BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
) No. 81N-1274-GO
SAM AND BETTY SPIEGEL)

Appearances:

For Appellants.: Valentine Brookes
Attorney at Law

For Respondent: Terry Collins
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 Sam and Betty Spiegel against proposed assessments of additional personal income tax plus penalties in the total amounts of $14,416.53 and $25,311.11 for the years 1975 and 1976, respectively, and pursuant to section 19057, subdivision (a), from the action of the Franchise Tax Board in denying the claim for refund of personal income tax in the amount of $19,057.00 for the year 1975.

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

Appeal Sam and Betty Spiegel

The primary issue for determination is what part of certain compensation received by appellant Sam Spiegel (hereinafter sometimes referred to as "appellant") through his wholly owned corporation Eagle Productions, Inc. (hereinafter "Eagle") for his services as producer of the movie "The Last Tycoon" (hereinafter "picture") was for services performed in California and, therefore, includible in his California gross income for the years at issue. In addition, we must determine whether reasonable cause exists to excuse appellants' late filing of their California Individual Income Tax return (form 540 NR) for 1975, and their failure to file such a return for 1976.

Appellant is a motion picture producer by profession. During the appeal years, he was a resident of New York. Beginning in May of 1973, prior to the years under appeal, appellant and/or corporations controlled by him, commenced to develop the above-noted picture. By letter dated May 10, 1973, Horizon Pictures, Inc. (hereinafter "Horizon"), a corporation wholly owned by appellant, obtained from Frances Scott Fitzgerald Smith, the widow of the famous author F. Scott Fitzgerald, the option to purchase the motion picture and related rights in the literary work entitled "The Last Tycoon." (Resp. Ex. N-4.) Pursuant to a document entitled Memorandum of Agreement dated October 23, 1973, Horizon agreed with Paramount Pictures Corporation (hereinafter "Paramount") to develop and produce the picture. (Resp. Ex. B.) In that document, Horizon was denoted as "producer" and it was agreed that Horizon would develop and produce the picture while Paramount would underwrite certain costs of the production. In return for such financial assistance, Paramount was to recoup such advancements and, thereafter, to participate, along with Horizon, in the gross receipts from the distribution of the picture. For example, the agreement provided that after gross receipts amounted to $6,250,000, Horizon, as producer, and Paramount would each be entitled to 50 percent of the gross receipts. (Resp. Ex. B at 3.)

In furtherance of this endeavor, on December 1, 1973, Horizon Pictures (GB) Limited (hereinafter "Horizon Pictures"), another corporation controlled by appellant, agreed with the wholly owned corporation of the British writer Harold Pinter for him to write the screenplay for the picture. (Resp. Ex. N-5.) That agreement provided that during the writing, revision and filming of said picture, Mr. Pinter would discuss and consult with the "Director and/or Producer." In return, Horizon Pictures

agreed to pay Mr. Pinter's wholly owned corporation a fee plus a percentage of its share of the profit from the picture. Moreover, by letter dated December 20, 1974, Horizon agreed to engage Elia Kazan as director for the picture. (App. Ex. A.) That agreement provided that Mr. Kazan and Horizon, as producer, would mutually agree to the principal members of the cast, art director, costume designer, cameraman, cutting and editing of the picture. (App. Ex. A at 3.) In return for his services, Mr.. Kazan was to receive a set fee plus a percentage of gross receipts beyond certain revenues. The agreement provided that the percentage participation by Mr. Kazan was to occur after Horizon fully recouped the entire "negative cost" of the picture or when gross receipts reached $12,000,000, whichever point occurred first. For that purpose, Horizon represented that at such point (i.e., full recoupment or $12,000,000 of gross receipts), "its share (including,. for the purpose of this provision, the share of any other company owned or controlled by Sam Spiegel) of the revenues from the Picture will be no less than 10% of such gross receipts . ..." (App. Ex. A at 2.)[2/]

Sometime in 1975, Tycoon Service Company (hereinafter "Service"), a limited partnership was formed as a vehicle for providing the remaining financing needed for the picture. Apparently, Service, of which appellant had no ownership interest,[3/] was an isolated venture, devoted only to the subject picture. A document dated May 15, 1975, denoting Service as the producer of the picture, provided that Service agreed with Eagle to have its employee, appellant herein, "render all services usually and customarily rendered by and required of producers employed in the motion picture industry." (Resp. Ex. N-1 at 2.) The document provided that the "guaranteed period" was "from commencement of preproduc-

2/ As a way of illustration, Horizon thus warrantied that if the $12,000,000 gross receipts figure became the operative point, its share, including the share of any other companies owned by appellant, would be no less than 10 percent or no less than $1,200,000.

3/ Appellant testified at the oral hearing that he had no ownership interest in, or control of, Service. (Tr. at 24.) However, the May 15, 1975, document referred to below indicated the same mailing address for Service as for his wholly owned corporation Eagle.

tion to completion and delivery of the Picture to the distributor" and that the "start date" was "[c]ommencing with the preproduction activity of the Picture." That document further provided that, in return, compensation of $500,000 was to be paid, "payable after commencement of production (shooting) of the Picture, of which [$300,000] shall be payable no later than December 31, 1975, and [$200,000] payable following completion of production of the Picture."

A 1975 California Individual Income Tax Return, form 540 NR, filed August 13, 1976, indicated that appellant received the above-noted $300,000 of compensation in 1975 and denoted it as "California Income" for which, after various deductions, $19,057 in tax was paid. (Resp. Ex. A.) After audit, respondent determined that additional tax of $121013.78 was due since itemized deductions claimed by appellant could not be taken since such items did not relate to income taxable by this state and, additionally, determined that a penalty of $2,402.75 for late filing was due. (Resp. Ex. A-3.) Moreover, based on the May 15, 1975, document noted above, respondent concluded that appellant had been paid an additional $200,000 for services rendered in California in 1976 for which no return had been filed and, accordingly, issued a proposed assessment of additional tax of $20,248.48 plus penalty of $5,062.22 for failure to file a return for 1976. (Resp. Ex. A-5.)

After further reflection, appellant concluded that his computation of taxable income should actually be based upon an allocation of gross income to California of $35,070 in 1975, and $30,280 in 1976, rather than including the entire $300,000 as California income in 1975 as his 1975 return indicated.[4/] (App. Br. at 16,) Moreover, appellant contends that the late filing in 1975, and failure to file in 1976, were for reasonable cause. As a consequence of this conclusion, appellant protested the above-noted proposed assessments and filed a claim for refund of the taxes paid for 1975. Denial of the protest and claim led to this appeal.

The parties agree that the law with respect to taxation of nonresidents for services performed in

4/ Appellant contends and, apparently, respondent agrees, that the parties can readily compute the net taxable income arising from the allocation of any income to California. (App. Br. at 16.)

California is beyond dispute. The dispute here, however, centers upon the facts of this case. For purposes of the California Personal Income Tax Law, in the case of a nonresident taxpayer, gross income includes only the gross income from sources within this state. (Rev. & Tax. Code, § 17951.) The word "source" conveys the essential idea of origin. The critical factor which determines the source of income from personal services is not the residence of the taxpayer, or the place where the contract for services is entered into, or the place of payment. It is the place where the services are actually performed. (Ingram v. Bowers, 57 F.2d 65 (2d Cir. 1932); Perkins v. Commissioner, 40 T.C. 330, 341 (1963); Appeal of Janice Rule, Cal. St. Bd. of Equal., Oct. 6, 1976; Appeal of Charles W. and Mary D. Perelle, Cal. St. Bd. of Equal., Dec. 17, 1958; Appeal of Robert C. and Marian Thomas, Cal. St. Bd. of Equal., Apr. 20, 1955; cf. Rev. Rul. 60-55, 1960-1 C.B. 270.)

The case of Ingram v. Bowers, supra, illustrates this principle. Ingram concerned the source of income received by Enrico Caruso, a nonresident alien, from the sale of phonograph records outside the United States. The singing by Caruso used for the production of the records occurred within the United States. Caruso performed these services for the Victor Company and received a percentage of the sales price for each record sold by Victor. The amounts received from Victor were included in Caruso's gross income on the theory that the income was from sources within the United States. In upholding the taxing agency's position, the court held that the place where the services are performed, and not where payment is determined, is the source of the income.

Initially, respondent argues that the language of the May 15, 1975, document indicated that the compensation to be received by appellant from Service was for future services and not for any services appellant may have already performed and since "substantially all of these future services occurred in California, all of the $500,000 was California income." (App. Ex. H at 2.) In contrast, appellant first appears to argue that the above-noted May 15, 1975, document was not operative since appellant was unable to produce a signed copy of that document. [Emphasis added.] (App. Br. at 12.) However, appellant does not represent "that such a contract was not signed." Moreover,, appellant acknowledges that pursuant to the terms of such document, "the services were performed, and the fee was paid." (App. Br. at 12.) In this light, we find that the May 15, 1975, document

was, indeed, operative and is critical in the determination of this matter.

Notwithstanding this conclusion, appellant next argues that the compensation for appellant contemplated by the May 15, 1975, document included services already performed which were clearly performed outside of California. Appellant notes that by May 15, 1975, and beginning in May of 1973, he or his controlled corporations had obtained the film rights for the picture from Mrs. Smith, employed Harold Pinter to do the screenplay, interviewed various prospective actors, technicians, and directors, employed **Elia Kazan** to be director, and contracted with Paramount to provide financing and a studio. All of these services occurred outside of California and were critical to the making of the picture. Pursuant to the terms of the May 15, 1975, document, the "start **date**" of the agreement was **"[c]ommencing** with the preproduction activity of the Picture." (Resp. Ex. N-1 at 2.) This "preproduction activity" for which the compensation at issue was paid, appellant **argues,** included the services performed prior to May 15, 1975, which when considered with those performed in California, indicates that on a "qualitative basis" only 5 percent of the "fee was earned by his services in California and 95 percent should be allocated to other geographical areas." (App. Br. at 15.) The gist of this contention is that the important work appellant did on the picture and for which the. $500,000 was paid was done before he came to California and he was no more than a consultant in California. Appellant notes that there "was no expectation or intention that [he] would contribute all his work, his advances of expenses, and his rights in **the pre-production** contracts described, and those with actors, without compensation. The $500,000 was that compensation." [Emphasis added.] (App. Br. at 15.) Moreover, even assuming that the May 15, 1975, document covered only appellant's future services (i.e., subsequent to May 15, **1975),** appellant would argue that a substantial number of those services were performed outside of California so that respondent's conclusion that "substantially all of these future services occurred in California" is incorrect and its allocation of the entire $500,000 to California. **is** erroneous. To buttress this last argument, appellant has submitted an itinerary of his activities for 1975 which will be discussed later. **(Resp. Ex. E-3.)** Moreover, after vacationing from January 1, 1976, through February 4, 1976, **in** California, appellant indicated that from February 5, 1976, through June 30, 1976, he participated in the final editing and cutting of the picture in New

York City after which he received the $200,000 payment in New York. (App. Supp. Memo. at 12, 13.)

Respondent counters that since Service was named as producer of **the picture** (rather than Horizon) in the May 15, 1975, document, Service must have purchased the production rights from Horizon. Therefore, the agreement between Horizon and Service, respondent reasons must, have covered any compensation or participation in future profits for Horizon for past services by it or by appellant (i.e., prior to May 15, 1975). Accordingly, review of the contract between Horizon and Service is critical in order to determine if, in fact, the $500,000 **contemplated** in the May 15, 1975, document was, in fact, the entire compensation for appellant's services. Respondent adds that appellant's refusal or inability to produce the assignment documents between Horizon and Service gives rise to the presumption that, if provided, the evidence would be unfavorable to him. (See Appeals of James C. Coleman Psychological Corporation and James.C. and Azalea Coleman, Cal. St. Bd. of Equal., Apr. 9, 1985.) However, after review of the record and oral hearing, respondent apparently concedes that the entire $500,000 fee is not attributable to California, and requests that "based upon all the material which has been submitted," this board makes a determination of what part of that compensation was for services performed in California. (Resp. **Post-**Hearing Memorandum at 10, 11.)

Accordingly, at this juncture, the factual inquiry must be directed to, first, the effect of the May 15, 1975, document and, second, the determination of the services contemplated by that agreement which were performed in California.

At the outset, it must be stated that the May 15, 1975 document is not a model of clarity. Respondent contends that much of the grammatical construction of that document would indicate that the subject compensation was to be paid for future services **and not** past services, for example: appellant was "to render" all customary service **"[c]ommencing"** (as opposed to "commenced") with preproduction activity. Furthermore, respondent maintains, the paragraphs covering reimbursement for expenses and transportation appear to be **prospective** and not retrospective in nature. (See Resp. Ex. N-1.) However, appellant's point that a broad reading of the phrases "commencement of preproduction activity" might indicate that the compensation contemplated services more than prospective in nature is also plausible. 'The

best that can be said for this document is that it is ambiguous.

We note that the intent of the parties is the paramount feature of any contract. (Flynn v. Flynn, 103 Cal.App.2d 91, [229 P.2d 51 (1951).) Accordingly, the function of all interpretation is to try to ascertain the true intent of the parties and the purpose of all rules for the interpretation of written instruments is to aid this function. (McPherson v. Great Western Milling Co., 44 Cal.App. 491 [186 P. 803] (1919).) Moreover, where the intent is doubtful on the face of the instrument or. the language used will admit to more than one interpretation, the trier of fact will look at the situation and motives of the parties making the agreement, its subject matter, and the object to be attained by it, and will allow these circumstances to be shown by parol evidence. (Isenberg v. Salyer, 62 Cal.App.2d 938 [145 P.2d 691] (1944).)

In this light, the foremost question, of course, would be whether the parties to the May 15, 1975, agreement--Service, Eagle and appellant--intended the compensation to be only for prospective services or to include compensation for past services and/or property. A pivotal point in this inquiry is whether the $500,000 payment was intended to be the only payment for appellant's entire work or only a partial payment as for one segment of that work. If the $500,000 payment was for appellant's or his corporations' entire work on the picture, it is clear that the parties intended that'the compensation cover the period beginning with the negotiation of the option from Mrs. Smith in May of 1973. However, if the $500,000 payment was only a payment for one segment of the work performed by appellant, it is likely that the parties intended the compensation to cover a different time frame, for example, subsequent to May 15, 1975.

As indicated above, appellant's attorney is certain that the $500,000 was appellant's entire compensation for the picture. (App. Br. at 15; App. Supp. Br. at 12.) However, respondent alleges that Horizon, appellant's wholly owned corporation, was compensated by Service for "past services" and that the compensation reflected in the May 15, 1975, document must then be entirely for future services. (App. Ex. H at 5.) To establish this allegation, respondent states that the "assignment document" transferring production rights from Horizon to Service must be produced. Rather than address

respondent's argument, appellant seems to ignore it stating that the only relevance regarding the line of questions regarding the ownership of Service was to establish if it was a corporation controlled by appellant. (App. Supp. Br. at 9.) To the contrary, the relevance of the questions surrounding Service was to establish what, if anything, it had paid Horizon to acquire the right to produce the picture and whether that payment was for services performed prior to May 15, 1975. As indicated above, respondent argues that the failure to produce the transfer document leads to the presumption that the document contains material adverse to appellant's case. (Appeals of James C. Coleman Psychological Corporation and James C. and Azalea Coleman, supra.) Accordingly, respondent concludes that it must be presumed that Horizon was compensated for appellant's and its activities prior to Yay 15, 1975, and that the compensation provided for in the May 15, 1975, agreement was only for future services.

We agree that this appeal is a proper case for the utilization of the Coleman presumption. Moreover, certain facts included in the record warrant the conclusion that the $500,000 fee was not envisioned as the entire compensation for appellant and/or his controlled corporations. As noted above, the employment contracts for the screenwriter and for the director envisioned a fee plus a percentage of the profits of the picture. It would appear unlikely that appellant, the prime entrepreneurial force behind the picture, would settle for only a set fee and not receive from Service through Horizon some percentage of the expected profits. We note that due to the lack of the economic success of the picture, no further payment might have been received. However, we feel that lack of ultimate success is irrelevant, but what is relevant is the retention of the right to receive potential profits. Moreover, as noted above, the agreement between Horizon and Mr. Kazan envisioned at least a 10 percent return of gross receipts for appellant and/or any companies owned or controlled by him. Accordingly, based upon the Coleman presumption and the factors noted above, we must conclude that the compensation provided by the May 15, 1975, was not envisioned as the entire compensation for appellant and that agreement must be interpreted as being for future services, not past services.

That having been decided, the proper identification of the services performed in California by appellant pursuant to that agreement must be made. As indicated above, appellant has submitted a schedule of his

activities involving the picture for 1975 (Resp. Ex. E-3) and has testified that for 1976, his only activity involving the picture was editing, which took place entirely in New York from February 5, 1976, through June 30, 1976. Respondent has offered no evidence to refute that offered by appellant. In this situation, we have no reason to question the veracity of appellant's schedule or testimony. (See Appeal of Janice Rule, supra.) While appellant argues that he was merely a consultant in California and that his real services were performed outside of California, we cannot perceive from the record presented us a difference in the quality of his services in or out of California.

Accordingly, based in the record presented, the inquiry becomes what amount of the $500,000 fee should be allocated to cervices performed in California, The respondent's regulations provide:

> If nonresident employees are employed in this State at intervals throughout the year . . . and are paid on a daily, weekly, or monthly basis, the gross income from sources within this State includes that portion of the total compensation for personal services which the total number of working days employed within the State bears to the total number of working days both within and without the State.

(Cal. Admin. Code, tit. 18, reg. 17951-5, subd. (b).)

However, that regulation provides that if the employee is paid on some other basis:

> [T]he total compensation for personal services must be apportioned between this State and other States and foreign countries in such a manner as to allocate to California that portion of the total compensation which is reasonably attributable to personal services performed in this State.

(Cal. Admin. Code, tit. 18, reg. 17951-5, subd. (b).)

Since we have found that, based on the record presented, any activity regarding the picture by appellant after May 15, 1975, is as important as any other activity, we find that a "reasonable attribution" of services performed in this State, can be made based on total number of working days employed within and without

this State. Moreover, since the total fee of $500,000 covered two years, we find that a reasonable attribution would encompass the entire period..

Accordingly, based on an allocation of days worked in California between the agreement date of May 15, 1975, and the completion of the picture on June 30, 1976, and days worked on the picture outside of California during the same period, 5/ we find that 31.2 percent of the compensation received by appellant pursuant to the May 15, 1975, agreement or $156,000 was derived by appellant for his services performed in California. Thus, an equitable resolution of this appeal results from attributing $156,000 of the $300,000 compensation paid to sation paid to appellant in 1975 to services performed in California with the remainder of that sum or $144,000 together with the $200,000 paid to him in 1976 to be attributed to services performed by him outside of California.

5/ Respondent's Exhibit E-3 and appellant's testimony indicates the following days working on the picture subsequent to the May 15, 1975, agreement:

In California	Outside of California
	5/15/75 thru 8/26/75 (104 days)
8/27/75 thru 8/29/75 (3 days)	
	8/30/75 thru 9/5/75 (7 days)
9/6/75 thru 10/2/75 (26 days)	
	10/3/75 thru 10/10/75 (8 days)
10/11/75 thru 12/31/75 (91 days)	
	2/5/76 thru 6/30/76 (145 days)
TOTAL 120 days (31.2%)	264 days (68.8%)

The second issue for our determination is whether the penalties imposed by respondent for appellant's late filing of his 1975 income tax return and his failure to file a 1976 return can be excused by reasonable cause. Appellant alleges that both penalties should be excused because his New York accountant did not realize that it was necessary to file a complete return for 1975 since the tax was collected and the full amount paid in 1975, and also believed that no return was necessary in 1976 since an excessive amount had been collected for 1975. We note that because of the allocation of income to California discussed above, the question for 1976 is now moot. We have held before that where a taxpayer employed a competent tax advisor, supplied him with all necessary information, and relied upon him to prepare all necessary tax returns, the failure to file a nonresident return was due to reasonable cause. (Appeal of Estate of Anna Armstrong, Deceased, Cal. St. Bd. of Equal., Oct. 27, 1964.) However, the Armstrong holding is somewhat diminished in light of the United States Supreme Court's recent decision in United States v. Boyle, 469 U.S. -- [83 L.Ed.2d 622] (1985). In Boyle, the Court held specifically that: "The failure to make a timely filing of a tax return is not excused by the taxpayer's reliance on an agent, and such reliance is not 'reasonable cause' for a late filing under [the statute]." (United States v. Boyle, supra, 83 L.Ed. 2d at 632.) (See also, Appeal of Robert T. and M. R. Curry, Cal. St. Bd. of Equal., Mar. 4, 1986.) The Court first acknowledged that it was reasonable for a taxpayer to rely on an accountant's or attorney's advice on a matter of tax law, such as whether a liability existed. (United States v. Boyle, 83 L.Ed.2d at 631.) However, the Court pointed out that it did not take a tax expert to know that "tax returns have fixed filing dates and that taxes must be paid when they are due." (Id.) We believe that Boyle controls with respect to the penalty for 1975 and compels a conclusion in respondent's favor on this issue.

Accordingly, for the reasons set out above, respondent's determination must be modified in accordance with the foregoing opinion.

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 Sam and Betty Spiegel against a proposed assessment of additional personal income tax and penalty in the total amount of $25,311.11 for the year 1976 be and the same is hereby reversed, and that the action of the Franchise Tax Board in the protest of Sam and Betty Spiegel against a proposed assessment of additional personal income tax and penalty in the total amount of $14,416.53 for the year 1975 be and the same is hereby modified in accordance with this opinion; and pursuant to section 19060 of the Revenue and Taxation Code that the action of the Franchise Tax Board in denying the claim for refund of personal income tax in the amount of $19,057.00 for the year 1975, be and the same is hereby modified in accordance with this opinion.

Done at Sacramento, California, this 10th day of June , 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