CALIFORNIA STATE BOARD OF EQUALIZATION

SUMMARY DECISION UNDER REVENUE AND TAXATION CODE SECTION 40

In the Matter of the Appeal of:	Case No.'s 610028, 782397
MICHAEL J. BILLS AND MARY E. BILLS	Oral hearing date: May 28, 2015 Decision rendered: April 28, 2016[1] Publication due by: August 26, 2016

Representing the Parties:

For Appellants: Jeffrey M. Vesely, Pillsbury Winthrop Shaw Pittman LLP
Annie H. Huang, Pillsbury Winthrop Shaw Pittman LLP

For Respondent: Brian C. Miller, Tax Counsel III

Counsel for the Board of Equalization: Louis A. Ambrose, Tax Counsel IV

LEGAL ISSUE 1

Whether appellants were residents of California through April 23, 2005, and taxable by California on income from all sources until that date.

BACKGROUND AND FINDINGS OF FACT

Appellant-husband moved to California in 1997 to accept a managing partner position with Brandes Investment Partners, LP (Brandes) as an "at will" employee and, in February of 1998, appellants purchased a condominium in California in which appellant-husband resided. Appellant-wife moved to California in the middle of 1998 and, in June of 1998, appellants purchased a 3,938-square-foot home in Rancho Santa Fe (RSF Home) that appellants used as their primary residence.

In November of 2004, appellants purchased a completely furnished, 5,635-square-foot home on a 9.36-acre parcel located in Friday Harbor in Washington State (FH home) for $2,800,000. The

[1] Respondent filed a petition for rehearing. Following briefing, respondent's petition for rehearing was denied on March 29, 2016, and this decision became final 30 days later, on April 28, 2016.

escrow on the FH Home closed on December 1, 2004, and appellants stayed at the FH Home from January 10, 2005, through January 16, 2005. During that time, appellants registered to vote and registered three automobiles in Washington although those vehicles were not moved to Washington during January of 2005. Appellant-husband also obtained a Washington State driver's license using the FH Home as his residence address and appellants received home furnishings at the FH Home. At some time later in 2005, appellants registered four other automobiles, which were originally registered in California, in Washington State. Appellants drove one of those vehicles to the FH Home from California in April 2005 and June 2005, but the other vehicles remained in California.

On January 16, 2005, appellants drove back to California and stayed at the RSF Home until they left for a series of trips beginning on February 3, 2005, until April 23, 2005. During the period after their return from the FH Home through April 23, 2005, appellants traveled most of the time but stayed at the RSF Home between trips. On April 23, 2005, appellants left the RSF Home and drove to the FH Home but discovered that the home's well required repairs. Appellants returned to the RSF Home until the repairs were completed and, in June of 2005, they travelled to the FH home.

Appellants filed joint California Non-Resident returns for tax years 2005 through 2009, reporting that they established residency in Washington State on January 11, 2005. For tax years 2005 through 2009, appellants received payments in liquidation of appellant-husband's partnership interest in Brandes, which they excluded from income on their California returns for those tax years. Upon examination, respondent determined that appellants were California residents through April 23, 2005, and that the payments from Brandes in 2005 through 2007 were California source income. Respondent issued a Notice of Proposed Assessment (NPA) for each of those years and appellants filed timely protests. After a protest hearing, respondent affirmed the NPAs and issued a Notice of Action (NOA) for each of those years, and appellants filed timely appeals. Respondent also examined appellants' returns for tax years 2008 and 2009 and determined that payments from Brandes for those years were California source income and issued NPAs for 2008 and 2009. Appellants filed timely protests of those NPAs but requested that respondent close the protests and issue NOAs so that the appeals of those years could be consolidated with the appeals of tax years 2005, 2006, and 2007.

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APPLICABLE LAW

It is well established that a presumption of correctness attends respondent's determinations of fact, including a determination of residency, and that an appellant has the burden of proving such determinations erroneous. This presumption is a rebuttable one and will support a finding only in the absence of sufficient evidence to the contrary. (*Appeal of George H. and Sky Williams, et al.*, 82-SBE-018, Jan. 5, 1982; *Appeal of Joe and Gloria Morgan*, 85-SBE-078, Jul. 30, 1985.)

Revenue and Taxation Code (R&TC) section 17041, subdivision (a)(1) provides, in pertinent part, that a tax shall be imposed for each taxable year upon the entire taxable income of every resident of California. R&TC section 17014, subdivision (a) provides that the term "resident" includes:
(1) every individual who is in California for other than a temporary or transitory purpose; and
(2) every individual domiciled in California who is outside of California for a temporary or transitory purpose. Thus, with respect to a residency determination, the key question is whether the individual is present in California, or absent from California, for a temporary or transitory purpose. (*Appeal of Stephen D. Bragg*, 2003-SBE-002, May 28, 2003.)

The term "domicile" refers to one's permanent home, the place to which he or she intends to return after an absence. (*Appeal of Anthony V. and Beverly Zupanovich*, 76-SBE-002, Jan. 6, 1976 (citing *Whittell v. Franchise Tax Board* (1964) 231 Cal.App.2d 278, 284).) An individual can have but one domicile at any one time. (Cal. Code Regs., tit. 18, § 17014, subd. (c).) To change a domicile, a taxpayer must move to a new residence and intend to remain there permanently or indefinitely. (*Appeal of Stephen D. Bragg*, 2003-SBE-002, May 28, 2003; Cal. Code Regs., tit. 18, § 17014, subd. (c).) The party asserting a change in domicile bears the burden of proving such change. (*Appeal of Terance and Brenda Harrison*, 85-SBE-059, June 25, 1985.) If there is doubt about domicile after the presentation of the facts and circumstances, the domicile must be found to have not changed. (*Appeal of Stephen D. Bragg, supra*.)

In relevant part, title 18 of the California Code of Regulations (Regulation) section 17014, subdivision (b) generally describes the term "temporary or transitory purpose," as used in R&TC section 17014, in the following manner:

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> . . . if an individual is simply passing through this State on his way to another state or country, or is here for a brief rest or vacation, or to complete a particular transaction, or perform a particular contract, or fulfill a particular engagement, which will require his presence in this State for but a short period, he is in this State for temporary or transitory purposes, and will not be a resident by virtue of his presence here.
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> If, however, an individual is in this State . . . for business purposes which will require a long or indefinite period to accomplish, or is employed in a position that may last permanently or indefinitely . . . he is in the State for other than temporary or transitory purposes, and accordingly, is a resident taxable upon his entire net income . . .
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> (Cal. Code Reg., tit. 18, § 17014.)

The underlying theory of R&TC sections 17014 to 17016 is that the state with which a person has the closest connection during the taxable year is the state of his residency. (Cal. Code Reg., tit. 18, § 17014, subd. (b).) Thus, the contacts a taxpayer maintains in California and outside of the state are important factors to be considered in determining whether California residency exists. Although the actual or potential duration of a taxpayer's presence in, or absence from, California is significant, it is also important in each case to examine the connections with California and to compare these connections with those maintained in other places. (*Appeal of Anthony V. and Beverly Zupanovich, supra*.) The type and amount of proof required to rebut a presumption of residence cannot be specified by general regulation, but will depend largely on the circumstances of each particular case. (Cal. Code Regs., tit. 18, § 17014, subd. (d)(1).)

ANALYSIS AND DISPOSITION

Here, the evidence shows that appellants abandoned their California domicile when they arrived at the FH Home on January 10, 2005. Prior to their arrival, appellants set up accounts with electric and gas utility companies in November and December of 2004 and purchased and received household and personal items for the FH Home on or about January 11, 2005. We disagree with respondent's assertion that appellants only "started to outfit [the FH Home] for occupancy" in January of 2005 and, in that regard, we note that appellants purchased the FH Home completely furnished. Thus, the FH Home was ready for occupancy by appellants upon their arrival on January 10, 2005. Appellants also hired a caretaker while they were absent from the FH Home on vacation and made arrangements with local contractors to perform home improvements.

In addition, appellants registered their automobiles and registered to vote in Washington and appellant-husband obtained a Washington State driver's license. They also opened an account at a local branch of Wells Fargo Bank and saw local doctors and dentists. In view of the foregoing, we find that appellants moved to Washington on January 11, 2005, with an intent to remain there permanently or indefinitely and thereby established domicile in Washington on that date.

Based on our finding that appellants established domicile in Washington as of January 11, 2005, for purposes of the residency determination, we must examine whether they were in California for other than a temporary or transitory purpose from January 16, 2005 to April 23, 2005. In the *Appeal of Stephen D. Bragg*, *supra*, this Board held that the contacts an individual maintains in California and other states are important objective indications of whether the individual's presence in or absence from California was for a temporary or transitory purpose. The Board also listed nonexclusive factors to aid it in determining with which state an individual has the closest connection. An analysis of the *Bragg* factors demonstrates that appellants had closer connections with Washington than California during the period at issue.

Among the *Bragg* factors are a taxpayer's registrations and filings and, as noted above, appellants registered to vote, registered their vehicles, and appellant-husband obtained a Washington driver's license during the period from January 11 to January 16, 2005. These facts show a strong connection to Washington. Another group of factors focuses on the taxpayer's day-to-day contacts in both the taxpayer's occupational life as well as personal life. As stated above, appellants opened a bank account at Friday Harbor and obtained dental and medical services. Because appellant-husband recently retired, he had no business location at which he was employed. Thus, to the extent that these factors are applicable to appellants, they show a closer connection with Washington.

A third group of factors focuses on the taxpayer's physical presence and the location of the taxpayer's property. As stated above, appellants purchased the FH Home in December of 2004 and transferred household and personal items from the RSF Home and from their New York apartment in January for their immediate and permanent occupancy. The appellants owned residential real property in Washington, California and New York; however, appellants intended the FH Home to be their primary residence as of January 11, 2005. Additionally, appellants did not sell the RSF Home but

rather allowed their adult daughter to reside there after they moved. The fact that appellants' children continued to reside in California has less weight on the facts before us as the children were all adults leading independent lives. Furthermore, the days that appellants spent in California during the period after January 16, 2005, were brief sojourns prior to and between a series of trips beginning on February 3, 2005, until April 23, 2005. These facts also show a closer connection to Washington than elsewhere.

Based on the foregoing facts and analysis, we find that appellants were residents of Washington as of January 11, 2005.

LEGAL ISSUE 2

Whether appellants have shown that payments they received upon appellant-husband's withdrawal from Brandes were not California-source income for tax years 2005 through 2009.

BACKGROUND AND FINDINGS OF FACT

Appellant-husband tendered his written resignation and retirement from Brandes effective December 31, 2004, and, thereafter, pursuant to the Brandes partnership agreement, received Partnership Interest payments from Brandes from 2005 through 2009. The partnership agreement provided that those payments would be treated as payments under IRC section 736(b), calculated by a formula under which the amount of each payment for each year was dependent upon Brandes's earnings from the prior year. Brandes treated the amounts paid as payments under IRC section 736(b) in accordance with the partnership agreement and did not deduct those payments as expenses on its returns. Accordingly, appellant-husband was entitled to receive payments over a five-year period and received his first payment of $7,553,083 on March 15, 2005, and subsequent payments in the amounts of $7,774,548, $9,205,847, $9,697,337, and $5,138,423 for the years 2006 through 2009, respectively.

APPLICABLE LAW

With respect to partnership distributions made in liquidation of a retiring partner's interest, IRC section 736(a) provides, in relevant part, that such payments shall, except as provided in subsection (b), be considered—

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> (1) as a distributive share to the recipient of partnership income if the amount thereof is determined with regard to the income of the partnership, or
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> (2) as a guaranteed payment described in section 707(c) if the amount thereof is determined without regard to the income of the partnership.

IRC section 736(b) provides, in relevant part, that payments in liquidation of a retiring partner's interest "shall, to the extent such payments (other than payments described in paragraph (2)) are determined, under regulations prescribed by the Secretary, to be made in exchange for the interest of such partner in partnership property, be considered as a distribution by the partnership and not as a distributive share or guaranteed payment under subsection (a)." Payments made in liquidation of a retiring partner's interest must be allocated between payments for a partner's interest in partnership property and all other payments. (Int.Rev. Code, § 736(a) & (b); Treas. Reg. § 1.736-1(a)(3).) Amounts paid for a partner's interest in partnership assets are treated in the same manner as a distribution in complete liquidation, and the partnership is allowed no deduction for such payments. (Treas. Reg. §§ 1.736-1(a)(2), 1.736-1(b)(2).)

For purposes of computing the taxable income of a nonresident or part-year resident as defined by R&TC section 17041, subdivision (i)(1), R&TC section 17951, subdivision (a) provides that "in the case of nonresident taxpayers the gross income includes only the gross income from sources within this state." Regulation 17951-4, subdivision (a) provides, in part, that if "the nonresident's business, trade or profession is conducted wholly within the state, the entire net income therefrom is derived from sources within this state."

R&TC section 17952 provides that "income of nonresidents from stocks, bonds, notes, or other intangible personal property is not income from sources within this state unless the property has acquired a business situs in this state . . . ."[2] With respect to business situs, subdivision (c) of Regulation 17952 provides that:

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[2] Regulation 17952, subdivision (b) is to the same effect.

> [i]ntangible personal property has a business situs in this State if it is employed as capital in this State or the possession and control of the property has been localized in connection with a business, trade or profession in this State so that its substantial use and value attach to and become an asset of the business, trade or profession in this State. For example, if a nonresident pledges stocks, bonds or other intangible personal property in California as security for the payment of indebtedness, taxes, etc., incurred in connection with a business in this State, the property has a business situs here. . . . If intangible personal property of a nonresident has acquired a business situs here, the entire income from the property including gains from the sale thereof, regardless of where the sale is consummated, is income from sources within this State, taxable to the nonresident.

In the *Appeals of Amyas and Evelyn P. Ames, et al*., (87-SBE-042) (hereafter *Appeals of Ames*), decided on June 17, 1987, this Board decided that the operation of a partnership in California did not create a business situs for the partnership interests in California and, thus, the gain on the sale of partnership interests was not taxable by California. The Board reasoned that the gain was not the result of partnership operations, but rather the result of the sale of intangible property and, therefore, the gains would be sourced to California only if the intangible property had a business situs in the state. Because the taxpayers did not integrate those partnership interests into business activities in California, the gain was sourced to the taxpayers' states of residence.

ANALYSIS

IRC section 736 makes a clear distinction between payments made under paragraph (a) "in liquidation of the interest of a retiring partner" as either "a distributive share to the recipient of partnership income if the amount thereof is determined with regard to the income of the partnership" or "as a guaranteed payment described in [IRC] section 707(c) if the amount thereof is determined without regard to the income of the partnership[,]" and payments made under paragraph (b) as "a distribution by the partnership and not as a distributive share or guaranteed payment under subsection (a)." Under Treasury Regulation § 1.736-1(b)(1), payments made in liquidation of the entire interest of a retiring partner "shall, to the extent made in exchange for such partner's interest in partnership property . . . be considered a distribution by the partnership (and not as a distributive share or guaranteed payment under section 736(a))." As we determined at the hearing and as respondent conceded in its petition for rehearing, the payments to appellant-husband were made in exchange for his interest in partnership property. Thus, these payments are properly considered a distribution under

IRC section 736(b).

Respondent asserts that the payments were "in exchange for property owned by [Brandes]" and that, for income tax purposes, appellant-husband should be treated "as if he directly owned [Brandes'] property" during the tax years in issue. On that basis, respondent concludes that Brandes's 99-percent membership interest in a limited liability company, which conducted business activities in California, is the relevant intangible personal property for purposes of applying R&TC section 17952, subdivision (c) to determine the proper sourcing of the payments from Brandes to appellant-husband.

However, as this Board held in *Appeals of Ames,* gains realized on the sale of limited partnership interests by nonresident appellants "result from the sale of an intangible" that "would only be taxable in California if we found that the intangible had a business situs in this state" under the rule articulated by the court in *Holly Sugar Corp. v Johnson* (1941) 18 Cal.2d 218. In *Appeals of Ames,* the Board applied the rule of *Holly Sugar Corp.* and found that the limited partnership interests did not acquire a business situs in California because the nonresident appellants did not "attempt to employ the wealth represented by their limited partnership interests so as to integrate that interest into the business activities of California."

Here, we find that appellants established residency and domicile in the state of Washington and were not residents of California prior to the receipt of the payments. Therefore, the holding in *Appeals of Ames* is applicable and the situs of appellant-husband's Brandes partnership interest during the years in issue will determine the sourcing of those payments for income tax purposes. Consequently, pursuant to R&TC section 17952 and Regulation 17952, the relevant property for income sourcing purposes is the partnership interest, which constitutes intangible personal property.

Under the doctrine of *mobilia sequuntur personam*, the situs of the intangible personal property is appellants' domicile, unless the intangible personal property has acquired a business situs in California.[3] Regulation 17952 provides that intangible personal property has a business situs in California if the property is employed as capital in California or if the possession and control of the

[3] There is another exception that applies where a nonresident buys or sells stock or other intangible personal property "regularly, systematically and continuously as to constitute doing business in this State . . . [,]" but this exception is not relevant to the facts of this appeal.

property has been localized in connection with a business or profession in the state so that its substantial use and value attach to and become an asset of the business or profession. Regulation 17952 provides the example of a nonresident pledging stocks or other intangible personal property as security for debt incurred in connection with a business in California. There is no evidence that appellants have taken action to localize control over the partnership interest in connection with a business or profession in California. Therefore, the relevant intangible personal property has not acquired a business situs in California, and the payments are not properly sourced to this state.

DISPOSITION

For the foregoing reasons, appellants' appeal is granted.

ORDER

Pursuant to the analysis of the law and facts above, the Board ordered that the actions of the Franchise Tax Board on appellants' protests against the proposed assessments for the years 2005 through 2009 be reversed. Adopted at Sacramento, California, this 24th day of May, 2016.

Fiona Ma, Chairwoman

George Runner, Member

Diane L. Harkey, Member