

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeals of)	
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Amman & Schmid Finanz AG,)	Nos. 92N-0520, 92A-0521,
Anlabereratung Lehndorff Verm GmbH)	92N-0522, 92N-0524,
& Co., Armand-Stiftung, Bihofin)	92R-0540, 92R-0545,
S.A., Euka Baulement Verkaufsges)	92N-0557, 92N-0561,
M., Grundstruescsverw Hohenufer)	92R-0577, 92R-0587,
MHB & Co., Kasdorp & Co. B.V.,)	92N-0535
Leher Investment & Finance Co.,)	
Inc., Sapona Stiftung Vaduz,)	
Vermögensverwaltung)	
Aktiengesellschaft, and Dr. L. N.)	
Zaaijer B. V.)	

Representing the Parties:

For Appellants:	Alan D. Bollinger, KPMG Peat Marwick
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For Respondent:	A. Kent Summers, Counsel
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Counsel for Board of Equalization:	Philip Dougherty, Staff Counsel
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OPINION

This appeal is made pursuant to section 25666,¹ (renumbered 19045 effective January 1, 1994) from the actions of the Franchise Tax Board on the protests of Amman & Schmid Finanz AG,

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

Anlabereratung Lehndorff Verm GmbH & Co., Armand-Stiftung, Bihofin S. A., Kasdorp & Co. B.V., Leher Investment & Finance Co., Inc., and Dr. L. N. Zaaijer B.V. against proposed assessments of additional franchise tax in the amounts, respectively, of \$622.00 (includes delinquent filing penalty), \$406.51 (includes delinquent filing and underpayment of estimated tax penalties), \$300.00, \$600.00, \$494.32 (includes delinquent filing and underpayment of estimated tax penalties), \$573.87 (includes delinquent filing and underpayment of estimated tax penalties), and \$494.32 (includes delinquent filing and underpayment of estimated tax penalties), all for the 1988 income year, and pursuant to Revenue and Taxation Code section 26075 subdivision (a), (renumbered 19324, effective January 1, 1994) from the actions of the Franchise Tax Board in denying the claims of Amman & Schmid Finanz AG, Armand-Stiftung, Bihofin S.A., Euka Baulement Verkaufsges M., Grundstruecksverw Hohenufer MBH & Co., Kasdorp & Co. B.V., Leher Invetment & Finance Co., Inc., Sapona Stiftung Vaduz, Vermögensverwaltung Aktiengesellschaft, and Dr. L. N. Zaaijer B.V. for refunds of franchise tax in the amounts, respectively, of \$102.00, \$300.00, \$370.00 \$130.00, \$ 101.00, \$88.00, \$ 49.00, \$33.00, \$81.00, and \$88.00, all for the 1988 income year.

The issue presented by this appeal is whether appellants were doing business in California within the meaning of Revenue and Taxation Code section 23151.

Appellants are associations (corporations) organized under the laws of countries other than the United States. These corporations, as limited partners, acquired partnership interests in descending tiers of limited partnerships (which often had other partners in addition to appellants). The "bottom" limited partnerships acquired, managed, rented, and sold California real properties and received income therefrom. Because of the tiers of intervening limited partnerships, the appellants individually had less than one percent of the distributive partnership interests in that California sourced income of the owning limited partnerships.

A corporation income tax is imposed by section 23501 upon corporations which, although not "doing business" in California, still "derive income from sources within the state." Appellants filed returns and reported their distributive shares of the California sourced income of the owning limited partnership as income taxable under section 23501. In some cases appellants' returns were filed late. The franchise tax is imposed by section 23151 upon all banks and corporations which are "doing business" in California. "Doing business" is defined in section 23101 to mean "actively engaging in any transaction for the purpose of financial or pecuniary gain or profit." Respondent determined that appellants were "doing business" in California and were therefore required to file returns and report franchise tax instead of corporation income tax. In most instances, respondent proposed to assess or billed additional (minimum) franchise tax. Some appellants protested the proposed assessments. Other appellants paid the amounts of the proposed assessments or billings and either filed claims for refund of those amounts or their payment of the proposed assessment is here treated as a claim for refund. Some appellants filed claims for refund of the amounts of estimated tax they paid which exceeded the amounts of tax they later reported on their returns. Respondent affirmed its proposed assessments and denied the claims for refund. These appeals followed.

Respondent's position is that the business transactions involving the California property were executed by the general partners as general agents for the partnerships and all the partners, and that through the mechanism of that agency, the limited partners were doing business in California within the meaning of section 23151, and were therefore subject to California's franchise tax.

Appellants' position is that "doing business" is defined by the Bank and Corporation Tax Law as "actively" engaging in any transaction for the purpose of financial or pecuniary gain or profit (Rev. & Tax. Code, § 23101). Appellants contend that, while that definition does not require the conduct of a regular course of business, it nevertheless does require active participation in the profit-seeking activity, and limited partners are necessarily passive or inactive members of the partnership.

Since the 1929 enactment of the Bank and Corporation Franchise Tax Act, California has imposed a tax on those nonfinancial corporations "doing business" in California for the privilege of exercising their corporate franchises here. Section 23151 presently provides, in part:

With the exception of financial corporations, every corporation doing business within the limits of this state and not expressly exempted from taxation by the provisions of the Constitution of this state or by this part, shall annually pay to the state, for the privilege of exercising its corporate franchises within this state, a tax according to or measured by its net income, to be computed at the rate of 7.6 percent upon the basis of its net income for the next preceding income year. In any event, each such corporation shall pay annually to the state, for the said privilege, a minimum tax determined in accordance with Section 23153.

Not until this appeal has the question been presented to this board (or to the California courts) whether this provision of California law taxes out-of-state corporations whose only California contacts are as limited partners in limited partnerships which are doing business in California. This question requires a direct construction of this provision of California law. Note that in this appeal it is clear that the limited partnerships which acquired, managed, rented, and sold California properties were doing business in California; that the general partners of those limited partnerships were doing business in California on behalf of their limited partnerships; and that the appellants received distributive shares of the California sourced income of those limited partnerships.

The general law of limited partnerships in California is contained in the Uniform Partnership Act (Cal. Corp. Code, tit. 2, ch. 1), the Uniform Limited Partnership Act (Cal. Corp. Code, tit. 2, ch. 2) and the California Revised Limited Partnership Act (Cal. Corp. Code, tit. 2, ch. 3). The record of these appeals contains only one of the limited partnership agreements for one of the partnerships that owned and operated California property. There is nothing in that agreement which appears to conflict with the general provisions of California limited partnership law, but the record contains none of the partnership agreements for any of the other partnerships operating in California nor any of the partnership agreements for the descending series of partnerships in which the appellants have interests. (See Cal. Corp. Code, § 15618.) As a consequence, we necessarily contemplate the limited partners' rights and liabilities as generally recognized by California partnership law and not as those rights and liabilities might be permissibly altered by partnership agreements as interpreted by the laws of states or countries in which they were organized. (See Cal. Corp. Code, § 15691.)

A partner's rights in a general partnership (Cal. Corp. Code, § 15024) are, inter alia, (1) the right to possess specific partnership property (i.e., property originally brought into the partnership stock or subsequently acquired by purchase or otherwise on account of the partnership) with the other partners as a tenant in common (Cal. Corp. Code, §15025), (2) the interest in the partnership, which is in a share of the profits and surplus and (3) the right to participate in partnership

management (Cal. Corp. Code, § 15024). Furthermore, general partners are liable jointly for the obligations of the partnership. (See Cal. Corp. Code § 15015.)

Except as otherwise provided in the California Revised Limited Partnership Act, the general partner of a limited partnership has the rights, powers and restrictions of a partner in a general partnership (Cal. Corp. Code, § 15643), which include the right to manage and conduct partnership business (Cal. Corp. Code, § 15018(e)). Acts of that partner for that purpose bind the partnership. (Cal. Corp. Code, § 15009(1).) But, a limited partner is not bound by the obligations of the partnership unless that partner is also named as a general partner or has participated in the control of the limited partnership's business. (Cal. Corp. Code, § 15632.) A partner in a limited partnership has no interest in specific (limited) partnership property. (Cal. Corp. Code, § 15671.) A limited partner's interest in the partnership is intangible personal property, which ordinarily is located in the domicile of the limited partner. (Appeals of Amyas and Evelyn P. Ames, et al., 87-SBE-042, June 17, 1987.)

On the basis of these rules, this board is unable to conclude that appellants are doing business here individually simply because they have interests as limited partners in limited partnerships which are engaged in business here. A general partner simply does not have agency rights over the obligations or the property of the limited partners.

The legislature has amended the California Revised Limited Partnership Act to provide that a foreign limited partnership shall not be considered to be transacting intrastate business merely because of its status as a limited partner of a domestic or foreign limited partnership which is transacting intrastate business (Stats. 1987, Ch. 1364; Cal. Corp. Code, § 15611, subd. (ag)(2)(C) and (D)) or of a domestic or foreign limited partnership which is registered to transact intrastate business (Stats. 1994, Ch. 1200; Cal. Corp. Code, § 15611, subd. (ag)(4)). While these recent enactments are not indicative of legislative intent in enacting the original provisions of the predecessor of the present section 23151, we note that our decision in this appeal is compatible with these later enactments.

We do not view the authorities cited by respondent as compelling a different result:

In Appeal of H.F. Ahmanson & Company, Cal. St. Bd. of Equal., April 5, 1965, a California corporation was principally engaged in business in California as a general insurance agent but was also a limited partner in two limited partnerships that were principally engaged in oil exploration in Turkey. The partnership agreements were entered into in California; all the partners were domiciled here; and partnership management offices were maintained here. The partnership operations resulted in losses. Appellant deducted its distributive share of those losses in determining its income for franchise tax purposes. The deduction was disallowed by respondent. The corporation's primary contention was that the losses were attributable to its intangible partnership interests, which had a situs in this state, and therefore the losses were derived from sources in this state. We concluded that authorities supported the view that the source of a limited partner's income or loss from the partnership is where the partnership property is located and the partnership activity is carried on. Thus, the partnership losses were sourced in Turkey and were not sourced in California. However, in that opinion we expansively observed "(t)he partnerships were regularly engaged in business in Turkey during the three years under consideration. As a partner, appellant was also engaged in business there." This observation is arguably true for general partnerships. But, as we noted above, more specific examination has convinced us that this dicta is not necessarily true for limited partners.

In People ex rel. Badische Anilin & Soda Fabrik v. Roberts, 11 App.Div. 310 [42 N.Y.S. 502] (1887), aff'd 152 N.Y. 59 [46 N.E. 161](1897), a German chemical corporation (Badische), as the only special (limited) partner, contributed \$150,000 to a New York limited partnership which carried on business as a seller in this country of imported chemicals. The partnership was the sole distributor in this country for Badische products, its sales of which averaged \$2,000,000 a year. New York's tax was imposed upon the franchises of New York corporations and upon the business done by foreign corporations in New York. The basis (measure) of the tax was the amount of capital stock employed within New York by the corporations. New York imposed the tax on Badische measured by its \$150,000 contribution to the limited partnership. The court observed that if capital contributed by the foreign entity was only an investment which other parties alone controlled and managed, the tax would not apply. The majority stated it could look through the form to the substance; assumed that the contribution of the \$150,000 was an efficient cause in the profitable marketing of Badische's products in this country; and concluded that Badische had, by the method of a limited partnership, established a place within New York, for the doing of a part of its business in New York within the meaning of the tax statute. Because of the unique relationship contemplated by this case, we do not regard its result to be apposite authority for the proposition that every limited partner is doing business at the location where the limited partnership is doing business.

In Donroy, Ltd. v. United States, 301 F.2d 200 (9th Cir. 1962), the court construed Article XI of the Tax Convention with Canada, 56 Stat. 1399, 1402 (1942). That provision of the Convention limits the rate of tax which, in that case, the United States could impose with respect to income derived from sources in the United States by corporations organized in Canada and having a "permanent establishment" in the United States. The Convention variously defined "permanent establishment." After examining these definitions, the court observed that the evident intent of the Convention was that the test was not entirely whether the employee or agent here had the power to make contracts binding upon the principal, but whether the employee or agent (who was not a mere broker) carried on a regular business here for the benefit of the principal. The court concluded accordingly that a general partner of a limited partnership here has the power to act for the business benefit of the limited partners, and therefore the office of the limited partnership here was, in effect, a permanent establishment of the limited partner within the meaning and intent of the Tax Convention. The result limited the rate of income tax that the United States could impose on the United States sourced income of the Canadian corporate limited partners. The construction of this Convention provides us with no significant guidance as to the intent of the California legislature in enacting the provisions of (Rev. & Tax. Code) section 23151 relating to "doing business" in California.

On the basis of the foregoing opinion, the action of the Franchise Tax Board must be reversed.

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 actions of the Franchise Tax Board on the protests of Amman & Schmid Finanz AG, Anlabereratung Lehndorff Verm GmbH & Co., Armand-Stiftung, Bihofin S. A., Kasdorp & Co. B.V., Leher Investment & Finance Co., Inc., and Dr. L. N. Zaaizer B.V. against proposed assessments of additional franchise tax in the amounts of \$622.00, \$406.51, \$300.00, \$600.00, \$494.32, \$573.87, and \$494.32, all for the 1988 income year, be and the same are hereby reversed, and pursuant to section 26077 of the Revenue and Taxation Code, that the actions of the Franchise Tax Board in denying the claims of Amman & Schmid Finanz AG, Armand-Stiftung, Bihofin S.A., Euka Baulement Verkaufsges M., Grundstruecksverw Hohenufer MBH & Co., Kasdorp & Co. B.V., Leher Investment & Finance Co., Inc., Sapona Stiftung Vaduz, Vermögensverwaltung Aktiengesellschaft, and Dr. L. N. Zaaizer B.V. for refunds of franchise tax in the amounts, respectively, of \$102.00, \$300.00, \$370.00 \$130.00, \$ 101.00, \$88.00, \$ 49.00, \$33.00, \$81.00, and \$88.00, all for the 1988 income year, be and the same are hereby reversed.

Done at Sacramento, California, this 11th day of April, 1996, by the State Board of Equalization, with Board Members Mr. Klehs, Mr. Dronenburg, Mr. Andal, Mr. Sherman and Mr. Halverson present.

_____, Chairman

Ernest Dronenburg, Jr., Member

Dean F. Andal, Member

Brad J. Sherman, Member

Rex Halverson*, Member

*For Kathleen Connell, per Government Code section 7.9.