



BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of }
WILLIAM E. AND ESPERANZA B. MABEE }

For Appellants: Ernst & Ernst and Walter E. Baca,
Certified Public Accountants,

For Respondent: Burl D. Lack, Chief Counsel;
Wilbur F. Lavelle, Associate Tax Counsel

O P I N I O N

This appeal is made pursuant to section 19059 of the Revenue and Taxation Code from the action of the Franchise Tax Board in denying the claims of William E. and Esperanza B. Mabee for refund of personal income tax in the amounts of \$49.56, \$137.28 and \$236.43 for the years 1958, 1959 and 1961, respectively.

Appellants, husband and wife, are California residents who received dividends from corporations operating in Mexico.- The corporations withheld 15 percent of the dividends and remitted that amount to Mexico, as required by Mexican law. The total amounts withheld for the years 1958, 1959 and 1961 were \$1,651.88, \$1,961.10 and \$3,377.56, respectively. On their California personal income tax returns, appellants reported the gross amounts of the dividends without deducting the amounts withheld.

Appellants contend, contrary to respondent's view, that the pertinent Mexican tax law imposes a deductible gross receipts tax. In the alternative, they maintain that the Mexican tax is on the corporations and therefore the amounts withheld are not includible in appellants' gross income.

Former section 17204 of the Revenue and Taxation Code provided that:

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(a) Except as otherwise provided in this section there shall be allowed as a deduction taxes paid or accrued within the taxable year,

(b) 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;

* * *

Pursuant to article 1 of the Mexican Income Tax Law, tax is imposed on the revenue derived from capital, from labor or from a combination of both, in the manner outlined in the law. The term "income" is defined in article 2 as including profits, proceeds, gains and in general,, *any* receipts in cash, in kind, or in credits which modify the net worth of the taxpayer, (See articles 1 and 2 of the Mexican Income Tax Law as reported in Foreign Tax Law Ass'n, Inc., Mexican Income Tax Service. See also 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 types of activity, It provides for a schedular income tax, an excess profits tax and a distributable profits tax, which is a tax on income from capital investment in **commercial** and other entities, (Harvard Law School, World Tax Series, Mexico, pp.53,54.) The distributable profits tax is computed at a rate of 15 percent on the net book profits of entities, including corporations, Net book profits are computed according to generally accepted accounting methods. In arriving at distributable profits, deductions are allowed for the schedular **income** taxes and excess profits taxes, paid by the corporation, (Harvard Law School, World Tax Series, Mexico, pp. 55, 315, 316,)

Appellants argue that the distributable profits tax, which was withheld from their dividends, is **analogous** to the tax withheld by Canada under section 106 of the Canadian Income Tax Act and that the Canadian tax is deductible as a gross receipts tax; We have not had occasion in the past to determine whether section 106 of the Canadian Income Tax **Act is** , a gross

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receipts tax and we make no decision as to whether a tax imposed thereunder is deductible. In the Appeal of Georgica Guettler, Cal, St. Bd. of Equal., April 1, 1953, and the Appeal of Edward Meltzer, Cal, St. Bd. of Equal., April 1, 1953, we did hold that the Canadian tax there involved was a gross receipts tax and therefore was deductible. The tax was imposed under section 27(1) of the Canadian Income War Tax Act on the gross amount of payments for anything used or sold in Canada. Since the Canadian law did not allow any deduction for the cost of goods sold, it was not an income tax but a gross receipts tax, imposed on returns of capital as well as income.

It is readily apparent that the distributable profits tax withheld from appellants' dividends is unlike that in the Guettler and Meltzer appeals. The distributable profits tax, consistent with the entire Mexican Income Tax Law, is a tax on "income" as that term is generally understood in this country, namely, a tax on gain or profit and not a tax on the return of capital,

As an alternative ground, appellants contend that the amounts withheld by the corporations in Mexico were actually taxes on the corporations and therefore only the net amount of dividends is **includible** in appellants' gross income.

The distributable profits tax is, by the express terms of the Mexican law, imposed on the shareholders. The tax is computed on the **profits** of the corporation whether or not distributed and the tax must be withheld and paid by the corporation for the account of the shareholders. If any distributions are made, the tax is required to be withheld and paid within one month after **distribution**. Any distributable profits remaining at the year's end are then taxed and the tax is remitted to the Republic of Mexico. The corporation and the shareholders are jointly liable for payment, (Harvard Law School, World Tax Series, Mexico, pp. 313, 314, 324, 325.)

In Biddle v. Commissioner, 302 U.S. 573 [82 L. Ed, 431], a British tax was held to have been paid by the corporation there involved, notwithstanding the fact that a proportionate amount of the tax was specifically deducted from the stockholder's dividend and that, for certain purposes, the British law regarded the tax as paid by the stockholder. As pointed out by the Court, the tax there was essentially the same as an income tax paid by a corporation under United States tax laws and passed on to the stockholders without formally deducting it from each dividend. A similar result was reached on the same grounds in Brantman v. United States, 167 F. Supp. 885, with respect to a Singapore tax.

In the case of: the Mexican tax law before us, the

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tax which is **essentially** the same as one paid by corporations under the laws of both California and the United States is the schedular income tax which the Mexican law imposes on business income of corporations. The distributable profits tax is expressly imposed on the stockholder and it is computed after deduction of the schedular **income** tax imposed **on the corporation**,

Construing an earlier but very similar Mexican tax law, the United States Internal Revenue Service has ruled that where a dividend was received by a corporate stockholder in the United States from a corporation in Mexico which had **withhe** the Mexican distributable profits tax prior to the date at **which** the tax was required to be paid, the tax was to be deemed imposed on the stockholder, The corporation was to be regarded as the taxpayer where the tax was paid on undistributed profits, since there was no certainty that the stockholder would ever receive the profits, (**I.T.3683, 1944 Cum, Bull, 290.**)

We have no doubt that the distributable profits tax paid on current profits within one month after they are distributed is properly regarded as a tax **on the stockholder and** that the gross amount of the dividend, without deduction for the tax withheld, is **includible** in **his** gross income, We need not decide whether the distributable profits tax is on the stockholder in other circumstances since there is no contention or evidence that such circumstances existed **in** the, case before us.

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**,

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IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section 19060 of the Revenue and Taxation Code, that the action of the Franchise Tax Board in denying the claims' of William E. and Esperanza B. Mabee for refund of personal income tax in the amounts of \$49.56, \$137.28 and \$236.43 for the years 1958, 1959 and 1961, respectively, be and the same is hereby sustained.

Done at Sacramento, California, this 4th day of January, 1966, by the State Board of Equalization.

Geo. R. Healey Chairman
John W. Lusk Member
Walter R. Lohr Member
Richard K. Klein Member
_____ Member

Attest, : [Signature] Secretary