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7 **BOARD OF EQUALIZATION**

8 **STATE OF CALIFORNIA**

9  
10 In the Matter of the Appeal of: ) **REHEARING SUMMARY**  
11 ) **PERSONAL INCOME TAX APPEAL**  
12 **RONALD N. FRAZAR AND** ) Case No. 494349  
13 **JANE A. FRAZAR<sup>1</sup>** )  
14 \_\_\_\_\_ )

	<u>Years</u>	<u>Proposed Assessment</u>
	2005	\$231,226
	2006	\$236,238

18 Representing the Parties:

19  
20 For Appellant: Marilyn Barrett, Attorney at Law  
21 For Franchise Tax Board: Natasha Sherwood Page, Tax Counsel III  
22

23 QUESTION: Whether respondent properly determined that nonresident appellants were subject to  
24 income tax on installment income from a sale of stock that occurred in California in  
25 a prior year when appellants were residents of California.

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27 \_\_\_\_\_  
28 <sup>1</sup> Appellants are currently residents of and domiciled in Montana.

1 HEARING SUMMARY

2 Prior Hearing

3 On June 16, 2010, the Board held an oral hearing in this appeal and sustained the  
4 determination of the Franchise Tax Board (FTB or respondent) that gain on installment payments from  
5 the sale of appellants' shares of Citizens Development Corporation (Citizens) stock remained taxable  
6 California source income when appellants received those payments after they became residents of  
7 Montana. Appellants then filed a petition for rehearing pursuant to section 19048 of the Revenue and  
8 Taxation Code (R&TC), which the Board granted on February 22, 2011.

9 Background

10 Appellants were long-time California residents prior to moving to Montana in December  
11 of 2004. In May and June of 2004, appellants entered into two installment sales agreements for the sale  
12 of stock in Citizens and for the sale of property known as FPA LSM Executive Golf Course (Lake San  
13 Marcos). Under the stock purchase agreement for Citizens, the shareholders (appellants and one other  
14 party) agreed to sell the stock concurrently with the sale of Lake San Marcos. The agreement recited a  
15 sale price of \$23 million with \$3 million due upon close of escrow, \$10 million in new loan proceeds  
16 upon closing and \$10 million in a seller carry-back loan with \$2 million due one year after closing, \$2  
17 million due two years after closing and the balance due eight years after closing. Under the agreement  
18 for the purchase and sale of Lake San Marcos, appellants' general partnership agreed to sell the property  
19 for a sale price of \$6 million, \$1.5 million in cash upon close of escrow and \$4.5 million in a seller  
20 carry-back loan with \$1 million due one year after closing and the balance of \$3.5 million due seven  
21 years after closing. The promissory note was later amended to provide that the \$1 million payment due  
22 one year after closing would not be due until seven years after closing. (Resp. Open. Br., pp. 1-2.)

23 On December 2, 2004, appellants moved to Montana and established domicile in that  
24 state. Respondent does not challenge appellants' residency in Montana during the years in issue. In  
25 2005 and 2006, appellants received installment payments of \$2,070,000 and \$2,484,000 for the sale of  
26 the Citizens' stock. Appellants did not report any income from these transactions on their California  
27 income tax returns for 2005 and 2006. Appellants did not elect out of the installment method under  
28 Internal Revenue Code (IRC) section 453 and R&TC section 17551. Respondent determined that

1 appellants incorrectly failed to report the installment sale income in 2005 and 2006 which respondent  
2 determined was sourced to California, and issued Notices of Proposed Assessment (NPAs) for both  
3 years 2005 and 2006 on October 27, 2008. The NPA for 2005 proposed additional tax in the amount of  
4 \$231,226 and the NPA for 2006 proposed additional tax in the amount of \$236,228.

5 Appellants protested the NPAs and respondent affirmed them by Notices of Action issued  
6 on June 8, 2009. This timely appeal followed. (Resp. Open. Br., pp. 2-3.)

7 **Issue: Whether respondent properly determined that nonresident appellants were subject to**  
8 **income tax on installment income from a sale of stock that occurred in California in a prior**  
9 **year when appellants were residents of California.**

10 Contentions

11 Appellants' Opening Brief

12 Appellants argue that the issue is whether California can impose income taxes on the  
13 2005 and 2006 installments under California Code of Regulations, title 18, section (Regulation) 17952,  
14 subdivision (d) (the "Amended Regulation") or under the doctrine of *mobilia sequuntur personam* of  
15 *Miller v. McColgan* (1941) 17 Cal.2d 432 [hereinafter, *Miller*]. Appellants argue that the Board's prior  
16 decision is wrong because: (1) the Board "failed to rule on Petitioner's position that the Amended  
17 Regulation became effective on August 1, 2007, and cannot be applied retroactively . . . [;]" (2) "[u]pon  
18 repeal of Section 17554, there was no statutory, regulatory or judicial basis for subjecting installment  
19 payments received when Petitioners were no longer resident in California[;] (3) Members of the Board  
20 who concluded that there was no change in the law when Section 17554 was repealed are wrong and the  
21 Amended Regulation is invalid[; and] (4) in its July 18, 2010 letter to Petitioner concerning its  
22 determination in this case, the Board failed to describe the reasons underlying its determination."  
23 (App. Op. Rehearing Br., pp. 1-2.)

24 As background, appellants note that former R&TC section 17554 provided that "[w]hen  
25 the status of a taxpayer changes from resident to nonresident, or from nonresident to resident, there shall  
26 be included in determining income from sources within or without this state, as the case may be, income  
27 and deductions accrued prior to the change of status even though not otherwise includable in respect of  
28 the period prior to that change, but the taxation or deduction of items accrued prior to the change of

1 status shall not be affected by the change.” Appellants further note that R&TC section 17554 was  
2 repealed in 2001 by AB 1115, which bill also enacted R&TC section 17041. Appellants quote R&TC  
3 section 17041, subdivision (b), which imposes a tax on “taxable income of a nonresident or part-year  
4 resident[.]” and R&TC section 17041, subdivision (i)(3), which provides that “[f]or purposes of  
5 computing ‘taxable income of a nonresident or part-year resident’ . . . any carryover items, deferred  
6 income, suspended losses, or suspended deductions shall only be includable or allowable to the extent  
7 that the carryover item, deferred income . . . was derived from sources within this state, calculated as if  
8 the nonresident or part-year resident, for the portion of the year he or she was a nonresident, had been a  
9 nonresident for all prior years. [emphasis added by appellants]” (App. Op. Rehearing Br., pp. 2-3.)

10 Appellants further note that the Amended Regulation became effective on August 1, 2007  
11 and states as follows:

12 (d) The source of gains and losses from the sale or other disposition of intangible  
13 personal property is determined at the time of the sale or disposition of that property. For  
14 example, if a California resident sells intangible personal property under the installment  
15 method, and subsequently becomes a nonresident, any later recognized gain attributable  
16 to any installment payment receipts relating to that sale will be sourced to California  
(absent a business situs exception). Further, a California nonresident who sells intangible  
17 personal property would be taxed by California on gain as it is recognized upon receipt of  
18 future installment payments if the intangible personal property had a business situs in  
19 California at the time of the sale.

20 Appellants argue that the Amended Regulation is invalid, but, even if it is found to be  
21 valid, it cannot be applied retroactively to appellants’ transaction. Appellants argue that Government  
22 Code section 11340 *et seq.* (the “Administrative Procedure Act”) was enacted to vest authority in a  
23 central office in order to insure that regulations are written in a comprehensible manner, are authorized  
24 by statute, and are consistent with other law. Appellants state that the Legislature expressed its belief  
25 that this office was necessary because the increasing number of confusing legislations imposed an undue  
26 burden on California residents and businesses. (App. Op. Rehearing Br., p. 4.)

27 Appellants state that Government Code section 11340.9 provides that Section 11340 *et*  
28 *seq.* does not apply to, among other things a “legal ruling of counsel issued by the Franchise Tax Board  
or State Board of Equalization.” Appellants argue that, with respect to permissible effective dates for  
regulations, section 11343.4 of the Government Code provides that:

A regulation or an order of repeal required to be filed with the Secretary of State shall  
become effective on the 30<sup>th</sup> day after the date of filing unless:

1 (a) Otherwise specifically provided by the statute pursuant to which the regulation or  
2 order of repeal was adopted, in which event it comes effective on the day prescribed by  
statute.

3 (b) A later date is prescribed by the state agency in a written instrument filed with, or  
as part of, the regulation or order of repeal.

4 (c) The agency makes a written request to the office demonstrating good cause for an  
earlier effective date, in which case the office may prescribe an earlier date.”

5 Appellants note that section 11346.2(a) provides that notice of proposed regulations must be filed and  
6 made available to the public. (App. Op. Rehearing Br., pp. 5-6.)

7 Having set forth the above background, appellants argue that respondent made the  
8 Amended Regulation effective on August 1, 2007, “but now, since the transaction at issue in this case  
9 was consummated more than three years before the regulation was effective, Respondent takes the  
10 position that the Amended Regulation is retroactive.” Appellants note that respondent argues that the  
11 Amended Regulation is only a clarifying regulation, but state that, “while Government Code section  
12 11340.9 excludes some regulations and agency pronouncements, it does not exclude regulations issued  
13 by Respondent.” Appellants argue that section 11340.9 specifically excludes rulings by legal counsel of  
14 Respondent “but notably fails likewise to exclude regulations by Respondent, clarifying or otherwise[,]”  
15 citing *Central Bank of Denver v. First Interstate Bank* (1994) 511 U.S. 164 and other cases to the effect  
16 that legislators know how to impose express statutory requirements or exceptions when they choose to  
17 do so. Appellants further contend that respondent has provided no notice that the Amended Regulation  
18 would be applied retroactively, and respondent’s failure to do so recognizes the constraints on its ability  
19 to make regulations retroactive. (App. Op. Rehearing Br., p. 6.)

20 Appellants argue that respondent’s current attempt to apply the Amended Regulation  
21 retroactively violates the Administrative Procedure Act under Government Code sections 11346.2 and  
22 11343.4 because respondent did not publicly disseminate the terms of the proposed regulation.  
23 Appellants argue that the public was not alerted to the retroactivity of the regulation, citing to The  
24 Taxpayers’ Bill of Rights, Government Code section 11364 *et seq.*, *Snap-Drape, Inc. v. Comm’r* (5th  
25 Cit. 1996) 297 U.S. 129 (holding that the IRS does not have carte blanche authority to issue retroactive  
26 regulations) and *Manhattan General Equipment Co. v. Comm’r of Internal Revenue* (1936) 297  
27 U.S. 129. (App. Op. Rehearing Br., p. 7.)

28 Appellants state that respondent has alluded to R&TC section 19503, which provides

1 generally that no regulation shall apply to any taxable year ending before the date on which any notice  
2 substantially describing the expected contents of any regulation is issued to the public. Appellants state  
3 that respondent issued its notice in 2003, but it was not broadly disseminated and many tax professionals  
4 were not aware of the proposed amendment. Moreover, appellants contend, the notice failed to include  
5 notice of respondent's intent to retroactively apply the Amended Regulation. In addition, appellants  
6 contend that section 19503 does not override the 30-day requirement of Government Code section  
7 11343.4. Appellants contend that section 19503 provides an additional and overlapping restriction on  
8 the permissible effective date of tax regulations. Citing *Montclair v. Ramsdell* (1883) 107 U.S. 147 and  
9 *Connecticut Nat'l Bank v. Germain* (1992) 503 U.S. 249, appellant argues that every clause or word of a  
10 statute should be given effect if possible and and two overlapping statutes should be given effect so long  
11 as there is no positive repugnance between them. (App. Op. Rehearing Br., pp. 7-8.)

12 Appellants contend that there is no legal basis for taxing the installment payments  
13 because the doctrine of *Mobilia sequuntur personam* was "expressly repudiated by the State Legislature  
14 when it enacted Section 17956 in 1955 and again when it replaced Section 17956 with Section 17554 in  
15 1983 to replace the *mobilia* principle with the accrual method." Appellants contend that respondent  
16 seems to be arguing, even though the *mobilia* principle has been repudiated by the Legislature, it  
17 "magically sprang back as the applicable law when Section 17554 was itself repealed, even though the  
18 State Legislature gave absolutely no indication that it believed the *mobilia* principle should determine  
19 the 'source' of income from intangibles and had twice repudiated it as the applicable test for a span of at  
20 least 46 years." (App. Op. Rehearing Br., pp. 8-9.)

21 Appellants further contend that respondent has admitted that the test to determine the  
22 source of gain from sales of intangible property was not defined after the repeal of section 17554.  
23 Appellants contend that the FTB Staff Report related to the Amended Regulation stated that "it was  
24 determined by FTB staff that *existing sourcing rules did not adequately address* the timing of  
25 determining the correct sourcing rule to apply in the case of the sale . . . of intangible property.  
26 [emphasis added by appellants]" Appellants further contend that in its Initial Statement of Reasons for  
27 the Amended Regulation, the FTB stated "if a California resident sells intangible property under the  
28 installment method . . . and subsequently moves away, *there may be some ambiguity* as to the source of

1 the gain. *Arguably*, the *mobilia* principle already provides that the source of the gain is in  
2 California . . . . [emphasis added by appellants]” (App. Op. Rehearing Br., p. 9.)

3 With regard to R&TC section 17041(i)(3), appellants argue that the provision states that  
4 deferred income will be includable only to the extent derived from sources within the state, but there is  
5 no statutory provision which defines what factors determine the “source” of income. Appellants argue  
6 that there can be no “automatic” sourcing and state that there are different definitions of “source” when  
7 dealing with intangible property, including: R&TC section 13402, which provides that, in the case of  
8 non-U.S. residents, intangible personal property sourced in California includes stock of corporations  
9 organized under California law, having a principle place of business in California or doing a major part  
10 of its business in California, regardless of domicile; IRC section 865, which for many years defined the  
11 source of gain on the sale of personal property as where legal title passed, but was only changed by the  
12 Tax Reform Act of 1986 to change source to the seller’s domicile (subject to exceptions); and R&TC  
13 section 17952, which provides an exception to domicile even in the case of sales of intangible property,  
14 namely, the business situs sourcing rule. (App. Op. Rehearing Br., pp. 9-10.)

15 Appellants contend that respondent’s statement that “arguably” the *mobilia* principle  
16 already provides the sourcing rule does not grant respondent the ability to make law. Further, appellant  
17 states, respondent’s position “flies in the face of the express repudiation of [the *mobilia* principle by the  
18 State Legislature on at least two separate occasions, which repudiation spanned at least 46 years . . . .”  
19 Appellants contend that “while the State Legislature’s failure to define the ‘source’ of sales of intangible  
20 property may appear to be a gap in the law, it is a gap that must be filled by the State Legislature and not  
21 Respondent[,]” citing *County of Los Angeles v. State Dept. of Public Health* (1958) 158 Cal. App. 2d 425  
22 and other cases. (App. Op. Rehearing Br., pp. 10-11.)

23 Appellants contend that, in response to a request by the Board of Equalization concerning  
24 the application of Business and Professions Code section 16102 pertaining to sales activities of military  
25 veterans, the California Attorney General reminded the Board of Equalization that its rulemaking  
26 authority is “limited to interpreting and clarifying matters within its jurisdiction as defined by statutes  
27 and the Constitution. It has no power to create taxes or to carve out new exemptions.” (Citing to 2010  
28 Cal. AG LEXIS 13, 93 Ops. Ca. Atty. Gen. 70 (July 19, 2010).) (App. Op. Rehearing Br., p. 11.)

1 Appellants argue that several Board members “justified the Amended Regulation on the  
2 basis that there was ‘no change in the law.’” Appellants contend that, since section 17554 clearly  
3 applied the accrual method, these Board members “apparently equate the accrual method with domicile  
4 and believe that the two sourcing principles produce the same result.” Appellants argue that this is  
5 incorrect and that FTB Legal Ruling No. 340 (withdrawn) provides an example of the different results  
6 that would apply under the two methods. In that ruling, the taxpayers sold patent rights for a percentage  
7 of sales while they were resident in California. At that time, R&TC section 17596, the predecessor to  
8 section 17554, applied, and respondent found that the income only accrued when the right to receive the  
9 income was “fixed and the amount thereof can be reasonably accurately determined.” Because the  
10 amount could not be determined, respondent ruled the income had not accrued and was not subject to  
11 tax. In contrast, appellants contend, if the income had been sourced based on domicile, the income  
12 would have been subject to California tax because the sale took place while the taxpayers were  
13 domiciled in California. (App. Op. Rehearing Br., pp. 12-13.) Appellants therefore contend that, prior  
14 to the repeal of section 17554, the source of income from the sale of intangibles was based on the  
15 accrual method and, after the repeal of section 17554, the Legislature “failed to enact a provision that  
16 defined ‘sourcing’ of gain or loss from intangibles.” Further, appellants contend, respondent cannot  
17 make new law, especially when the rule at issue has been “expressly repudiated on at least two  
18 occasions” by the Legislature. (App. Op. Rehearing Br., pp. 12-13.)

19 Appellants further argue that the Board’s July 18, 2010 letter notifying appellants of its  
20 decision failed to offer an adequate explanation of its decision. Appellants contend that the Board  
21 “failed to even discuss Petitioner’s argument that Regulation 17952(d), which is expressly stated to be  
22 effective August 1, 2007, cannot be applied retroactively.” Citing R&TC sections 19045 and 19047,  
23 appellants argue that, as the appellate body for appeals from income and franchise tax assessments, the  
24 Board must, as required by section 19047, “. . . notify the taxpayer and the Franchise Tax Board of its  
25 determination and the reasons therefore. [emphasis added by appellants] Appellants argue that the  
26 Board’s letter failed to fulfill its obligations and requests that the Board’s determination letter in this  
27 proceeding “include a full explanation of its reasons for its decision, including, but not limited to”  
28 explanations regarding (1) whether Government Code § 11342.2 applies to prohibit retroactive

1 application of the Amended Regulation, (2) whether the *mobilia* doctrine remains good law in light of  
2 the enactment of R&TC sections 17956 and 17554, FTB’s issuance of Legal Ruling No. 340 and the  
3 Legislature’s power to repudiate a judicial decision, (3), if the Board finds the Amended Regulation  
4 valid, whether respondent “has the legal authority to fill in legislative gaps via regulation.” (App. Op.  
5 Rehearing Br., pp. 14-15.)

6 Respondent’s Reply Brief

7 In summary, respondent argues that the Board correctly decided the case initially and that  
8 R&TC section 17041 operates to tax nonresidents on California source income, even when deferred.  
9 Respondent contends that appellants are arguing “about repealed code sections and improperly amended  
10 regulations and unclear or insufficient Board decisions,” but appellants “still owe the tax on the initial  
11 sale because moving away before you receive your next installment when you deferred tax under the  
12 installment method doesn’t make your tax liability go away.” (Resp. Reply Br., p. 2.) In further  
13 explanation, respondent makes four arguments, which are summarized below.

14 First, respondent argues that R&TC section 17041 taxes nonresidents on deferred income  
15 sourced to California. Respondent argues that, in this case, appellant’s income was deferred under the  
16 installment method, and, had this deferral not been available to them, the entire gain would have been  
17 taxed in 2004. Respondent argues that when California adopted the installment method, it merely  
18 delayed the collection of tax, rather than waiving the tax. (Resp. Reply Br., pp. 2-3.)

19 Second, respondent argues that gain on the sale of appellants’ stock is properly sourced to  
20 California under the *mobilia* doctrine. Citing *Miller, supra*, respondent contends that, under the *mobilia*  
21 doctrine, intangible property, such as stock, has a taxable situs at the residence of the owner. Since  
22 appellants were California residents at the time they sold the stock, respondent contends, the gain on the  
23 sale of the stock is California source income. (Resp. Reply Br., pp. 3-4.)

24 Respondent states that there are many cases that cite *Miller* in the corporate tax context  
25 where *mobilia* is used regularly to source income to a corporation’s commercial domicile. Respondent  
26 contends that, in the personal income tax context, *Miller* and the *mobilia* doctrine were most recently  
27 confirmed by the California Court of Appeal in 1976 in *Christman v. Franchise Tax Board* (1976)  
28 64 Cal.App.3d 751 [hereinafter, *Christman*]. Respondent states that the Board most recently recognized

1 the *mobilia* doctrine in the personal income tax context in *Appeal of Childs*, 80-SBE-085, decided  
2 August 1, 1980. (*Ibid.*)

3 Third, respondent argues that R&TC section 17554 is irrelevant in this appeal.  
4 Respondent states that the installment method is an accounting method which is set forth in R&TC  
5 section 17551 (which conforms to IRC section 453). Respondent contends there is no dispute that  
6 appellants deferred income under R&TC section 17551, and, rather than discussing this provision,  
7 appellants' brief "clouds the discussion with section 17554." Respondent notes that R&TC section  
8 17554 was repealed years before appellants' transactions. (Resp. Reply Br., pp. 4-5.)

9 Respondent argues that appellants' contention that former R&TC section 17554 was the  
10 sole basis for taxing installment sales conducted by former residents is contradicted by several cases  
11 from the Board which hold that R&TC section 17554 does not apply in the case of former residents.  
12 Respondent cites *Appeal of Baustian*, 79-SBE-054, decided March 7, 1979, which, addressing R&TC  
13 section 17596 (the predecessor to section 17554), stated that "[w]ith respect to income accrued  
14 subsequent to a change of residency status, the taxability of such income is governed solely by section  
15 17041." Respondent states that the Board confirmed this position in *Appeal of Moser*, 81-SBE-077,  
16 decided June 23, 1981, in which it stated that "[t]he taxability of California source income is unaffected  
17 by Section [17554], since under section 17041, such income is taxable by California regardless of the  
18 residency status of the recipient." Respondent contends that the Board's decision in *Appeal of Money*,  
19 83-SBE-267, put the "last nail . . . into the section 17554 coffin with respect to former residents of  
20 California" by stating that:

21 For a number of years this board has been concerned with the increasing attempts to give  
22 section [17554] a broad application. It has long been our conviction that this section was  
never intended to override fundamental tax principles regarding the taxation of residents.

23 With these considerations in mind, we have felt that section [17554] should be as limited  
24 as possible in its application to prevent the contravention of these fundamental principles.  
25 We noted previous appeals where we held that section [17554] was irrelevant when  
taxation was imposed on a source basis.

26 Respondent states that, in *Paine v. Franchise Tax Board* (2004), 118 Cal. App. 4th 63,  
27 the California Court of Appeal adopted the holding from *Appeal of Money* when it stated that the  
28 provision is only intended to avoid treating accrual and cash basis taxpayers differently and only applies

1 when two conditions are satisfied: “(1) when California’s sole basis for taxation is the taxpayer’s  
2 residency, and (2) when that taxation would differ depending on whether the taxpayer used the accrual  
3 method or the cash method of accounting.” (Resp. Reply Br., pp. 5-6.)

4 Respondent also argues that it is “patently untrue” that the Legislature repudiated the  
5 *mobilia* doctrine when it adopted the predecessors to R&TC section 17554 in 1955 and 1983.  
6 Respondent states that the predecessor to R&TC section 17554 was adopted in 1941, as subsection (g) to  
7 section 16 of the Personal Income Tax Act. Respondent states that the only differences between the  
8 provision as originally enacted and as ultimately repealed were minor, such as not capitalizing the word  
9 “State” and changing the spelling of “includible” to “includable.” Therefore, respondent argues, R&TC  
10 section 17554 was not adopted in 1955 or 1983 as an express repudiation of the *mobilia* doctrine, and,  
11 furthermore, it “has always been an accounting rule, not a sourcing rule.” Respondent further notes that  
12 when originally enacted, the section was entitled “Accounting Period,” and that the words “income from  
13 sources within or without the State, *as the case may be*” further confirm that R&TC section 17554 was  
14 an accounting provision and the Legislature intended that the sourcing determination be found  
15 elsewhere. (Resp. Reply Br., p. 7.)

16 Fourth, respondent argues that subsection (d) of Regulation 17952 is properly applied  
17 “since its principle has no effective date.” Respondent states that it promulgated subsection (d) merely  
18 as a clarification to “directly state that source is determined at the time of realization, i.e., at the time of  
19 the sale of the stock.” Respondent argues that “it makes no sense that a sourcing rule would be applied  
20 at some other time than at the time that the income was realized,” and “there is no need for the  
21 regulation to reach this result.” Furthermore, respondent contends, appellants’ objections to the *mobilia*  
22 doctrine are misplaced in light of the “solid 70-year history of the *mobilia* sourcing rule in California.”  
23 (Resp. Reply Br., p. 8.)

#### 24 Appellant’s Reply Brief

25 In their reply brief, appellants argue that the Board’s prior decision is wrong because  
26 (1) the Board failed to rule on whether the Amended Regulation can be applied retroactively, (2) upon  
27 repeal of section 17554, “there was no statutory, regulatory or judicial basis for subjecting installment  
28 payments received when Petitioners were no longer resident in California,” (3) “Members of the Board

1 who concluded that there was no change in law when Section 17554 was repealed are wrong and the  
2 Amended Regulation is invalid, and (4) the Board’s determination letter “failed to describe the reasons  
3 underlying its determination.” (App. Reply Br., p. 2.)

4 With regard to respondent’s brief, appellants argue that *Paine v. FTB, supra, Appeal of*  
5 *Baustian, supra, and Appeal of Money, supra* do not support respondent’s position that section 17554  
6 would have no application to its appeal. Appellants argue that, even under those rulings, California’s  
7 sole basis for taxation would have been their residency, and if their residence had not been in California  
8 at the time of the sale, they would not have been subject to tax. Consequently, appellants argue,  
9 California “would have had no basis for taxing the sale (assuming the stock had not acquired a business  
10 situs within the meaning of Section 17952, an argument Respondent has not raised and which has no  
11 basis in fact) and the taxation would vary depending on whether the taxpayer used the cash or the  
12 accrual method of accounting.” (App. Reply Br., p.4.)

13 Appellants further argue that the Board rulings cited by respondent have been overturned  
14 by legislation. Appellants state the rulings deal with the sourcing of retirement income received by  
15 former residents, which the federal government overruled in the State Taxation of Pension Income Act  
16 of 1995, H.R. 104-389, which was enacted into law in 1996 and by later California legislation.  
17 (App. Reply Br., p. 5.)

18 Appellants further contend that, the predecessor statute to R&TC section 17554, as  
19 quoted by respondent, does not state that the source of income is determined by residency. Instead,  
20 appellants argue, it states that income “accrued” while a resident is taxable. (*Ibid.*)

21 Appellants argue that respondent is “flat wrong” in stating that case law cannot be  
22 overturned by statute. Appellants contend that R&TC section 17952, which provides that intangibles  
23 shall be sourced to California if they have a business situs in the state, “clearly overrides” *mobilia*, and  
24 Section 13402, which provides a sourcing rule that is not based on the decedent’s domicile, also  
25 overrides *mobilia*. (*Ibid.*)

26 Appellants further argue that, while respondent contends they are confusing accrual with  
27 sourcing, it is respondent that is confusing realization with sourcing. Appellants contend that if, as  
28 respondent asserts, it would make no sense to apply a sourcing rule at some other time than at the time

1 the income is realized, “Respondent would not tax installment payments received by residents for  
2 income realized when the taxpayer was not a resident.” Appellants argue that respondent’s own  
3 admission, when it proposed the Amended Regulation, that the *mobilia* doctrine “arguably” applies,  
4 shows that the application of the doctrine is not clear, and “an arguable position does not make the  
5 position law.” (App. Reply Br., p. 6.)

6 In sum, appellants argue that respondent is ignoring rules of statutory construction, the  
7 Administrative Procedure Act, and the separation of powers doctrine. Appellants state that “respondent  
8 has no power to enact legislation and when the state legislature enacted the predecessor to Section  
9 17554, it expressly repudiated the *mobilia* doctrine just as it did when it enacted the business situs rule  
10 of Section 17952 and the place of business rule in Section 13402.” (App. Reply Br., pp. 6-7.)

#### 11 Applicable Law

12 R&TC section 17041, subdivision (b)(1) generally provides, “[t]here shall be imposed [a  
13 tax] for each taxable year upon the taxable income of every nonresident or part-year resident” that is  
14 calculated in the manner prescribed therein. Subdivision (i) of R&TC section 17041 provides that the  
15 term “taxable income of a nonresident or part-year resident” includes “[f]or any part of the taxable year  
16 during which the taxpayer was not a resident of this state, gross income and deductions derived from  
17 sources within this state, determined in accordance with Article 9 of Chapter 3 (commencing with  
18 Section 17301) and Chapter 11 (commencing with Section 17951).” (Rev. & Tax. Code, § 17041, subd.  
19 (i)(1)(B).) R&TC section 17041, subdivision (i)(3) provides that “deferred income . . . shall only be  
20 includable or allowable to the extent that the . . . deferred income . . . was derived from sources within  
21 this state, calculated as if the nonresident . . . had been a nonresident for all prior years.”

22 R&TC section 17951, subdivision (a) provides that “[f]or purposes of computing ‘taxable  
23 income of a nonresident or part-year resident’” under the foregoing provision, the gross income of  
24 nonresident taxpayers “includes only the gross income from sources within this state.”

25 Subdivision (d) of Regulation 17952, which has been cited by the parties, was added to  
26 the regulation and became operative August 1, 2007. Subdivision (d) provides in relevant part that:

27 The source of gains and losses from the sale or other disposition of intangible personal  
28 property is determined at the time of the sale or disposition of that property. For  
example, if a California resident sells intangible personal property under the installment  
method, and subsequently becomes a nonresident, any later recognized gain attributable

1 to any installment payment receipts relating to that sale will be sourced to California  
2 (absent a business situs exception).

3 With respect to appellants' contention that the foregoing regulatory provision is  
4 unsupported by statutory authority and thus invalid, California Code of Regulations, title 18, section  
5 5412, subdivision (b)(1) provides that the Board does not have jurisdiction to consider "[w]hether a  
6 California statute or regulation is invalid or unenforceable under the Federal or California Constitutions,  
7 unless a federal or California appellate court has already made such a determination."

8 With respect to the retroactive application of regulations promulgated by respondent,  
9 paragraph (1) of subdivision (b) of R&TC section 19503 provides that:

10 (b) (1) Except as otherwise provided in this subdivision, no regulation relating to Part 10  
11 (commencing with Section 17001) . . . shall apply to any taxable year ending before the  
12 date on which any notice substantially describing the expected contents of any regulation  
is issued to the public.

13 Paragraph (2) of subdivision (b) excepts from the rule against retroactive application:

14 (A) Regulations issued within 24 months of the date of the enactment of the statutory  
15 provision to which the regulation relates [and]  
16 (B) Regulations issued within 24 months of the date that temporary or final federal  
regulations with respect to statutory provisions to which California conforms are filed  
with the Federal Register.

17 Subdivision (c) also provides, in part, that the exceptions "are operative with respect to regulations  
18 which relate to California statutory provisions enacted on or after January 1, 1998."

19 In *Miller, supra*, the California Supreme Court held in 1941 that when the Income Tax  
20 Act was enacted in 1935, the federal and state courts "declared that the taxation of intangibles was  
21 subject to the rule of *mobilia sequuntur personam*" so that shares of corporate stock have situs in the  
22 state or country where the owner resides. (*Miller v. McColgan, supra* at p. 439.) California appellate  
23 courts have cited *Miller v. McColgan, supra*, as the law of California with respect to the sourcing of  
24 intangible property for purposes of income taxation. For example, in *Milhous v. Franchise Tax Bd.*  
25 (2005) 131 Cal.App.4th 1260, 1269, the court of appeal held that California historically taxed income  
26 from intangibles when the owner is domiciled in California based on the doctrine of *mobilia sequuntur*  
27 *personam*, which means only that "it is the identity or association of intangibles with the person of their  
28 owner at his domicile which gives jurisdiction to tax."

1 Former R&TC section 17554 provided that:

2 When the status of a taxpayer changes from resident to nonresident, or from nonresident  
3 to resident, there shall be included in determining income from sources within or without  
4 this state, as the case may be, income and deductions accrued prior to the change of status  
5 even though not otherwise includable in respect of the period prior to that change, but the  
6 taxation or deduction of items accrued prior to the change of status shall not be affected  
7 by the change.

8 In the *Appeal of Virgil M. and Jeanne P. Money, supra*, the Board discussed the history and purpose of  
9 section 17554 and concluded that the statutory language:

10 [M]ust have been intended to prevent double taxation of income on a non-source  
11 jurisdictional basis when taxpayers change their residency status.

12 The Board also noted, however, that former R&TC section 17554 “was never intended to override  
13 fundamental tax principles” and, consequently, that section “should be as limited as possible in its  
14 application . . . .” With these considerations in mind, the Board developed what has become known as  
15 the “*Money Test*,” under which section 17554 will apply only when two conditions are met:

- 16 1. California’s sole basis for taxation is the taxpayer’s residency; and
- 17 2. Tax treatment would differ depending on whether the taxpayer used the accrual or the  
18 cash method of accounting.

19 The Board reaffirmed the *Money Test* and provided this description of section 17554:

20 [Section 17554] was designed merely to prevent California from treating cash-basis and  
21 accrual-basis taxpayers differently when they change residency and are subject to  
22 California tax by virtue of their residency. Consistent treatment is accomplished under  
23 [section 17554] by placing all taxpayers on the accrual method of accounting, even  
24 though a taxpayer may be on the cash receipts and disbursements accounting basis.

25 (*Estate of Albert (Dec’d) and Lillian Kahn*, 86-SBE-077, Apr. 9, 1986.)

26 Respondent also promulgated Regulation 17554 which provided, in pertinent part:

27 When a resident becomes a nonresident or a nonresident becomes a resident, the  
28 taxability of income and the allowability of deductions accrued prior to the change in  
29 residency status will not be affected by the change, even though the taxpayer may be on  
30 the cash receipts or disbursements accounting method. The taxable period during which  
31 such income or deductions are to be reported will nevertheless be determined in  
32 accordance with the taxpayer’s normal accounting period.

33 (Cal. Code Regs., tit. 18, former § 17554, repealed eff. Jan. 9, 2003.) The regulation included two  
34 examples to demonstrate how former R&TC section 17554 applied to taxpayers whose status changes  
35 from resident to nonresident:

1       **Example (1):** X was a resident of California and a cash basis taxpayer. He performed  
2 services in California for which he earned \$2,000. He then moved to New York and  
3 became a resident of the state on November 1, 1975. He received from his California  
4 employer one \$1,000 payment on December 1, 1975, and another \$1,000 payment a  
5 January 1, 1976. The payments are subject to California tax regardless of X's residency  
6 status since they are derived from a California source. X must report \$1,000 on his 1975  
7 California return, and \$1,000 on his 1976 California return.

8       ... [¶] ...

9       **Example (3):** X was a resident of California and a cash basis taxpayer. On July 1, 1975,  
10 he sold a parcel of real property located in Nevada for \$60,000. The buyer paid \$10,000  
11 down and agreed to pay the remainder in two equal installments. X elected to report the  
12 income from the sale using the installment method. X moved to New York and became a  
13 resident of that state on October 1, 1975. He received one \$25,000 installment payment  
14 on December 1, 1975, and the other \$25,000 installment payment on June 1, 1976. The  
15 payments are subject to California tax even though they were not derived from a  
16 California source, since the right to receive them accrued before the change in X's  
17 residency status. X must report the \$10,000 down payment and the first \$25,000  
18 installment payment on a 1975 California return and the other installment payment on a  
19 1976 California return.

20 (*Id.* [bold in original].)

### 21 STAFF COMMENTS

22               Subdivision (d) of Regulation 17952 was not promulgated with a retroactive effective  
23 date, and it is not clear to staff that there is a legal basis to give it retroactive effect. As a result, it  
24 appears to staff that the crucial issue is whether existing law, as in effect during the years at issue and  
25 applied by California courts, supports respondent's proposed assessment.

26               At the hearing, both parties should be prepared to discuss further the Legislature's intent  
27 in enacting R&TC section 17041, subdivision (i)(3). Respondent should be prepared to address  
28 appellants' argument that R&TC section 17952 is inconsistent with, and repudiates, the *mobilia*  
doctrines. Appellants should be prepared to discuss respondent's argument that the *mobilia* doctrine has  
been cited favorably by the Board and by California courts which have not found the doctrine to have  
been repudiated by the Legislature. In addition, appellants should be prepared to address respondent's  
argument that installment method reporting permits taxpayers to defer the payment of tax, but does not  
otherwise change the tax treatment of income deferred through the installment method. Pursuant to  
California Code of Regulations, title 18, section 5523.6, if either party has any additional evidentiary

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1 exhibits, such exhibits should be submitted to the Board<sup>2</sup> and the other party at least 14 days prior to the  
2 rehearing date.

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<sup>2</sup> Exhibits should be submitted to: Claudia Madrigal, Board of Equalization, Board Proceedings Division, P.O. Box 942879 MIC: 80, Sacramento, CA 94279-0080.