

Appeal of Angelus Hudson, Inc.

The question presented is whether, in computing its income subject to taxation by California, appellant, a California corporation, may deduct the distributive losses incurred by a Louisiana partnership in which appellant is a partner.

Appellant is engaged in the refuse disposal business in Los Angeles. With the exception of the partnership at issue, appellant does not engage in any activities outside California. In December of 1978, appellant invested \$20,000 of accumulated earnings in a partnership with Fiscal Dynamics Incorporated involving an interest in three oil wells to be drilled in Louisiana. Appellant was not active in the actual drilling. In the year at issue, the drilling activity yielded no income. Appellant deducted intangible drilling costs of \$18,000 on its 1978 California return. Respondent disallowed this deduction on the basis that the loss was generated from sources outside California.

The net income by which the franchise tax is measured is restricted to net income from California sources. (Rev. & Tax. Code, § 25101.) Conversely, any losses from California sources are deductible while losses attributable to out-of-state sources are not deductible. (Appeal of Custom Component Switches, Inc., Cal. St. Bd. of Equal., Feb. 3, 1977; Appeal of H. F. Ahmanson & Co., Cal. St. Bd. of Equal., April 5, 1965.)

The Ahmanson case presented an issue very similar to the instant appeal. In Ahmanson, the corporate appellant was primarily engaged in the insurance business in California but also was a limited partner in two partnerships engaged in oil exploration in Turkey. The partnership incurred losses in the oil venture, and the taxpayer attempted to deduct those losses from its California income. In denying the taxpayer's claim, we concluded that the source of a partner's income is where the property is located and where the partnership activity is carried on.

Since the deduction in question arose from partnership property outside California, respondent's action in disallowing the deduction was correct and **must** be sustained.

