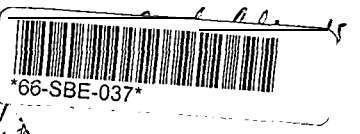
Reallocation of pa
share in partnersh
family relationship



BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of

SAM T. AND ANDREA K. HAYWARD

Appearances:

For Appellants: William H. Jeffrey
Certified Public Accountant

For Respondent: Burl D. Lack
Chief Counsel

O P I N I O N

This appeal is made pursuant to section 19059 of the Revenue and Taxation Code from the action of the Franchise Tax Board in denying the claims of Sam T. and Andrea K. Hayward for refund of personal income tax as follows:

YEAR	SAM T. HAYWARD	ANDREA K. HAYWARD
1946	$1,160.54	$1,210.21
1947	1,761.44	2,120.16
1948	269.39	1,471.03

Appellants, who are husband and wife, filed separate income tax returns for the years on appeal. They have several children, who also filed separate returns. Part of Andrea Hayward's taxable income is community income earned by her husband and part is derived from capital investments on her own behalf.

Appellants are members of eight partnerships engaged in operating various businesses. Their children and trustees for their children were also purportedly partners in these enterprises, having contributed capital which had originally been given to them by appellants. At least one of the partners in each of the businesses was not a trustee and had no family relationship with appellants.

After auditing their federal income tax returns, the federal authorities allocated to appellants a portion of the partnership income which had been reported by the children and by the trusts of which the children were beneficiaries. The federal revenue agent's report set forth the reasons for the reallocation as follows:

> ...(2) inclusion of certain partnership income previously reported as income of children and now determined not bona fide partners, (3) reallocation of 37-1/2% of income from partnership interest of his family members and trusts to this taxpayer as income earned by his services.

Respondent Franchise Tax Board issued notices of proposed deficiencies and of overpayments to the related taxpayers based on the adjustments made by the federal authorities. The deficiencies were thereafter satisfied, in part through offsets against overpayments, the offsets being made with the consent of the taxpayers involved.

The claims for refund which are in question in this appeal were filed by appellants on the ground that the reallocation of income was improper.

Appellants contend that a family partnership is either wholly valid or wholly invalid and cannot be considered partially invalid. They allege that each partner here involved owned the property which he contributed, that property was a principal factor in the earning capacity of each partnership, and that the services rendered by Sam T. Hayward to each partnership were minimal.

During the years on appeal there were no California statutes relating specifically to family partnerships and there are no reported decisions by California courts on the issue before us. In this period, however, the California and federal income tax laws were substantially the same in all material respects and, therefore, decisions by federal courts on the issue are relevant. The subject of family partnerships is now expressly covered by similar California and federal statutes. (Rev. & Tax. Code, § 17859; Int. Rev. Code of 1954, § 704(e).) We shall, however, consider only those federal decisions covering years before the enactment of the specific statutes.

The federal courts have long been concerned with

the problem presented where members of the same family purport to enter into partnership with each other with the object of splitting income to gain the advantage of lower tax brackets. In Commissioner v. Culbertson, 337 U.S. 732, 742 [93 L. Ed. 1659, 1665], it was held that the validity of a family partnership turns upon

> ... whether, considering all the facts - the agreement, the conduct of the parties in execution of its provisions, their statements, the testimony of disinterested persons, the relationship of the parties, their respective abilities and capital contributions, the actual control of income and the purposes for which it is used, and any and all other facts throwing light on their true intent - the parties in good faith and acting with a business purpose intended to join together in the present conduct of the enterprise.

Depending upon the particular facts, the reported income of a family partnership during the years in question could be reallocated to assign income derived from personal services to the persons who rendered the services and the income from property to the actual owners of the property. (Wofford v. Commissioner, 207 F.2d 749; Max German, 2 T.C. 474; Stanback v. Commissioner, 271 F.2d 514.)

Section 18451 of the Revenue and Taxation Code provides that if a change is made by the federal government in a taxpayer's income as reported in a federal return, the taxpayer shall "concede the accuracy of such determination or state wherein it is erroneous." The action taken by the Franchise Tax Board is presumed correct and the burden is on the taxpayer to prove error. (Todd v. McColgan, 89 Cal. App. 2d 509 [209 P.2d 414]; Cal. Admin. Code, tit. 18, § 5036; Poggetto v. United States, 193 F. Supp. 688, aff'd, 306 F.2d 76.)

The facts and arguments offered by appellants fall far short of establishing that respondent erred in reallocating the partnership income. Any finding that the children or their trustees were bona fide partners must rest upon detailed facts such as those specified in Commissioner v. Culbertson, supra. The reallocation of income, in turn, depends upon the amount of income attributable to personal services and the amount attributable to property actually owned by the individuals concerned. Upon these critical points, appellants have presented only self-serving general allegations unsupported by testimony or documentary evidence.

Appeal of Sam T. and Andrea K. Hayward

On the record before us, appellants are not entitled to the refunds which they claim.

O R D E R

Pursuant to the views expressed in the opinion of the board on file in this matter, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section 19060 of the Revenue and Taxation Code, that the action of the Franchise Tax Board in denying the claims of Sam T. and Andrea K. Hayward for refund of personal income tax as follows, be and the same is hereby sustained:

YEAR	SAM T. HAYWARD	ANDREA K. HAYWARD
1946	$1,160.54	$1,210.21
1947	1,761.44	2,120.16
1948	269.39	1,471.03

Gone at Pasadena, California, this 28th day of June, 1966, by the State Board of Equalization.

_____, Chairman

_____, Member

_____, Member

_____, Member

_____, Member

Attest: _____, Acting Secretary