



BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
COVERT, JR., AND LAURA J. ROBERTSON)

For Appellants: Pier Gherini, Attorney at Law

For Respondent: Burl D. Lack, Chief Counsel;
James T. Philbin, Junior 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 Covert, Jr., and Laura J. Robertson to a proposed assessment of additional personal income tax in the amount of \$25'7.10 for the year 1956.

Appellants, California residents, owned a forty (40) percent interest in the Hickory Hill Land Co., a Michigan partnership, which paid to the State of Michigan tax due for the year 1956 under the Michigan Business Activities Tax (Act 150, P.A. 1953 as amended by Act 17, P.A. 1954; Act 9, P.A. 1955; and Act 282, P.A. 1955). As husband and wife, Appellants filed a joint California personal income tax return for 1956 on which they credited against the tax due their proportionate share of the business tax paid by the Michigan partnership. The amount claimed was \$273.52. The Franchise Tax Board disallowed the credit but did permit a deduction for the Michigan tax in computing net income; thus it assessed additional personal income tax in the amount of \$257.10.

The Franchise Tax Board contends that the Michigan Business Activities Tax is not a net income tax within the meaning of Section 18001 of the Revenue and Taxation Code and Appellants claim that it is. This is the sole issue before us.

Section 18001 of the Revenue and Taxation Code permits residents of California a credit against their personal income tax "... for net income taxes imposed by and paid to another state on income taxable under this part ..." Reg. 17976(a) Title 18, California Administrative Code, provides:

"(1) . . . Since credit may be allowed only for net income taxes, no credit may be allowed for taxes imposed on gross receipts, gross income, dividends, etc., which must be paid regardless of whether or not the subject of the tax constitutes net income, even though in particular instances the subject taxed is net income in whole or in part."

Appeal of Covert, Jr., and Laura J. Robertson

Credit provisions must be strictly construed. As Justice Curtis said in Miller v. McColgan, 17 Cal. 2d 432, 441 "... allowing a credit is in effect an exemption from liability for a tax already determined and admittedly valid, and such statute must be strictly construed against the taxpayer . . ." Therefore, Appellants are not entitled to a credit unless the Michigan Business Activities Tax is a net income tax. Nothing less than that, no matter how similar, will suffice.

It is axiomatic that a tax which is payable when there is no net income cannot be a net income tax. In applying this test to the question here posed, we must analyze the Michigan tax.

Basically, the Business Activities Tax imposes upon all persons engaged in business activity, except salary and wage earners, a tax on that person's "adjusted receipts." "Adjusted receipts" are the gross receipts from business less deductions for: (1) certain taxes, (2) any amounts paid to other businesses for the acquisition or use of property or services other than capital assets, (3) interest, (4) rent, and (5) depreciation. A deduction of 50% of the gross receipts is allowed even if the total of the above-mentioned deductions is less than that amount. No deduction is allowed for wages, except that if they exceed 50% of the gross receipts then a deduction of 10% of the gross receipts or half of the excess, whichever is smaller, may be taken in addition to the basic 50% deduction. The act provides that the tax is to be reduced in the percentage, not in excess of 25%, that 1% of the "adjusted receipts" bears to the "net income." "Net income" is defined by the act as the gross receipts less certain costs, including the cost of wages.

Without discussing the economic theory upon which this unusual tax is based, it is clear that the tax could apply even if the cost of wages were so high as to eliminate any net income to the taxpayer. While a precise and universally acceptable definition of net income may not be possible, it is not needed here. It is commonly understood, and is recognized by the Michigan act itself, that a deduction for the entire cost of wages is a basic requirement in arriving at the net income of a business. (Webster's New International Dictionary, 2d Ed. (see "income"); First Trust Co. of St. Paul v. Commonwealth Co., 98 Fed. 2d 27, 31 Hawaii Consolidated Ry., Ltd. v. Borthwick, 105 Fed. 2d 286; Cook v. Walters Dry Goods Co., 206 S. W. 2d 74.2; People v. Knapp, 175 N. Y. Supp. 337.) Since the Michigan tax could apply despite the lack of net income, it cannot be a net income tax.

The conclusion that the tax involved is not a net income tax is supported by the views of the Deputy Commissioner, the Business Activities Tax Director, and the Research Analyst in the Michigan

Appeal of Covert, Jr., and Laura J. Robertson

Department of Revenue. They have stated that "It will be observed that the tax is something of a hybrid, possessing characteristics of a net income tax and a gross receipts tax, but differing fundamentally from them" and that "The weight of academic opinion, definitely, is that the value-added tax is a species of sales tax." (The Michigan Value-Added Tax, 8 National Tax Journal, 357, 361, 369.)

Our holding is confirmed by a recent decision of the Michigan Supreme Court which clearly indicates that the Michigan Business Activities Tax is not a net income tax. Armco Steel Corp. v. Michigan, 102 N. W. 2d 552, app. disp. ___ u. s. Nov. 7, 1960, ~~deal~~ with the problem of whether a foreign corporation doing interstate business in Michigan is exempt from the Business Activities Tax by reason of the Commerce Clause or the Due Process Clause of the United States Constitution. In denying such an exemption the court finds support for its reasoning in United States Supreme Court decisions approving state taxes on a reasonably allocated portion of net income derived from interstate commerce. However, nowhere in its opinion does the court directly refer to the Michigan tax as a net income tax. It states that the mentioned cases support the holding by "analogy," thus recognizing that, while similar, the Michigan Business Activities Tax is not a true net income tax.

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 Covert, Jr., and Laura

Appeal of Covert, Jr., and Laura J. Robertson

J. Robertson to a proposed assessment of additional personal income tax in the amount of \$257.10 for the year 1956 be, and the same is hereby, sustained.

Done at Sacramento, California, this 13th day of December, 1960, by the State Board of Equalization,

John W. Lynch, Chairman

Richard Nevins, Member

Paul R. Leake, Member

_____, Member

_____, Member

ATTEST: Dixwell L. Pierce, Secretary