69-SBE-001

BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
R.M. AND KATHRYN L. BLANKENBECKLER)

Appearances:

For Appellants: Joseph J. Hyde
Certified Public Accountant

For Respondent: Robert S. Shelburne
Counsel

O P I N I O N

This appeal is made pursuant to section 18594 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protests of R. M. and Kathryn L. Blankenbeckler against proposed assessments of additional personal income tax in the amounts of $537.55 and $365.74 for the years 1963 and 1964, respectively.

The question presented is whether appellants' share of certain taxes paid pursuant to Mexican tax law was a proper deduction.

Appellants are residents of California. During the years in question they were members of a partnership, Geo. H. McFadden & Bros., which had loaned money to an associated Mexican corporation. In 1963 and 1964 the partnership received interest on that loan. In compliance with Mexican law the debtor corporation in Mexico withheld tax from the interest payments due the partnership in each of those years.

In their California personal income tax returns for 1963 and 1964 appellants deducted their pro rata shares of the Mexican taxes withheld. Those deductions, amounting to $7,679.28 for 1963 and $5,224.86 for 1964, were disallowed

by respondent. Appellants protested the resulting proposed additional assessments, and respondent's affirmation of those assessments gave rise to this appeal.

Respondent's disallowance of the claimed deductions was based upon section 17204, subdivision (c), of the Revenue and Taxation Code, which provides:

> No deduction shall be allowed for the following taxes:
>
> * * *
>
> (2) Taxes on or according to or measured by income or profits paid or accrued within the taxable year imposed by the authority of:
>
> (A) The government of the United States or any foreign country; . . . .
>
> * * *

Respondent concluded that since the Mexican tax in question was imposed on interest income, deduction was precluded under this section.

Appellants contend that the word "income" as it is used in section 17204, subdivision (c)(2), means "net income," and since the Mexican tax in question is imposed on gross, rather than net, interest income its deduction is not precluded by that section.

In support of their contention appellants rely on our decision in Appeal of Edward and Frieda Liffman Meltzer, Cal. St. Bd. of Equal., April 1, 1953, wherein we held that a Canadian tax was a gross receipts tax which was deductible under section 17305 (now section 17204, subd. (c)) of the Revenue and Taxation Code. The tax in the Meltzer appeal was levied on gross rental income pursuant to section 27(1) *of* the Canadian Income War Tax Act, which imposed a tax on nonresidents on the gross amount of rents, royalties, or similar payments for anything used or sold in Canada. However, as we have pointed out in subsequent opinions, our decision in the Meltzer appeal did not *turn* upon the fact that the Canadian tax was on the gross rental income, but on the fact that the tax was on all payments for anything used or sold in Canada. In a case where such payments were consideration for the sale of property, part of the ***returns*** represented a return of

capital. (Appeal of Don Baxter, Inc., Cal. St. Bd. of Equal., Oct. 21, 1963; Appeals of L. N. Jesson, Cal. St. Bd. of Equal., June 24, 1957.) Our determination of deductibility in Meltzer was based upon the fact that the Canadian tax was a **gross** receipts tax which sought to tax not only income, but capital as well.

An analysis of the Mexican income tax reveals that it is imposed generally on revenue derived from capital, from labor, or from a combination of both (Mexican Income Tax Law, Art. 1). The term 'income" is defined as including all kinds of profits, proceeds, gains, benefits, etc., and, in general, any receipts in cash, in kind, in securities, or in credits which modify the net worth of the taxpayer. (Mexican Income' Tax Law, Art. 2. See Harvard Law School, World Tax Series, Mexico, p. 119.) Excluded from the statutory concept of income are receipts which constitute a return of capital. (Harvard Law School, World Tax Series, Mexico, p. 121.)

The Mexican Income Tax Law classifies income according to various types of income-producing activity. Interest income of the type received by appellant is taxed'under Schedule VI, which deals generally with income derived from the investment of capital. (Mexican Income Tax Law, Title II, Schedule VI, Arts. 125-147.) The tax imposed on income from capital under Schedule VI is based on gross income, and income-producing expenses are not usually recognized. (Harvard Law School, World Tax Series, Mexico, p. 194.) The amount of the tax is a percentage of interest income, the rate being dependent upon the amount received.

It seems quite clear from the above analysis that the Mexican tax in question was not a tax imposed on capital, but was rather a tax on, according to, or measured by income from capital, which is nondeductible under section 17204, subdivision (c)(2)(A). The mere fact that no deductions were allowed in arriving at taxable income does not convert a tax on income into a tax on gross receipts. We must therefore sustain respondent's action in this matter.

O R D E R

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

Appeal of R. M. and Kathryn L. Blankenbeckler

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section 18595 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protests of R. M. and Kathryn L. Blankenbeckler against proposed assessments of additional personal income tax in the amounts of $537.55 and $365.74 for the years 1963 and 1964, respectively, be and the same is hereby sustained.

Done at Sacramento, California, this 6th day of January, 1969, by the State Board of Equalization.

John W. Lynch, Chairman

_____, Member

_____, Member

_____, Member

_____ Member

Attest: _____, acting Secretary