

BEFORE THE STATE BOARD OF EQUALIZATION  
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of )  
  )  
ARTHUR P. AND JEAN MAY RECH      )

Appearances:

For Appellants: Gerard C. Tracy  
  Attorney at Law

For Respondent: Joseph W. Kegler  
  Supervising 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 Arthur P. and Jean May Rech against a proposed assessment of additional personal income tax for the year 1960. After the filing of the appeal, respondent agreed with appellants that the amount in issue was \$25,690.94 rather than \$29,296.79. Appellants paid the lesser amount, and under section 19061.1 of the Revenue and Taxation Code, we shall treat the appeal from the action of the Franchise Tax Board as an appeal from the denial of a claim for refund of personal income tax in the amount of \$25,690.94.

The question presented is whether appellants may deduct or credit income taxes paid to five foreign countries in determining their California income tax liability.

Appellants Arthur P. and Jean May Rech reside in California. During 1960 Mrs. Rech was a partner in the following foreign partnerships: -George S. May Company, Canada; George S. May International Company, Great Britain; George S. May International K. G. and

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George S. May International Company; Germany; George S. May International K. G. and George S. May International Company, Belgium; George S. May International K. G. and George S. May International Company, Netherlands; George S. May International Company, Austria; George S. May International Company, Italy; and George S. May International Company, France. Mrs. Rech was also a partner in the following domestic partnerships located in Illinois: George S. May International Company and International Marketing; George S. May Company; and Tam O'Shanter Enterprises. These foreign and domestic partnerships were engaged in providing counseling in business organization, systems, and methods.

On their original 1960 return appellants reported net income from all the partnerships of \$446,094.32, which was appellants' share of the net gains and losses.. This return indicated that their share of partnership net-income, from the British, French, Dutch, German, and Belgian partnerships totaled \$583,872.39 upon which foreign taxes amounted to \$383,880.80. This latter amount was credited against California income tax liability of \$29,296.79 and consequently appellants reported that no California income tax was due. Respondent disallowed the entire credit and reinstated the tax. Appellants protested, and respondent's affirmation of the assessment gave rise to this appeal.

Figures relating to appellants' 1960 income and 1960 foreign income taxes, paid or accrued, were revised slightly as a result of more accurate calculations by appellants and an audit completed by the Internal Revenue Service. These subsequent revisions established that total California taxable income amounted to \$382,013.36 and that foreign income taxes for 1960, paid or accrued, totaled \$342,185.94.

Section 18001 of the Revenue and Taxation Code provides:

... residents shall be allowed a credit against the taxes imposed by this part for net income taxes imposed by and paid to another state on income taxable under this part.

Prior to 1957, section 18001 allowed a credit for taxes paid to foreign countries. In that year, the Legislature deleted the words "or country" following the word "state." (See Stats. 1957, ch. 215, p. 877.)

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Section 17202 of the Revenue and Tax and Code allows a deduction for all the ordinary and necessary business expenses paid or incurred in carrying on a trade or business. Section 17204 of that code disallows the deduction of taxes on or according to or measured by income or profits imposed, by any foreign country or any state.

Respondent disallowed the credit against the tax for foreign taxes paid or accrued because of the absence of any statutory authority for such a credit. It also concluded that section 17204 precluded the alternative of taking a deduction against income;

Appellants contend that under both the federal and California Constitutions the statutory denial of either a credit against tax or a deduction against income, is unconstitutional when applied to their circumstances. They stress that their total foreign and California income tax liability is \$367,876.88, or 96.3 percent of California taxable income of \$382,013.36.

It is true that statutes, innocuous and valid on their face, may become invalid in their application where, their operation fails to provide constitutional equal protection or where their operation results in the taking of private property without due process of law... (Bernstein v. Bush, 29 Cal. 2d 773 [177 P.2d 913].) However, the Legislature is accorded great latitude in establishing tax policy and its power to make classifications in the field of taxation is very broad. (Crocker-Anglo National Bank v. Franchise Tax Board, 179 Cal. App. 2d 591, 594-595 [3 Cal. Rptr. 905].)

Some of the specific constitutional objections now raised by appellants were considered in Tetreault v. Franchise Tax Board, 255 Cal. App. 2d 277 [63 Cal. Rptr. 326], where taxpayers residing and domiciled in California unsuccessfully contended that sections 17204 and 18001 were unconstitutional in operating to deny a deduction or credit for the payment of certain Japanese income taxes; The court concluded that the equal protection clause of the Fourteenth Amendment to the federal Constitution was not violated despite the fact that section 18001 allowed a credit for taxes paid to sister states but not for taxes paid to foreign countries.

In their claim of denial of equal protection, appellants further argue that the instant situation is

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governed by recent court decisions involving one-year residency requirements for public assistance grant eligibility. The principal decision relied upon is Shapiro v. Thompson 394 U.S. 618 [22 L. Ed. 2d 600]. In that case the United States Supreme Court determined that the residency classification penalized the appellant's constitutional right of interstate travel. Since a constitutional right was involved, the Court stated that the classification denied equal protection of the laws unless shown to be necessary to promote a compelling governmental interest. The Court examined and rejected the proposed governmental objectives and held that the classification violated the equal protection clause. We conclude, however, that the denial of a credit, or deduction for foreign taxes does not deter any appreciable number of persons engaging in foreign businesses from exercising their constitutional right of moving into this state. There are differences in the income tax laws of the various states; but, in our opinion, such differences do not have any appreciable, "chilling effect" on the flow of residents to California." (See also Kirk v. Regents of the University of California, \* 273 Cal. App. 2d \_\_\_ [78 Cal. Rptr. 260].) We are not presently concerned with a situation such as in the Supra case, where the residency requirements could cause great suffering and even loss of life. Accordingly, the classification made by the Legislature should be judged by ordinary equal protection standards and respondent need not show that the classification was necessary to promote a compelling state interest.

As explained in the Tetreault case, *supra*, the tax is also not an unconstitutional tax on the privilege of engaging in foreign commerce; Appellants receive income because they are entitled to a share of the profits, and they are not engaged in foreign commerce merely, because they receive income from a foreign source.

We are also unable to conclude that under the facts of this case there has been any confiscation of property without just compensation. Multiple taxation of the same income by different states is valid. (See for example, Guaranty Trust Co. v. Virginia, 305 U.S. 19 83 L. Ed 161; 3 Witkin, Summary of Cal. Law, Taxation 6 13, p. 2122.) The, same result logically follows where

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\* Advance Report Citation: 273 A.C.A. 463.

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some of the jurisdictions are foreign countries. It was also determined in the Tetreault case, supra, that the denial of ' a deduction for a foreign tax paid did not operate unconstitutionally. Income taxes on business income are not- ordinary and necessary expenses-paid or incurred in carrying on a trade or business but are personal expenditures deductible from adjusted gross income only when expressly allowed by statute. (Douglas H. Tanner, 45 T.C. 145, aff'd, 363 F.2d 36; Lutts v. United States, 15 Am. Fed. Tax R.2d 702.)

A similar wide latitude is afforded the Legislature's classification when the state constitutional provisions are considered.' (See, for example, Sawyer v. Barbour, 142 Cal. App. 2d 827 [300 P.2d 1873; Anneal of Richfield Oil Corp., Cal. St. Bd. of Equal., March 2, 1950.) Accordingly, since neither state nor federal constitutional provisions invalidate the code sections relied upon by respondent, we find no basis for altering or overturning its action in this matter.

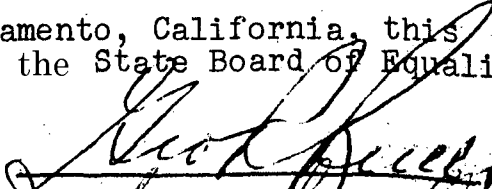
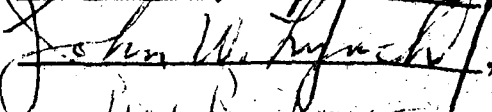
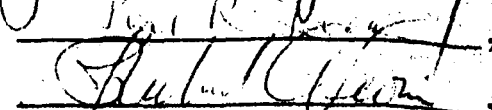
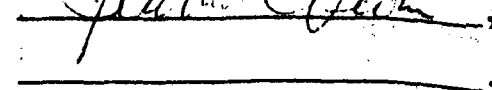
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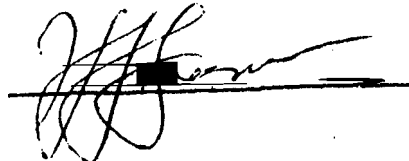
Pursuant to the views expressed in the opinion of the board on file in this proceeding, and good cause appearing therefor,

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IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section 19060 of the Revenue and Taxation Code, that the disallowance by the Franchise Tax Board of the claim of Arthur P. and Jean May Rech for refund of personal income tax in the amount of \$25,690.74 for the year 1960 be and the same is hereby sustained.

Done at Sacramento, California, this 3rd day of August, 1970, by the State Board of Equalization.

  
\_\_\_\_\_, Chairman  
  
\_\_\_\_\_, Member  
  
\_\_\_\_\_, Member  
  
\_\_\_\_\_, Member  
\_\_\_\_\_, Member

ATTEST:  \_\_\_\_\_, Secretary