BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
) No. 81A-1438-MW
HOLIDAY INNS, INC.)

For Appellant: Earl G. Meggs
State Income Tax Manager

For Respondent: Donald C. McKenzie
Counsel

OPINION

This appeal is made pursuant to section 25666[1/] of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Holiday Inns, Inc., against proposed assessments of additional franchise tax in the amounts of $98,230.53, $175,214.48, $123,193.26, $70,950.47, and $37,720.32 for the income years 1970, 1971, 1972, 1973, and 1974, respectively.

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.

The sole question presented by this appeal is whether the gain from the sale of appellant's interest in a California real property partnership may be specifically allocated to California. All other issues have been resolved, leaving the amounts in controversy as $51,068.29, $69,091.17, and $70,502.84 for the income years 1970, 1971, and 1972. The income years 1973 and 1974 are no longer at issue.

Appellant has its commercial domicile in Tennessee and does business in California and other states. In 1963, appellant purchased 155 acres of land in Orange County, California, for commercial development. In 1964, appellant used five acres, on which it built a motel, and sold the remaining land to a partnership formed to purchase (and, apparently, develop) the property. Appellant held a 25 percent interest in the partnership. In 1970, appellant sold its interest in the partnership, resulting in substantial gain. The gain was reported on the installment basis over a three-year period from 1970 through 1972.

Appellant and respondent have agreed that the income and losses from the sale of real estate to the joint venture in 1964 and from the operation of the partnership over the next six years were nonbusiness in nature and wholly assignable to California. They also agree that the gain on the sale of appellant's partnership interest was nonbusiness income.. On its 1970 tax return, appellant allocated its share of the joint venture operating losses to California, but did not report the installment sale gain from the sale of its interest in the partnership. Similarly, the gain reportable in 1971 and 1972 was not reported as California taxable income. Respondent's determination that the capital gain from the sale of the partnership interest should be allocated to California led to this appeal.

Appellant derives income from sources both within and without California. Therefore, section 25101 provides that its tax must be measured by the net income derived from or attributable to sources within this state according to the provisions of the Uniform Division of Income for Tax Purposes Act (UDITPA) contained in section 25120 through 25139.

"Business income" is apportioned to this state by a three-factor formula consisting of the property factor, the payroll factor, and the sales factor. (Rev. & Tax. Code, § 25128.) "Nonbusiness income" is not apportioned by- formula, but is specifically allocated to particular states in accordance with the provisions of sections 25124 through 25127. (Rev. & Tax. Code, § 25123.) Section 25125, subdivision (c), provides: "Capital gains and losses from sales of intangible personal property are allocable to this state if the taxpayer's commercial domicile is in this state."

Appellant argues that, since the capital gain was nonbusiness income from the sale of an intangible (its partnership interest), it should be allocated as provided in section 25125; that is, to the state of appellant's commercial domicile, Tennessee, rather than to California. Respondent contends that the gain should be allocated to California because it was derived from property located in this state.

Respondent states that if the gain were from the sale of real property, there is no question but that it would be taxable by California, since subdivision (a) of section 25125 provides that capital gains from the sale of real property located in this state are allocable to this state. We agree with respondent, but fail to see the relevance of this statement, since real property, as even respondent appears to admit, was not sold.

Respondent appears to argue that appellant's interest in the partnership was not intangible personal property. Respondent does not, however, attempt to characterize the nature of appellant's partnership interest. However, it was clearly not real property, so it must have been personal property of some kind. This conclusion is supported by the California Corporations Code, which specifically provides that a partner's interest in a partnership is personal property. (Corp. Code, § 15026; Stilgenbaur v. United States, 115 F.2d 283, 286 (9th Cir. 1940).) Since a partnership interest is clearly not tangible personal property, it must be intangible personal property. In the absence of any evidence to the contrary, we must so conclude.

Respondent then abandons the line of argument described above and contends that, even if the partnership interest were an intangible, that characterization is irrelevant, since it is the location of the partnership property which determines the source of a partner's income. In support of this proposition, respondent cites the Appeal of Custom Component Switches, Inc. decided by this board on February 3, 1977, and the Appeal of H. F. Ahmanson & Co., decided by this board on April 5, 1965.

Those two appeals both involved the allocation of distributive shares of current partnership losses and neither considered the question of allocating capital gains from the sale of an interest in a partnership. Respondent argues that this makes no difference, because "such gains or losses cannot be separated from the gain or loss on the sale of partnership property." (Resp. Br. at 10.) Whether or not respondent's statement is true, it is irrelevant because we are considering here the sale of a partner's interest, not the sale of partnership property. Although it is fairly obvious that respondent would like to have us treat this sale as that of real estate, real estate was not sold and, in fact, appellant could not have separately sold its interest in the real estate. (Corp. Code, § 15025, subd. (b), Security First Nat. Bank v. Whittaker, 241 Cal.App.2d 554 [SO Cal.Rptr. 652] (1966).)

Respondent's second major argument appears to be that subdivision (c) of section 25125 is a codification of the common law doctrine of mobilia sequuntur personam, and should be subject to the common law exception to this doctrine, the "business situs" exception, which is codified in section 23040. These doctrines were often used in pre-UDITPA cases to allocate the income from intangibles to a particular state as the source of the income. (See Appeal of Standard Oil of California, Cal. St. Bd. of Equal.,, Mar. 2, 1983.)

However, as we stated in Standard Oil, supra, "[w]ith the adoption of UDITPA, however, section 25101 was amended to mandate application of the UDITPA provisions in determining income derived from California sources." We have also held that the provisions of section 23040 do not override the provisions of section 25101. (Appeal of Pacific Telephone and Telegraph Company, Cal. St. Bd. of Equal., May 4, 1978.)

The foregoing leads us inevitably to the conclusion that when a taxpayer has income from sources both within and without the state, the UDITPA provisions are the exclusive method to be used for apportioning and allocating that taxpayer's business and nonbusiness income. Therefore, we must look to UDITPA for the proper method of allocating appellant's capital gains.

Subdivision (c) of section 25125 provides a specific rule for allocating nonbusiness capital gains from intangibles. However, respondent contends that under section 25137, the gain should be allocated to

California. Section 25137 authorizes discretionary adjustments to the statutory allocation and apportionment methods only in exceptional circumstances, that is, where UDITPA's basic provisions "do not fairly represent the extent of the taxpayer's business activity in this state." (Rev. & Tax. Code, § 25137.) The party seeking to deviate from the statutory formula bears the burden of proving that such exceptional circumstances exist. (Appeal of New York Football Giants, Inc., Cal. St. Bd. of Equal., Feb. 3, 1977.) We do not believe that respondent has met this burden.

Respondent has presented no proof as to what appellant's activities were in this state, beyond an allegation that they involved "developing the Orange County property." (Resp. Br. at 20.) Such a vague, unsupported allegation does not meet respondent's burden of showing that appellant's business activity would not be fairly represented if the capital gains were allocated outside California.

Respondent contends that "appellant's position would lead to the anomalous [situation] -in which California would tax the identical property when sold by . . . the partnership itself but not when the partners sell their interest& in the partnership." (Resp. Br. at 21.) We fail to see the anomaly in this since the partnership property and the partners' interest in the partnership are different interests and different tax results often occur depending upon the type of interest which is sold. In any case, this "anomalous" situation does not show that appellant's business activity in this state is not fairly represented by applying the normal allocation rules of UDITPA.

Respondent, having conceded that the income in question is nonbusiness income, has not presented any argument which convinces us that the normal allocation provisions of section 25125 should not be used. Accordingly, respondent's action in allocating the gain from the sale of appellant's partnership interest to California must be reversed.

Appeal of Holiday Inns, Inc.

ORDER

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 Holiday Inns, Inc., against proposed assessments of additional franchise tax in the amounts of $98,230.53, $175,214.48, $123,193.26, $70,950.47, and $37,720.32 for the income years 1970, 1971, 1972, 1973, and 1974, respectively, be and the same is hereby reversed with respect to its allocation of the gain from the sale of appellant's partnership interest.

Done at Sacramento, California, this 9th day of April, 1986, by the State Board of Equalization, with Board Members Mr. Nevins, Mr. Collis, Mr. Bennett and Mr. Harvey present.

Richard Nevins, Chairman

Conway H. Collis, Member

William M. Bennett, Member

Walter Harvey*, Member

______________________, Member

*For Kenneth Cory, per Government Code section 7.9