BEFORE TEE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
THEO AND AUDREY CHRISTMAN)

Appearances:

For Appellants: Richard F. Davis
Attorney at Law

For Respondent: Paul J. Petrozzi
Counsel

O P I N I O N

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 Theo and Audrey Christman against a proposed assessment of additional personal income tax in the amount of $4,664.53 for the year 1970.

Appellants are California residents. Appellant Theo Christman owns stock in Chris Motors Corporation, a small business corporation located in Decatur, Georgia.

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When the Georgia corporation was formed in 1965 there were three shareholders, appellant, his brother and their father. In 1970 there were seven shareholders all of **whom were** Georgia residents except appellant and **his** father. In 1968, pursuant to Subchapter S of the Internal Revenue Code, the corporation elected to be taxed as if it were a partnership. **This** election was also effective for purposes of the Georgia income tax law. However, in order for the election to be effective in Georgia, the **two** nonresident shareholders were required to pay Georgia income tax on their share of the corporate **income.**

At **all times** pertinent to this controversy, Mr. Christman was employed in a full-time capacity by Litton Systems, Inc. Since the formation of Chris Motors Corporation, he has also Served as vice **president** and as a director of the corporation. In those capacities he assisted the corporation in the areas of planning, forecasting and reviewing performances. His corporate responsibilities required him to visit the corporate headquarters in Georgia approximately **three** times a year. Prior to 1968, Mr. Christman received an annual salary as vice president of the corporation. However, after **the tax option election he received his** distributive share of the corporate earnings in lieu of a salary.

The corporate stock was not pledged or otherwise encumbered, nor was it subject to a voting trust during 1970. However, prior to February 1968 the stock had been pledged as security for a corporate debt. After **the** stock was **released** it was held in trust by a Georgia trustee pursuant to the trust provisions of a "buy.-sell agreement" between the original three shareholders of the corporation.

During 1970 Theo Christman received $95,334 as his allocated share of the earnings of the Georgia corporation. 'On their joint California personal income tax return for that year, appellants claimed a credit against their California income tax in the amount **of $4,739** which

reflected the amount of tax imposed by Georgia on appellant's share of the corporate income. In claiming the credit appellants relied on section 18001 of the Revenue and Taxation Code1/ which permits a California resident who has paid a net income tax to a sister state on income derived from sources within that state to credit the tax paid against his California personal income tax. The credit does not apply to income derived from a California source. Respondent disallowed the credit on the basis that the corporate distribution was derived from intangible personal property, the corporate stock, which is presumed to have a situs at the owner's residence. Appellants protested the disallowance of the credit but their protest was denied. This appeal followed.

The ultimate question for determination is whether appellants may credit the amount of the net income tax paid to the State of Georgia for 1970 against their California personal income tax for the same year. The resolution of this question turns on whether the source of the income was actually at the business situs of the corporation as contended by appellants, or whether the corporate distribution was derived from the corporate stock which is presumed to have a situs at the shareholder's residence as maintained by respondent.

1/ Rev. & Tax. Code, § 18001 provides, in pertinent part:

> Subject to the following conditions, residents shall be allowed a credit against the taxes imposed by this part for net income taxes imposed by and paid to another state on income taxable under this part:
>
> (a) The credit shall be allowed only for taxes paid to the other state on income derived from sources within that state which is taxable under its laws irrespective of the residence or domicile of the recipient.

* * *

Under the well recognized doctrine of mobilia sequuntur personam, literally, movables follow the person, the situs of corporate stock and, therefore, the source of corporate dividends is in the state or country where the owner of the stock resides unless the stock has acquired a business situs elsewhere. (Miller v. McColgan, 17 Cal. 2d 432 [110 P.2d 4191: Appeal of John K. and Patricia J. Withers, Cal. St. Bd. of Equal., Sept. 1, 1966; Appeal of Anne Bachrach, Cal. St. Bd. of Equal., July 22, 1958.) Thus, where shareholders are California residents the source of their dividend income, is presumed to be in California, and the credit provision of section 18001 of the 'Revenue and Taxation Code is inapplicable, unless the stock has acquired a foreign business situs. Appellants recognize the well settled principle of mobilia sequuntur personam but maintain that the stock has acquired a business situs in Georgia.

The business situs rule applies where intangibles are used in connection with a business away from the owner's domicile. (Westinghouse Electric & Mfg. Co. v. Los Angeles County; 188 Cal. 491 [205 P. 1076]; Appeal of Anne Bachrach, supra.) The standards for comparison that determine the existence of a business situs have been set out by the court in Southern Pacific Co. v. McColgan, 68 Cal. App. 2d 48 1156 P.2d 811 as follows:

> In these cases, and many more that might be cited, we find an individual or a corporation engaging in activities with its intangible property with a view to profit outside the corporate domicile. 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. It was held that the maxim of mobilia sequuntur personam did not preclude the imposition of a tax by the state of the business situs imposed for the advantages enjoyed by the owner in that state. (See Southern-Pacific Co. v. McColgan, supra, at p. 70-72 and the cases cited therein.)

Intangible personal property acquires a business **situs** in a foreign state if it is employed as capital in that state or if the possession and control of the property has been localized in connection with a business in that state so that its substantial use and value attach to and become an asset of the foreign business. (Cf. Cal. Admin. Code, tit. 18, reg. 17951-17954(f), subd. **(3).)** To overcome the presumption of domiciliary location, the proof of business **situs** must definitely connect the intangibles with the business as an integral part of its local-activity. (Newark Fire Insurance Co. v. State Board of Tax Appeals, 307 U.S. 313 **[83** L. Ed. 13121.)

In support of their position that the stock has acquired a business **situs** in Georgia, appellants rely on three factors: (1) the share certificates were physically located in Georgia; (2) appellant was employed by the corporation; and (3) the stock had actually been used in the business activity of the corporation in Georgia. We do not find these factors persuasive, either singularly or in combination.

The fact that the stock certificates are physically located in Georgia is not persuasive. Neither the presence nor the absence of the physical evidence of the intangible controls the determination of a business **situs.** (Southern Pacific Co. v. **McColgan,** supra, at p. 71.)

Appellants cite no authority nor have we discovered any in which stock had been held to acquire a business **situs** by virtue of the shareholder's employment by the issuing corporation. While employment may be sufficient to connect a shareholder with the corporation's business it does not necessarily follow that the **situs** of **his** stock is located at the corporation's place of business. (Appeal of John K. and Patricia-J. Withers; supra.) This conclusion is emphasized by the tenuous connection between the corporation and appellant in his capacity as an "employee" since the employment required his presence in Georgia no more than three times a year.

Finally, the fact that the stock had been pledged as security for a corporate debt in a prior year did not establish the existence of a business situs in Georgia for the year 1970. (Cf. Appeal of Allied Equities Corp., Cal. St. Bd. of Equal., July 31, 1973.) Furthermore, the fact that the stock was held in trust pursuant to the terms of a "buy-sell agreement" between the original three shareholders in order to provide for an orderly transfer of corporate control to the surviving brother is not a commercial or business-related purpose that will establish a business situs for the stock. Although continuity of control is essential to the successful operation of a small business corporation the use of the stock anticipated by the "buy-sell agreement" is primarily for the estate planning benefit of the shareholders and not for the benefit of the corporation. In order to establish a business situs the intangibles must be definitely connected with the local business as an integral part of its activity. (Newark Fire Insurance Co. v. State Board of Tax Appeals, supra, at p. 321.) This appellants have failed to do.

Appellants also maintain that since the income from the corporate business is taxed personally to the shareholders at the place of corporate activity whether the income is distributed or not, the income is derived ndt from the intangible stock, but from the corporate activity in Georgia. From this, appellants conclude that the rule of mobilia sequuntur personam is inapplicable. We do not agree.

Neither Subchapter S (Int. Rev. Code, §§ 1371-1379) nor its Georgia counterpart (Ga. Code, § 92-3102, subd. (b) (10) (ii)) purport to convert a corporation into a partnership or a shareholder into a partner as a matter of substantive law. (Appeals of David W. and Marion Burke, Cal. St. Bd. of Equal., Oct. 27 1964.) An election pursuant to Subchapter S does not alter the status of the corporation or its shareholders, nor does it alter the tax consequences of transactions between them. Thus, we must conclude that the corporate distribution in question constituted dividends whose source was attributable to the intangible corporate stock.

Finally, appellants argue that failure to allow the claimed credit for the net income tax paid to Georgia will result in double taxation in contravention of the legislative intent of section 18001 of the Revenue and Taxation Code. In answer to this contention it is sufficient to point out that there is no double taxation. The incidence of the Georgia tax is on the corporation notwithstanding the fact that the corporation has elected to be taxed as if it were a partnership. The incidence of the proposed California tax is on the income received by appellants as individuals.

For the reasons set out above, we conclude that appellants' stock had a **situs** in California and that dividends received therefrom constitute income from a source within California. Therefore, respondent properly disallowed the credit claimed for the taxes paid to Georgia.

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 Theo and Audrey **Christman** against a proposed assessment of additional personal income tax in the amount of **$4,664.53** for the year **1970, be** and the same is hereby sustained.

Done at Sacramento, California, this 11th day of December, 1973, by the State Board of Equalization.

, Chairman

, Member

, Member

, **Member**

, Member

ATTEST: , Secretary