of-state sources are not deductible. (Appeal of Angelus Hudson, Inc., Cal. St. Bd. of Equal., Dec. 17, 1983; Appeal of Custom Component Switches, Inc., Cal. St. Bd. of Equal., Feb. 3, 1977.)

Where a taxpayer realizes income from a partnership, the source of the taxpayer's share of the partnership income is where the property of the

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partnership is located and where the partnership activity is carried on. (Appeal of H. F. Ahmanson & Company, supra.) **Thus,** if the partnership derives business income from sources entirely-outside this state, none of its income or loss is assignable to California for determining the taxpayer's **taxable** income. (Appeal of Bay Alarm Company, Cal. St. Ed. of Equal., June 29, 1982; Cal. Admin. Code, tit. 18, reg. 25137, subd. (e)(7)(B) (art. 2.5).)

In the instant appeal, the **situs** of the partnership property in which appellant purchased a mining interest was in Canada where the partnership also conducted the mining operations. Clearly, appellant's loss from this partnership enterprise is derived from a source located entirely outside this state. **Therefore,** the claimed deduction for the loss from the mining venture was properly disallowed. It is irrelevant whether appellant reasonably believed at **the** time it entered into this partnership that the investment would prove to be profitable, for only income or loss attributable to California sources can be included in determining its income **taxable by** California; (Appeal of Custom Component Switches, Inc., supra.) Based on the **foregoing,** respondent's action in this matter must be sustained.

