



87-SBE-048

BEFORE **THE** STATE BOARD OF EQUALIZATION
OF **THE** STATE OF CALIFORNIA

In the Matter of the **Appeal** of)
NEW AMERICA FUND, INC.) **No. 82A-1022-KP**

Appearances:

For Appellant: Ellen P. **Aprill**
Attorney at Law

For Respondent: Anna Jovanovich
Counsel

O P I N I O N

25666^{1/} This appeal is made pursuant to section of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of New America Fund, Inc., against a proposed assessment of additional franchise tax in the amount of \$20,240 for the income year ended September 30, 1977.

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

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The issues presented by this appeal are:

(1) whether net trust income appellant received from its interest in the **Mesabi** Trust should be included in the **measurement** of its franchise tax liability for the year in question: and, (2) whether appellant has proven that **certain** stock it held became worthless during the year at issue.

Appellant is a nondiversified investment **com-**pany incorporated in 1968 under the laws of Delaware, which began doing business in California shortly after its creation. Appellant's sole office is located in Beverly Hills, California. During the income year at issue, appellant held equitable **interests** in banking, manufacturing, and publishing concerns.

In 1976, appellant acquired 100,000 certificates of beneficial interest in the Mesabi Trust, a trust **created** in 1961 under the laws of New York. The trust **was** formed to collect and distribute royalties received from the **exploitation of iron ore** mined on fee and lessor interests **the** trust held in the Mesabi Range in **Minnesota.**^{2/} The **beneficial** interest of the **trust is** represented by **13,120,010** equal undivided portions, represented by certificates which are freely transferable and are listed for sale on the New York stock exchange. As explained, *infra*, the Reserve Mining Company paid royalties to the trustees of the trust, who, in turn, distributed those payments, along with any other trust income, to the beneficiaries of the trust. Appellant, apparently believing that its interest in the trust **was a real** property interest, and that its association with the trust made it a unitary business, specifically allocated the trust income it received to Minnesota, thereby excluding that income from the measure of its California franchise tax **liability**. Upon review of appellant's return, respondent determined that appellant was not a unitary business and that the trust income should have been included in determining appellant's California franchise tax.

When a taxpayer derives income from sources both within and without California, its tax liability is measured by its net income derived from or **attribut-**

^{2/} A complete description of the formation of the Mesabi Trust is found in Bankers Trust Company v. United States, 518 F.2d 1210 (1975).

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able to sources within this state. (Rev. & Tax. Code, § 25101.) If the taxpayer is engaged in a unitary business with affiliated corporations, the amount of income attributable to California sources must be determined by applying an apportionment formula to the total income derived from the combined unitary operations of the affiliated corporations. (See Edison California Stores, Inc. v. McColgan, 30 Cal.2d 472 [183 P.2d 16] (1947); John Deere Plow Co. v. Franchise Tax Board, 38 Cal.2d 214 [238 P.2d 569] (1951), app. dism., 343 U.S. 939 (96 L.Ed. 1345) (1952).) A unitary business exists when there is *unity* of ownership, unity of operation, and unity of use (Butler Bros. v. McColgan, 17 Cal.2d 664 [111 P.2d 334] (1941), affd., 315 U.S. 501 [86 L.Ed. 991] (1942)), or when the operation of the business within California contributes to or is dependent upon the operation of the business outside this state. (Edison California Stores, Inc. v. McColgan, supra, 30 Cal.2d at 48 .

Appellant apparently believes that its interest in the trust and its own operations constituted a unitary business. No evidence is presented, however, to support the conclusion that it was unitary with the trust. Such unsupported assertions are insufficient to overcome the presumptive correctness of respondent's determination. (Appeal of New Rome Sewing Machine Company, Cal. St. Bd. of Equal., Aug. 17, 1982.) We must conclude, therefore, that respondent's determination of unity was correct.

Since appellant is not a unitary business, the determination of the correctness of the Franchise Tax Board's action must be made under section 23040. Section 23040 states that:

Income derived from or attributable to sources within this State includes income from tangible or intangible property located or having a **situs** in this State and income from any activities carried on in this State, regardless of whether carried on in intrastate, interstate or foreign commerce.

Appellant contends that its Mesabi Trust holdings are an interest in real property. Therefore, appellant argues, all of the income derived from its interest in the trust must be attributed to Minnesota, the **situs** of the real property. In contrast, the Franchise Tax Board contends that appellant's interest in

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the trust is an intangible represented by the beneficial certificates. Respondent argues that since the **interest** is intangible personal property, all income derived from the certificates must be attributed to California, appellant's commercial domicile, under the doctrine of mobilia sequuntur personam.

To discover the true nature of appellant's interest in the Mesabi Trust, a close examination of the trust documents is needed. **The** income in question is **actually a** product of two separate trusts. **The legal** title to the land and mineral rights of the Mesabi Range is held by the Land Trust, the trustees of which are also the trustees of the **Mesabi Trust**. The equitable title to the Mesabi Range is held by the **Mesabi Trust**. The Land Trust receives royalty and lease **payments** from the Reserve Mining Company for the right to exploit the **land and its minerals**. The net trust income is then passed by the trustees through the Mesabi Trust to holders of the beneficial certificates. By the terms of the trust, the certificate holders' only right is the right to receive money: there are no real property rights to the land in their hands. (Agreement of Trust, art. 3, sec. 3.2.) Therefore, appellant's interest in the **Mesabi Trust** is not an interest in real property, but ^{is}, instead, an intangible personal property interest. ^{3/} **under** the doctrine of mobilia sequuntur personam, the **situs** of the intangible personal property **is** at the domicile of the **owner**. (Fibreboard Paper Products v. Franchise Tax Board, 268 **Cal.App.2d** 363 [74 **Cal.Rptr.** 46] (1968).) Respondent's regulation under section 23040 restates the mobilia rule and its so-called "**business situs**" exception:

In the case of... foreign corporations which have acquired a commercial domicile within the State, all income . . . **from** . . . intangible personal property ...

^{3/} This result is in accordance with California law which states that the right to receive royalty payments for extracted minerals is not a real property interest. (See Atlantic Oil Co. v. County of Los Angeles, 69 **Cal.2d** 585 [72 **Cal.Rptr.** 886] (1968). See also New York ex rel. Cohn v. Graves, 300 U.S. 308 [81 **L.Ed.** 666] (1937), which arrived at a similar distinction thereby allowing income received from real property interests to be taxed by **another** state.)

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is income from sources within this State, unless the property is so used in connection with a business carried on outside this State as to have acquired a business **situs** outside of this State.

(Cal. Admin. **Code**, tit. 18, reg. 23040, subd. (a).)

Since appellant has not shown that its intangible personal property has a business **situs** outside of its commercial domicile, **all** of the income derived from appellant's interest in the **Mesabi** Trust is attributable to California and must be included in the measurement of appellant's franchise tax liability.

Appellant attempts to dispute this conclusion by pointing out that the Minnesota **Department of Revenue** has determined that appellant's interest **was a real** property interest. Appellant argues that any attempt by California to tax the trust income violates the constitutional prohibition against one state attempting to tax real property located in another state. (See **Senior v. Braden**, 295 U.S. 421 [79 L.Ed. 1520] (1935).) **Appellant also points to State Tax Commissioner v. Fine**, 356 Mass. 51 (1969), wherein the **Massachusetts court** agreed that the beneficial interests in question were real property interests; Therefore, appellant concludes, this board is bound to follow Minnesota's determination that the beneficial interests in the trust are real property interests and that the income generated by the real property interests must be specifically allocated to Minnesota.

Despite appellant's contentions, we are bound by neither Minnesota's nor Massachusetts' determinations. "The sovereign authority of every state is confined within its own territory ... and the law of no state has any effect of its own force beyond the enacting state's boundaries." (Appeal of tee J. and Charlotte Wojack, Cal. St. **Bd.** of Equal., Mar. 22, 1971.)

We also disagree with appellant's contention that it is being subject to double taxation as a result of respondent's action. A similar argument was refuted **in Appeal of Thor Electronics of California, Inc., decided** February 4, 1975, wherein we stated that:

Forbidden double taxation occurs only when two taxes **of** the same character **are** imposed on the same property for the same purpose, by the same taxing authority within

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the same jurisdiction during **the same** taxing period. (Citation.)

* * *

The initial flaw in appellant's double taxation argument is its improper **characteriza-**tion of the franchise tax as a tax on property or income. It has long been held that the franchise tax is an excise tax imposed on the privilege of exercising the **corporate fran-**chise which is measured by the corporation's net income. The franchise tax is a tax imposed **upon a corporation** for the right or privilege of being a corporation or doing business in a **corporate** capacity. (Citations.)

In conclusion, we **find** that the Franchise Tax **Board** properly allocated all of the royalty income appellant **received from** the Mesabi Trust to California in determining appellant's franchise tax liability for the income year at issue.

In 1970, in an unrelated transaction, appellant acquired stock in a company called International Displays, Inc. (**IDI**). In 1977, appellant allegedly received information that **IDI** was in financial difficulties. Appellant made various unsuccessful attempts **to** contact the officers of **IDI** prior to the end of the 1977 income year. **As** a result of this lack of communication, appellant believed that **IDI** had failed. Consequently, appellant deducted its \$120,000 investment in **IDI** as a worthless stock loss on its 1977 income year franchise tax return.

A loss **from** a security which becomes worthless **during the income year is deductible, if not compensated for by insurance or otherwise.** (Rev. & Tax. Code, § 24347, subd. (d).) **It is** well settled that the taxpayer bears the burden of showing that the stock became worthless in the year for which the deduction is claimed, and that, to meet this burden, a taxpayer must show both that the stock had value at the beginning of its income year, and that some identifiable event occurred in that year which rendered it worthless by the end of the income year. (Appeal of **V.I.E. Industries, Inc.**, Cal. St. Bd. of Equal., June 29, 1982; Appeal of **Medical Arts Prescription Pharmacy, Inc.**, Cal. St. Bd. of Equal., June 13, 1974.)

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Appellant has failed to meet either of the above-stated requirements. There is nothing in the record to indicate that the stock **in** question had any value at the beginning of the income year in question. **There** is also no identifiable event showing that the stock was worthless at the end of the year. Appellant's assumption that the corporation was **no** longer operational and that the stock it held was worthless fails to satisfy its burden of proving that the shares actually became worthless in 1977. (See Appeal of V.I.E. Industries, Inc., supra; Appeal of Medical Arts Prescription Pharmacy, Inc., supra.)

For the above-stated **reasons**, respondent's action in this matter must be sustained.

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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 25667 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of New America Fund, Inc., against a proposed assessment of additional franchise tax in the amount of \$20,240 for the income year ended September 30, 1977, be and the same is hereby sustained.

Done at **Sacramento**, California, this 17th day of June , 1987, by the State Board of Equalization, with Board Members Mr. **Collis**, Mr. Dronenburg, Mr. Bennett, Mr. Carpenter and **Ms. Baker** present.

Conway H. Collis , Chairman
Ernest J. Dronenburg, Jr. , Member
William M. Bennett , Member
Paul Carpenter , Member
Anne Baker* , Member

*For Gray Davis, per Government Code section 7.9