BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
JERALD L. AND JOAN KATLEMAN)

For Appellants: Marshall A. Lewis
Attorney at Law

For Respondent: Bruce W. Walker
Chief Counsel

Steven S. Bronson
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 Jerald L. and Joan Katleman against proposed assessments of additional personal income tax in the amounts of $16,601.78 and $3,041.90 for the years 1969 and 1971, respectively.

Subsequent to the filing of this appeal, respondent acknowledged that it had incorrectly computed appellants' tax liability for 1969 and that the proposed assessment for that year should be reduced by $323.59. Also during the pendency of this appeal, appellants conceded their liability for a portion of the proposed assessment for 1971 and forwarded payment of principal and interest in the amount of $2,288.08 to the Franchise Tax Board.

With respect to the proposed assessment for 1969, the questions presented for resolution are whether appellants were residents of California during that year and, if so, whether respondent properly computed appellants' taxable income for that year. With respect to the proposed assessment for 1971, the sole question presented is whether certain business losses incurred by appellants in that year are allowable as an offset against their 1971 preference income for purposes of computing the tax imposed on such income by section 17062 of the Revenue and Taxation Code.

Jerald L. Katleman (hereinafter referred to as appellant) is a real estate developer. During the years preceding 1969, appellant was engaged in the development and construction of a low-income housing project at Park Forest, Illinois. Immediately prior to the summer of 1968, appellant and his family resided in Park Forest at the home of his father-in-law.

Sometime in the summer of 1968, appellants and their children traveled from Illinois to San Diego, California. Shortly after their arrival in San Diego, appellants joined the community center and the zoological society, and they opened a personal checking account at a local bank. In September 1968, appellants contracted to lease a house in San Diego for a term of one year. Also in that month, appellants enrolled their school-age children in the San Diego public school system.

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On May 20, 1269, appellants acquired title to a residential lot in San Diego and, shortly thereafter, they arranged for the construction of a house on that lot. The house was completed in 1970, and appellants currently reside at that location. Appellants owned an automobile which was registered in California in 1969, and they were issued California drivers' licenses in that year.

Appellant's wife and children lived in San Diego for at least five months during 1968 and for at least eight months in 1969. Appellant, however, was involved with various business ventures during 1969, which required his presence in Illinois as well as in California. However, the record on appeal indicates that appellant spent at least six months of 1969 in California.

Appellant's business activity in California during the year in question primarily related to his investigation into the feasibility of constructing a multimillion dollar low-income housing project in the San Diego area. In January 1969, appellant obtained a California real estate broker's license, which he maintained in inactive status until June 1970. In March 1969, appellant located property in San Diego suitable for the planned housing project site and, pursuant to his plan to purchase the property, appellant opened escrow with a San Diego title insurance company. On October 15, 1969, appellant formed a California corporation, Apartment Constructors, Inc., to handle the construction aspects of the planned housing project. Appellant also operated a sole proprietorship in California during 1969, under whose name he secured financing for the housing project. Appellant's California business activities were conducted from rented office space in San Diego during the latter five months of 1969.

Appellant was also involved with various real estate development ventures in Illinois during 1969. For example, he was planning the development of another housing project and the construction of a restaurant. He also operated a real estate brokerage office and spent some time in Illinois in connection with the completion of the Park Forest housing project.

Although appellants lived in California for at least half of 1969, they remained members of social organizations in Illinois, they were registered to vote in Illinois, and they filed a 1969 Illinois state income tax return.

Section 17041 of the Revenue and Taxation Code imposes a tax upon the entire taxable income of every resident of California. The term "resident" is defined in section 17014 to include "[e]very individual who is in this State for other than a temporary or transitory purpose." Respondent contends that appellants were residents of California during 1969 because they were in this state for other than a temporary or transitory purpose. Appellants, on the other hand, contend that their stay in California during 1969 was merely temporary or transitory, as evidenced by the significant contacts which they maintained with Illinois during that year. Thus, the narrow issue presented is whether appellants were in California "for other than a temporary or transitory purpose" during the year in question,

Respondent's regulations contain the following explanation of the term "temporary or transitory purpose":

> Whether or not the purpose for which an individual is in this State will be considered temporary or transitory in character will depend to a large extent upon the facts and circumstances of each particular case. It can be stated generally, however, that if an individual is simply passing through this State on his way to another state or country, or is here for a brief rest or vacation, or to complete a particular transaction, or perform a particular contract, or fulfill a particular engagement, which will require his presence in this State for but a short period, he is in this State for temporary or transitory purposes, and will not be a resident by virtue of his presence here. (Cal. Admin. Code, tit. 18, reg. 17014-17016(b).)

The statute and regulations under consideration were designed to insure that all individuals physically present in California for other than a temporary or transitory purpose and enjoying the benefit and protection of its laws and government, should contribute to its support. (Whittell v. Franchise Tax Board, 231 Cal. App. 2d 278, 285 [41 Cal. Rptr. 673] (1964); Appeal of Theodore W. and Mary A. Manthei, Cal. St. Bd. of Equal., Jan. 8, 1968.) The underlying theory of the cited provisions is that the state with which a person has the closest connection during the taxable year is the state of his residence. (Appeal of Donald E. and Betty J. MacInnes, Cal. St. Bd. of Equal., Oct. 24, 1972; Appeal of Jack E. Jenkins, Cal. St. Bd. of Equal., June 6, 1973.)

The facts and circumstances of the instant appeal indicate that by 1969 appellants established a closer connection with California than with Illinois, and that appellants enjoyed substantial benefits and protection from the laws and government of California during that year. During the period from about August 1968 to January 1970, appellant's wife and children spent at least thirteen months in California and appellant spent at least nine months in this state. During that period appellants were active members of social organizations in California and their children attended California public schools. Appellants owned and leased real property and maintained a bank account in this state. They were licensed to drive in California, and they owned and operated an automobile which was registered here. Furthermore, during 1969, appellant was actively engaged in preliminary negotiations and planning for the development of a multimillion dollar housing project in San Diego. In connection with that venture, appellant formed a California corporation and operated a sole proprietorship in this state. Thus, it is clear from the nature of appellant's business connections in California that he was actively engaged in a project which would require a long or indefinite period to accomplish. Finally, although appellant had significant business interests in Illinois which required his presence there during a portion of 1969, he could be secure in the knowledge that his family, home, and substantial California business interests were receiving the benefit and protection of the laws and government of this state during his absence.

Appellants rely on the case of Klemp v. Franchise Tax Board, 45 Cal. App. 3d 870 [119 Cal. Rptr. 821] (1975), as support for the contention that their stay in California during the year in question was merely temporary or transitory. However, although the facts and circumstances of that case are somewhat similar to those presented by the instant appeal, it is our opinion that the case is distinguishable. In Klemp the court found that the purported residents did not "engage in any activity in California 'other than that of a seasonal visitor or tourist." (Klemp v. Franchise Tax Board, supra, 45 Cal. App. 3d at 876.) (Emphasis added.2 Over the years at issue in that case, the Klemps had established a definite pattern of spending the colder' half of the years as visitors in the California desert. Such a pattern of seasonal visitation to California is not indicated by the facts of the instant appeal. To the contrary, once appellants had established a home in California, their absences from this state, other than appellant's business trips, appear to have been for the purpose of seasonal visits to Illinois.

In support of their position, appellants also rely on the facts that they were members of social organization in Illinois and that they were registered to vote there during the year in question. However, the record on appeal contains no evidence that appellants were active members of any social organizations in Illinois during the year in question. Furthermore, the fact that appellants were registered to vote in Illinois, while relevant, is not a controlling indicator of the state of their residence. (See Whittell v. Franchise Tax Board, supra, 231 Cal. App. 2d at 288; Cal. Admin. Code, tit. 18, reg. 17014-17016(f), subd. (1).)

We conclude that appellants' presence in this state during 1969 was not for a temporary or transitory purpose and, therefore, that appellants were residents of California throughout that year. Thus, we now turn to the question whether respondent correctly computed appellants' 1969 taxable income.

Appellants contend that respondent improperly included in their 1969 taxable income certain capital gains, which they realized on the sale of stock, as well as certain partnership income. Specifically, appellants contend that the income in question accrued or was earned prior to 1969 and, therefore, that it must be excluded from their 1969 taxable income pursuant to the provisions of section 17596 of the Revenue and Taxation Code.

Section 17596 provides:

> When the status of a taxpayer changes from resident to nonresident, or from nonresident to resident, there shall be included in determining income from sources within or without this State, as the case may be, income and deductions accrued prior to the change of status even though not otherwise includible in respect of the period prior to such change, but the taxation or deduction of items accrued prior to the change of status shall not be affected by the change.

As applied to the facts and circumstances of this appeal, section 17596 provides, in effect, that income which accrued to appellants prior to the year in which they became California residents is not includible in their taxable income for that year. (See Appeal of Frank F. and Vee Z. Elliott, Cal. St. Bd. of Equal., March 27, 1973; Cal. Admin. Code, tit. 18, reg. 17596.) The accrual treatment provided for in section 17596 is equivalent to that utilized for purposes of accrual method accounting. (See Appeal of Kenneth Ellington and Estate of Harriet Ellington, Deceased, Cal. St. Bd. of Equal., Oct. 17, 1973.) Accordingly, income does not accrue within the meaning of section 17596 until all events have occurred which fix the right to receive such income and the amount thereof can be ascertained with reasonable certainty. (Appeal of Kenneth Ellington and Estate of Harriet Ellington, Deceased, supra; Cal. Admin. Code, tit. 18, reg. 17571 (a).)

With respect to appellants' gain from the sale of stock, the record indicates that the stock in question was sold on May 13, 1269. Furthermore, the record contains no evidence which indicates that appellants had a fixed right to receive money or property in exchange for the stock prior to the date of its sale. Thus, it is clear that appellants did not realize any gain, by virtue of their ownership of the stock, prior to May 1969. (See generally, 2 Merten's, Law of Federal Income Taxation §12.126.) The gain or income in question did not accrue to appellants prior to their change of residence.

With respect to the partnership income, we note initially that the fiscal or taxable year of the partnership in question ended January 31, 1969. Under California tax law, a partner's distributive share of partnership income is not ascertainable or identifiable until the close of the partnership's taxable year. (Rev. & Tax. Code, § 17861; Cal. Admin. Code, tit. 18, reg. 17861-17863.) Furthermore, it is the partnership's taxable year ending within or with the partner's taxable year which determines the partner's distributive share for that year. (Rev. & Tax. Code, § 17861.) Therefore, with respect to the instant appeal, it is the partnership's distributive income for the taxable year ended January 31, 1969 which is includible in appellants' gross income for the calendar year 1969. Accordingly, the partnership income in question did not accrue to appellants prior to 1969.1/

In summary, it is our opinion that respondent properly included the gain from the stock sale and the partnership income in appellants' taxable income for 1969 since those items of income accrued to appellants after the time when they became California residents.

1/ Appellants argue that a partner's distributive share of partnership income may be ascertained prior to the close of the partnership's taxable year if the partner sells or exchanges his partnership interest prior to that time. (Rev. & Tax. Code, § 17863.) However, the record on appeal contains no evidence that appellants sold or exchanged their partnership interest prior to January 31, 1969. Thus, while we agree with appellants' statement of law, we find that it has little relevancy to the question presented.

The final issue presented by this appeal concerns that portion of the assessment for 1971 which respondent proposed pursuant to section 17062 of the Revenue and Taxation Code.

During the year in issue section 17062 provided, in pertinent part:

> In addition to other taxesimposed by this part, there is hereby imposed ... a tax equal to 2.5 percent of the amount (if any) by which the sum of the items of tax preference in excess of thirty thousand dollars ($30,000) is greater than the amount of net business loss for the taxable year. (Emphasis added.)

On their 1971 California personal income tax return appellants reported, after applying the $30,000 exclusion, preference income in the amount of $52,281. Appellants applied a partnership loss of $14,993 and a rental loss of $107,337 to completely offset the preference income. Appellants apparently contend that such losses constitute a "net business loss" as that term is used in section 17062.

The factual situation and issues raised by this portion of the appeal are similar, if not identical, to those presented in the Appeal of Richard C. and Emily A. Biagi, Cal. St. Bd. of Equal., May 4, 1976. In that appeal we held that a taxpayer may not escape the preference tax imposed by section 17062 merely by sheltering preference items under select business losses. The record in the instant appeal contains no evidence that appellants incurred a "net business loss" in 1971. In the absence of such evidence, and on the basis of our decision in Biagi, supra, we conclude that respondent properly disallowed appellants' application of the partnership and rental losses as an offset against their preference income for 1971.

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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 Jerald L. and Joan Katleman against proposed assessments of additional personal income tax in the amounts of $16,601.78 and $3,041.90 for the years 1969 and 1971, respectively, be and the same are modified to reflect the parties' concessions with respect thereto and to reflect appellants' payment of principal and interest in the amount of $2,288.08 for the year 1971. In all other respects the action of the Franchise Tax Board is sustained.

Done at Sacramento, California, this 15th day of December, 1976, by the State Board of Equalization.

William M. Bennett, Chairman

George R. Reilly, Member

William T. Bagley, Member

Iris Sankey, Member

________________, Member

ATTEST: W. W. Dunlop, Executive Secretary