

CALIFORNIA FRANCHISE TAX BOARD

Legal Ruling No. 415

April 17, 1980

SALE OF A PARTNERSHIP INTEREST

Syllabus:

A California domiciled corporation carried on its principal business activity, radio and television broadcasting, primarily as a general partner in a partnership which operated stations located within and without California. The partnership operations were deemed to be a part of the unitary business of the corporate partner. The income and factors of the partnership attributable to the corporation were included in the formula apportionment of income to California on the corporate returns. This manner of reporting and apportioning the partnership income was accepted by this department in field audits.

In 1977, the corporation sold its interest in the partnership at a substantial gain. The gain was reported as business income subject to apportionment.

Question:

Does the gain or loss on the sale of an interest in a partnership, the activities of which were unitary with those of the corporate partner, constitute apportionable business income?

Decision:

Yes.

Discussion:

A partnership is "an association of two or more persons to carry on as co-owners a business for profit." Corp. Code § 15006. Property of the partnership is the property of the partners. Corp. Code §§15008, 15024, 15025. The activities of the partnership are the activities of the partners. Corp. Code § 15009. A partner's property rights in the partnership are threefold and consist of "(1) his rights in specific partnership property, (2) his interest in the partnership, and (3) his right to participate in the management." Corp. Code § 15024.

The second of the above enumerated property rights, the partnership interest, is alienable, Corp. Code § 15027, and is defined as the partner's share of the profits and surplus. Corp. Code § 15026. The question presented is whether a

partnership interest may be considered to be an analog of shares in a corporation so that gain or loss upon its disposition is allocable or apportionable according to the applicable rules for the sale of corporate shares in the particular situation. For the following reasons, it is concluded that such an analogy is inappropriate.

The issue which lies at the analytical threshold of this discussion is whether a partnership interest, like a corporate share, constitutes intangible property. In the Appeal of H. F. Ahmanson & Co., Cal. St. Bd. of Equal., April 15, 1965, CCH 205-855, P-H 13,363, the State Board of Equalization rejected the taxpayer's contention that because a limited partnership interest was an intangible, the corporate partner's distributive share of the partnership income should be allocated to its commercial domicile. The appellate court, in an unpublished decision, upheld the trial court's affirmation of the Board's decision. Ahmanson, however, was concerned with the proper attribution of partnership income, and is not controlling upon the question of the tangibility of a partnership interest, per se, or the proper tax treatment of such an interest upon its disposition.

A partnership interest is, as statutorily limited and defined, no more than the partner's share of the profits and surplus; it is a right to share in the partnership assets after the partnership liabilities have been satisfied. It is, therefore, an intangible, a chose in action, which carries with it a right to an accounting. Blodgett v. Silberman, 277 US 1, 48 S.Ct. 410, 72 L.Ed. 749; see also Revenue & Taxation Code § 13303, and the regulations thereunder.

However, the determination that a partnership interest, in the abstract, is intangible property is not dispositive of the question of the proper attribution of gain or loss realized upon the disposition of such an interest. A partnership is an entity only for the purpose of calculating and filing informational returns, it is a conduit through which the individual partners become liable for tax upon their distributive shares of the partnership income. Revenue & Taxation Code §§ 17851, et seq.

A corporate partner, limited or general, unlike the holder of shares in a corporation, is considered to be doing business wherever the partnership may operate, and income is apportioned accordingly. Appeal of Custom Component Switches, Inc., Cal. St. Bd. of Equal., February 3, 1977, CCH 205-613, P-H 13,102-B; Appeal of H. F. Ahmanson & Co., supra; Reg. 25137(e)(6), 25137(e)(7). In Crocker-Anglo National Bank v. Franchise Tax Board, 179 Cal.App.2d, 591, 3 Cal. Rptr. 905 (1960), the court explained the underlying difference between the nature of partnership and dividend income:

There is a basic distinction between partnership income and income in the form of dividends received by a California resident from stock in a corporation. In Miller v. McColgan, supra, 17 Cal. 2d 432, 437, the nature of a stockholder's interest is carefully analyzed. "The shares of stock are the

immediate source of the income to the recipient, though the ultimate source is to be found one or more steps back in the process where the new wealth was first called into existence." The owner of shares of stock in a corporation is not the owner of the corporation's property. In a partnership the immediate source of the income is the "new wealth" which was called into existence. A partner, of course, is an owner of the partnership property. The difference in the nature of a stockholder's interest in a corporation and a partner's interest in a partnership gives rise to a difference in source of income of a California resident.

Thus, a partner's partnership interest is both the immediate and the ultimate source of income to the partner, and, as such, a partnership interest is distinguishable from the ownership of shares in a corporation. Business income to a partnership is business income to the corporate partner. Reg. 25137(e)(1). This income is distributed in accord with and as a result of the partnership interest, which is, therefore, intangible property, used in the trade or business, which by its very nature is so inextricably entwined with the partnership business as to acquire a business situs wherever the partnership business is conducted.

Regulation 25120(c) provides:

Gain or loss from the sale, exchange or other disposition of real or tangible or intangible personal property constitutes business income if the property while owned by the taxpayer was used in the taxpayer's trade or business.

Therefore, gain or loss from the sale of a partnership interest in a business which was unitary with that of the corporate partner gives rise to apportionable business income.