BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeals)
of)
E. B. BISHOP and HELEN BISHOP)

Appearances:

For Appellants: McDonough and Wahrhaftig, Attorneys at Law

For Respondent: Burl D. Lack, Chief Counsel; John S. Warren, Associate Tax Counsel

O P I N I O N

These appeals are made pursuant to Section 18593 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protests of E. B. Bishop and Helen Bishop to proposed assessments of additional personal income tax in the amount of $622.05 against each of the Appellants for the year 1952. As each Appellant concedes an underpayment of tax in the amount of $7.10, the amount in dispute in each appeal is $614.95.

The question presented by these appeals concerns the computation of the credit allowable under Section 17976 (now Section 18001) of the Revenue and Taxation Code for income taxes paid by Appellants to the State of Oregon, Section 17976 allowed residents of this State a credit against their California taxes for net income taxes paid to another state, but in subdivision (c) limited the credit as follows:

> "(c) The credit shall not exceed such proportion of the tax payable under this part as the income subject to tax in the other state or country and also taxable under this part bears to the taxpayer's entire income upon which the tax is imposed by this part."

Appellants, residents of California, filed separate California returns in which they reported an aggregate gross income of $81,883.73, of which $69,066.44 represented gross income from Oregon sources. Their aggregate net income for California purposes, less personal exemptions, was $77,783.73, on which the California tax, before the allowance of any tax credit, was $3,167.02. Net income for Oregon purposes, less exemptions, was $38,852.81, on which Appellant3 paid a tax to that state in the amount of $2,738.22.

The low net income for.Oregon purposes is accounted for primarily by the allowance as a deduction from gross income of $28,493.63, representing Federal income taxes paid by Appellants. The deduction for Federal income taxes under the Oregon statute is, however! reflected in the rate structure, since Oregon, allowing the deduction ha3 higher rates than California, which does not allow the deduction.

Both the Franchise Tax Board and Appellants agree that the legislative purpose in enacting Section 17976 was the avoidance of double taxation, They differ sharply, however, on the extent of the relief intended and center their opposing arguments on the construction of the phrase "income subject to tax in the other state or country and also taxable under this part" in subdivision (c), It is Appellant's contention that the word "income" for the purpose of subdivision (c) means gross income. On this basisthey have computed their credit as follows (using combined figures from their separate returns):

$$\frac{\$69,066.44}{\$81,883.73} \times \$3,167.02 = \$2,655.47 \text{ (maximum credit)}$$

The Franchise Tax Board, on the other hand, argues that for purposes of the limitation imposed by subdivision (c) the term "income" means the "tax base," comprising net income less exemptions, It, accordingly, recomputed the credit as follows (using combined figures and taking into account certain Oregon audit adjustments made subsequent to the issuance of the notices of proposed assessments):

$$\frac{\$38,852.81}{\$77,783.73} \times \$3,167.02 = \$1,581.92 \text{ (maximum credit)}$$

As can be seen, the method employed by the Franchise Tax Board gives effect to differences in deductions, personal exemptions and credits for dependents allowed in the state in which the income is derived, without giving similar effect to any compensating variation in tax rates, This interpretation, accordingly, exalts the computed tax base and ignores the actual tax burden imposed by the foreign taxing jurisdiction.

It is of little consequence to the taxpayer claiming a credit against his California tax whether the tax paid to the other state resulted from a small tax base combined with a high tax rate, or a large tax base combined with a low tax rate. To the extent that the total taxes paid to the other state and to California, attributable to the extra-territorial income, exceed the taxes payable on the same income to the state with the highest effective rate, the taxpayer, in either case, is the victim of discriminatory double taxation of the same income, which all parties agree Section 17976 was intended to alleviate,

Where the taxes paid to the state in which the income was derived do not exceed the taxes paid to California and attributable to the same income, the credit allowed by Section 17976 will, if properly applied, reduce the California taxes to the full extent of the taxes paid to the other state. Since the total taxes paid to both states and attributable to the same income will then exactly equal the tax which would have been paid to California if the income had been subject to tax only in this State, there is no double taxation of the same income,

Where the taxes paid to the other state exceed the taxes paid to California with respect to the same income, the credit, except for the limitation of subdivision (c), would exceed the California taxes attributable to the extraterritorial income. It appears obvious, therefore, that the function of subdivision (c) is merely to limit the credit allowed under Section 17976 to that portion of the California taxes attributable to the extraterritorial income, thereby preventing the allowance of the credit out of taxes payable on other income.

That the use of the "tax base" by the Franchise Tax Board, rather than gross income, for purposes of computing the maximum credit permitted by subdivision (c) produces discrimination between resident taxpayers deriving income from out-of-state sources may be demonstrated by the following example of two unmarried California residents, without dependents, each of whom has income of $50,000, earned entirely in North Dakota and Arkansas, respectively.

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	Federal	California	North Dakota	Arkansas
Gross income	$50,000	$50,000	$50,000	$50,000
Standard deduction, Federal income tax, and personal exemption	1,600	2,600	26,000	3,500
Taxable balance	$48,400	, 4 0 0	$24,000	$46, 5 0 0
Tax-approximated	$25,000	$ 2,000	$ 2,000	$ 2,000

In this example, the income, the effective tax rates, and the tax, being the same in all three states, it is clear that both taxpayers should be treated alike and that the total taxes payable by each should not exceed $2,000. The Franchise Tax Board, however, would limit the credit for taxes paid to North Dakota to $24,000/$47,400 of the California taxes, or $1,000. It would limit the credit for taxes paid to Arkansas, however, only to $46,500/$47,400 of the California tax, or $1,960. Thus the taxpayer deriving his income from sources In North Dakota would pay to both states total taxes of $3,000. The taxpayer deriving income from Arkansas sources would pay total taxes to both states of only $2,040. Using gross income in the computation, however, would limit the credit of both taxpayers to $50,000/$50,000 x the California taxes, or $2,000, We are of the opinion, accordingly; that for purposes of the limitation the term "income" means gross income. See Rosemary Properties, Inc. v. McColgan, 29 Cal. 2d 677, and Burton E. Green Investment Co. v. McColgan, 60 Cal, App, 2d 224,

The Franchise Tax Board argues that its method of computing the allowable credit was approved by this Board in Appeal of Tirzah M. G. Roosevelt, decided May 19, 1954. The issue decided in that appeal, however, was whether the Franchise Tax Board, on the facts then presented, was estopped from recomputing the credit claimed by the taxpayer. The taxpayer did not dispute, and we accepted without critical analysis, the propriety of the method used by the Franchise Tax Board in recomputing the credit. Any statements in that opinion which are inconsistent with our decision herein are, accordingly, disapproved,

As its final argument the Franchise Tax Board asserts that its formula has been used consistently by it and its predecessor, the Franchise Tax Commissioner, since the adoption of the Personal Income Tax Act in 1935, and that a uniform and long-standing construction of a statute by the officials charged with its administration is entitled to great weight unless shown to be clearly erroneous. Richfield Oil Corporation v. Crawford, 39 Cal. 2d 729, 736; Mudd v. McColgan, 30 Cal. 2d 463, 470; Nelson v. Dean, 27 Cal. 2d 873, 880-881; Whitcomb Hotel, Inc. v. California Employment Commission, 24 Cal. 2d 753, 756-757. In our opinion the results obtained by use of the formula show the Franchise Tax Board's construction to be clearly erroneous.

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,

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 E. B. Bishop and Helen Bishop to proposed assessments of additional personal income tax against each of them in the amount of $622.05 for the year 1952 be, and the same hereby is modified as follows: that the tax credit allowed to Each Appellant under Section 17976 (now Section 18001) of the Revenue and Taxation Code for the year 1952 be increased in the amount of $614.95 and that the amounts of the deficiency assessments be adjusted accordingly; as so modified said action is hereby sustained.

Done at Sacramento, California, this 7th day of May, 1958, by the State Board of Equalization.

George R. Reilly, Chairman

J. H. Quinn, Member

Paul R. Leake, Member

Robert E. McDavid, Member

________________, Member

ATTEST: Dixwell L. Pierce, Secretary