74-SBE-021

BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
LLOYD W. AND RUTH BOCHNER)

Appearances:

For Appellants: Abraham Berman
Attorney at Law

For Respondent: Richard A. Watson
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 protest of Lloyd W. and Ruth Bochner against a proposed assessment of additional personal income tax in the amount of $184.60 for the year 1969.

Appellants, husband and wife, are California residents. During 1969 they received payments from Canadian sources in the form of cash dividends, cash distributions from an estate, and

interest. Pursuant to the Canadian Income Tax Act*, certain amounts of tax were withheld from the above distributions. Appellants deducted the taxes withheld by Canada on their 1969 income tax returns. Respondent's denial of those deductions gave rise to this appeal.

The question for determination is whether appellants are entitled to deduct the taxes withheld by Canada.

Section 17204 of the Revenue and Taxation Code provides in pertinent part:

> (c) 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:

Whether the withheld taxes were "on or according to or measured by income or profits" thus becomes the critical inquiry in determining their deductibility.

Appellants contend that in 1969 the Canadian income tax was not measured by income but rather by gross receipts (i.e., the tax was levied on both capital and income) and therefore deduction of these taxes was not precluded by the above quoted portions of section 17204. They base this contention on their allegation that certain sections of the Canadian Income Tax Act which provided for a tax on stock dividends constituted a tax on both capital and income. To support their position, appellants rely on three prior board decisions: Appeal of Paul D. and Mildred W. Newby, Cal. St. Bd. of

*All references in this opinion to the "Canadian Income Tax Act" or its sections are to that act as it read in 1969, the year in issue in this case.

Equal., Sept. 18, 1957; Appeal of Georsica Guettler, Cal. St. Bd. of Equal., April 1, 1953; and Appeals of Edward Meltzer and Frieda Liffman Meltzer, Cal. St. Bd. of Equal., April 1, 1953.

With respect to the Newby decision, appellants apparently misread the opinion of this board. We made no finding in that case as to whether the tax involved therein was a gross receipts tax. Our decision in Newby was that the tax was not a net income tax, h Guettler and Meltzer were cases wherein this board held section 27(1) of the Canadian Income War Tax Act to be a gross receipts tax and not an income tax on grounds that it taxed gross receipts from the sale of property without a deduction for cost of goods sold. Although the appellants in both Guettler and Meltzer were taxed pursuant to section 27 (1), in neither case was a sale of property involved. In Guettler taxes were paid on royalties and in Meltzer the taxed income was derived from rents. In effect, these cases classified an entire section of the Canadian law on the basis of the characteristics of a portion of that section which was not even in issue. This overly broad approach to classifying foreign law was subsequently overruled by our decision in Appeal of Charles T. and Mary R. Haubiel, decided on January 16, 1973. In that case only the specific tax for which the deduction was claimed was considered in determining whether the tax was on gross receipts or income. Applying the principle used in Haubiel to the case at hand, whether or not certain provisions of the Canadian Income Tax Act pertaining to stock dividends imposed a tax measured by gross receipts is irrelevant, since in this case no stock dividends are in issue. Here, we are only concerned with the specific provisions of the Canadian Income Tax Act relating to cash dividends, estate distributions, and interest .

With respect to the cash dividends, section 106(1a) of the Canadian Income Tax Act provided for the withholding of an income tax on dividends paid to non-residents. " Dividend", as used in that act, was defined by section 139(1)(k) not to include a stock dividend. Furthermore, "dividend" has been defined in Commonwealth case law as a share of the profits of a company which is distributed to the shareholders otherwise than on a liquidation, winding up, redemption of shares or an authorized reduction

of Capital. (Hill J. Permanent Trust Company of New South Wales, [1930] A.C. 720 at 731; In re Bates, [1928] 1 Ch. 682.) Under our law, the concept of income includes gains realized or profits derived from capital, labor, or both, and excludes receipts which constitute the- return of capital. (Eisner v. Macomber, 252 U.S. 189 [64 L. Ed. 5.21); Southern Pacific Co. v. Lowe, 247 U.S. 330 [62 L. Ed. 1142]; see also Motland v. United States, 192 F. Supp. 358.) It is clear, then, that the dividends in question here fit within our concept of income since by the Commonwealth definition they could only have been paid out of the company's profits. It follows that the income tax withheld on these amounts was "on or according to or measured by income or profits."

The income taxes paid by appellants on the estate distributions were authorized by section 106(1) (c) of the Canadian Income Tax Act which provided in pertinent part:

> Every non-resident person shall pay an income tax of 15% on every amount that a person resident in Canada pays or credits, or is deemed by Part I to pay or credit, to him as, on account of or in lieu of payment of, or in satisfaction of, . . . (c) income of or from an estate or trust; ...

Further clarification of section 106(1)(c) was to be found in section 10 6 (6) which stated:

> Where an amount has been paid or credited by a trust or estate to a beneficiary or other person beneficially interested therein (otherwise than on a distribution or payment of capital) it shall, regardless of the source from which the trust or estate derived it, be deemed, for the purpose of paragraph (c) of subsection (1) and without limiting the generality thereof, to have been paid or credited as income of the trust or estate.

In light of the language of section 106(6), specifically excluding capital payments from taxable estate distributions, and in the absence of any evidence appearing to the contrary, we must conclude that the income tax imposed on estate distributions by section 106(1)(c) was a tax on "income" within our previously discussed meaning of that term.

Finally, there is the matter of the income taxes paid by appellants on interest, pursuant to section 106(1)(b) of the Canadian Income Tax Act. It is undisputed that interest does not include an element of capital: rather, it is income earned from invested capital. Consequently, the tax in question here was a tax measured by income and not by gross receipts.

The foregoing clearly demonstrates that appellants were not entitled to the deductions claimed. Accordingly, respondent's determinations are sustained.

ORDER

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

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 protest of Lloyd W. and Ruth Bochner against a proposed assessment of additional personal income tax in the amount of $184.60 for the year 1969, be and the same is hereby sustained.

Done at Sacramento, California, this 15th day of May, 1974, by the State Board of Equalization.

_____, Chairman

_____, Member

_____, Member

_____, Member

_____, Member

ATTEST: Secretary