86-SBE-097

BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
) No. 84A-1008-GO
ESTATE OF MARION MARKUS)

For Appellant: Robert K. Johnson
Attorney at Law

For Respondent: Bill S. Heir
Counsel

O P I N I O N

This appeal is made pursuant to section 18593[1/] of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Estate of Marion Markus against proposed assessments of additional personal income tax in the amounts of $5,940.41, $2,779.31, $44,384.57 $64,551.99 and $148,321.80 for the years 1975, 1977, 1978, 1979, and 1980, respectively.,

1/ Unless otherwise specified, all section references are to sections of the Revenue and Taxation Code as in effect for the years in issue.

The central issue presented is whether appellant derived income from sources within the State of California during the years at issue. Appellant also argues that even if it is held that California is the source of the subject income, the statute of limitations bars collection of the assessments for the years 1975, 1977, and 1978.

The estate, appellant herein, was created on February 3, 1983, upon the death of Marion **Markus.** For the sake of convenience, the decedent will be referred to as **"appellant."** During the years at issue, appellant was a nonresident of the State of California, being a resident and domiciliary of the States of Ohio and Tennessee. During calendar years 1975 and 1977 through 1980, appellant held a limited partnership interest in the Talisman Fund (hereinafter "Fund"), a California limited partnership. During the appeal period, the **Fund's** principal office was located in Marina Del Rey, California, where **it employed** from four to five persons at any one time. While maintaining its major bank accounts with California banks, the Fund had, from time to time, maintained bank accounts with out-of-state banks. The Fund's primary business activity involved trading commodity future contracts and commodity forward contracts. Appellant states **that the trades were generally executed through** the New York Mercantile Exchange, the Chicago Board of Trade, the New York Futures Exchange, Commodity Exchanges, Inc., and Loconex in London. Apparently, no trades were placed with commodity exchanges located within California.

Appellant alleges that **"[a]pproximately** fifty percent of the Fund's trades resulted from recommendations by Robert **Kent ('Kent')** who lived in California, and approximately fifty percent resulted from recommendations by Richard Walsh ('Walsh'), who lived in Europe." (App. Br. at 4.) During the appeal years, the Fund's principal broker was **Bache** Halsey Stuart Shields, Inc. (now Prudential-Bathe Securities, Inc.) (hereinafter **"Bache").**

On pages five and six of its brief, appellant describes the Fund's business activities as follows:

> **Kent** communicates his recommendations out of **Bache's** Office in Beverly Hills. In the case of futures contracts, **Kent** telephones a broker at whichever exchange he wishes to place the trade and the broker then takes **the necessary actions to-execute the**

> trade. When a trade on one of the above enumerated exchanges is complete, Kent will get a confirmation. However, no negotiable instrument or similar document is forwarded to Kent, but all documents remain at the exchange. In fact, under the rules of each exchange where the Fund trades, a futures contract can be offset only by another trade on the same exchange. Walsh makes recommendations out of Europe in a-similar manner.

Respondent determined that appellant's distributive share of partnership income from the Fund was derived from property or business within this state. Moreover, respondent ascertained that appellant had not filed a nonresident return for the years 1975, 1977 or 1978. Accordingly, on April 29, 1983, respondent issued Notices of Additional Tax Proposed To Be Assessed for the appeal years in question. Denial of appellant's protest led to this appeal.

For purposes of the California Personal Income Tax Law, in the case of a nonresident taxpayer, gross income includes only gross income from sources within this state. (Rev. & Tax. Code, § 17951.) In general, income of nonresidents from intangible personal property such as shares in a corporation is not income from sources within this state "unless the property has acquired a business situs in this State . . . ." (Rev. & Tax. Code, § 17952.) -Respondent's regulations provide:

> Income of nonresidents from intangible personal property such as shares of stock in corporations, bonds, notes, bank deposits, and other indebtedness is taxable as income from sources within this State only if the property has a situs for taxation in this State, except that if a nonresident buys or sells stock, bonds, and other such property in California, or places orders with brokers in California to buy or sell such property, so regularly, systematically and continuously as to constitute doing business in this State, the profit or gain derived from such activity is taxable as income from a business carried on here, irrespective of the situs of the property for taxation.

(Cal. Admin. Code, tit. 18, reg. 17952, subd. (b).)

However, the regulations provide a somewhat different rule for partnership interests held by nonresidents:

> The gross income of a nonresident of the State who is a member of a partnership, pool or syndicate includes, in addition to any other income from sources within this State, the member's distributive share of the taxable income of the partnership, pool or syndicate to the extent that the member's distributive share is derived from sources within this State. Amounts received from a partnership by a nonresident partner as payments for services or use of capital, constitute gross income of a nonresident. See Section 17866(b).

(Cal. Admin. Code, tit, 18, reg. 17951.1, subd. (b).)

To illustrate, under the rule mobilia sequuntur personam, income in the form of a dividend from stock received by a California resident from a corporation operating out of state is income attributable to this state because the stock, an intangible having its situs at the owner's residence, is the immediate source of the income. (Miller v. McColgan, 17 Cal.2d 432 [110 P.2d 419] (1941).) Contrariwise, under the same rule, income received by a nonresident of California from dividends from stock of a corporation operating in this state would ordinarily not be income attributable to this state. (See Rev. & Tax. Code, §§ 17951, and 17952.)

However, we have long held that due to the difference in the nature of a stockholder's interest in a corporation and a partner's interest in a partnership, a different source of income rule arises for stockholders than for partners. (Appeal of H. F. Ahmanson & Company, Cal. St. Bd. of Equal., Apr. 5, 1965.) In Ahmanson, we held that the source of even a limited partner's income is where the property of the partnership is located and where the partnership activity is carried on. This view is in accord with the 'conduit theory of partnerships" which indicates that partnerships are conduits through which the taxpaying obligation passes to the individual partners in accord with their distributive shares. (United States v. Basye, 410 U.S. 441 (35 L.Ed.2d 412] (1973).) For example, in Ahmanson, the taxpayer, a California corporation, was a limited partner in two limited partnerships engaged in oil exploration in Turkey. While all partners were domiciled in California

and management offices were maintained here, the principal activities of the partnerships consisted of exploring for oil in Turkey. As a result, we held that losses incurred from such partnerships had their source in Turkey and were, therefore, not deductible in California.

Accordingly, the determinative question here is where the property of the Fund is located and where its activity is carried on. However, rather than directly addressing the Ahmanson criteria or regulation section 17951.1, subd. (b), appellant bases her attack on the framework of regulation section 17952 and marshals facts which allegedly show that the intangible property (i.e., appellant's partnership interest) has not acquired a business situs in California (App. Br. at 8.) or that as investors, neither appellant nor the Fund is doing business in California. (App. Br. at 11.) Appellant's first argument is clearly misdirected. It is not the situs of appellant's partnership subscription agreement which is controlling (App. Br. at 8), but the situs of the property of the Fund itself which controls. In, addition, as indicated above, under the conduit theory of partnerships, the activity of the Fund, and not of appellant, is critical.

Relying upon the record, as presented, we find that the critical property of the Fund is located in California. The Fund's principal office is located at Marina Del Rey, California, where during the years at issue it employed, at any one time, from four to five persons. It's major bank accounts were located in California and Kent directed the Fund's activities out of Bache's office in Beverly Hills, California.[2/] Clearly, the partnership infrastructure was located in California. Moreover, the epicenter of the Fund's activity was its Marina Del Rey office. Although some of the Fund's activities may have been conducted outside California, appellant does not contend that income should be allocated partly within and partly without the state, nor has it presented evidence which would permit such an allocation. (See Appeal of H. F. Ahmanson & Company, supra.) Accordingly, upon the record before us, respondent's action with respect to the first issue must be sustained.

2/ We do not find it relevant that the futures contracts or forward contracts may have been executed at exchanges outside of California.

As indicated above, appellant also argues that even if it is held that California is the source of the subject income, the statute of limitations bars collection of the assessments for the years 1975, 1977, and 1978. It is clear that when no return is filed, the tax may be assessed at any time after the date prescribed for filing the return. (Treas. Reg. § 301.6501(c)-1, subd. (c).) Appellant admits that she herself filed no return for those years. However, she argues that the Fund filed a partnership return which reported all of her income and that this partnership return was sufficient notice to respondent to begin the running of the statute of limitations. (App. Br. at 13.) This same argument has been-rejected in Durovic v. Commissioner, 487 F.2d 36 (7th Cir. 1973). For the reasons cited there, we also reject appellant's second argument.

Accordingly, for the reasons cited above, respondent's action must be sustained.

Appeal of Estate of Marion **Markus**

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 Estate of Marion **Markus** against proposed assessments of additional personal income tax in the amounts of **$5,940.41, $2,779.31, $44,384.57, $64,551.99,** and **$148,321.80** for the years 1975, 1977, 1978, 1979, and 1980, respectively, be and the same is hereby sustained.

Done at Sacramento, California, this 6th day of **May** , 1986, by the State Board of Equalization, with Board **Members** Mr. Nevins, Mr. Collis, Mr. Bennett, Mr. Dronenburg and Mr. Harvey present.

Richard Nevins , Chairman

Conway H. Collis , Member

William M. Bennett , Member

Ernest J. Dronenburg, Jr. , Member

Walter Harvey* , Member

*For Kenneth Cory, per Government Code section 7.9