



BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
CHARLES T. AND MARY R. HAUBIEL)

Appearances:

For Appellants: Charles J. Higson
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 Charles T. and Mary R. Haubiel against proposed assessments of additional personal income tax in the amounts of \$1,466.39, \$3,663.26, \$3,655.91, and \$5,279.69 for the years 1964, 1965, 1966 and 1967, respectively.

Appellants, residents of California, filed joint California personal income tax returns for each of the appeal years. Mrs. Haubiel is a substantial shareholder in Tsumeb Corporation, a South West African corporation engaged in mining copper and other metals. During the appeal years substantially all of appellants' income was derived from cash dividends paid from the earnings of Tsumeb Corporation. Pursuant to the nonresident shareholders' tax provisions of

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the South West African Income Tax Act of 1962, Tsumeb Corporation withheld a percentage of the dividends declared with respect to Mrs. Haubiel's stock. In their California income tax returns appellants included the entire amount of the dividends declared and claimed the amount of the tax withheld in each year by the corporation as an itemized deduction.

Respondent disallowed each deduction on the grounds that the South West African nonresident shareholders* tax is a nondeductible foreign tax "on or according to or measured by income or profits" within the meaning of section 17204 (c) (2)(A) of the Revenue and Taxation Code. The resulting proposed assessments were protested by appellants. Respondent's denial of that protest gave rise to this appeal.

Section 17204 of the Revenue and Taxation Code provides that all taxes paid or accrued within the taxable year in carrying on a trade or business or in the production of income shall be allowed as a deduction except that:

(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;

* * *

The sole question for determination is whether the South West African nonresident shareholders' tax withheld from appellants' dividends is a tax "on or according to or measured by income or profits."

The nonresident shareholders' tax provides, in pertinent part, that the tax shall be paid in respect of the amount of any dividend declared after June 30, 1962, if the shareholder to whom the dividend has been paid or is payable is a person not ordinarily resident nor carrying on a business in the Republic. (Part III, Section 42, South West African Income Tax Act of 1962.)

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The term "dividend" is defined in section one of the act which provides:

S.1 (viii) 'dividend' means any amount distributed by a company...to its shareholders...and in this definition the expression 'amount distributed' includes--

* * *

(b) in relation to a company that is not being wound up or liquidated, any profits distributed, whether in cash or otherwise, and whether of a capital nature or not, including an amount equal to the nominal value of any bonus shares, debentures or securities awarded to the shareholders;

* * *

It is well settled that the criteria prescribed by our own revenue laws and court decisions control the meaning of the words "income taxes" and that the label placed upon the tax by a foreign government is not controlling. (Biddle v. Commissioner, 302 U.S. 573 [82 L. Ed. 431].) For our purposes 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. 521]; Southern Pacific Co. v. Lowe, 247 U.S. 330 [6 L. Ed. 1142]; see also Motland v. United States, 192 F. Supp. 358.)

In the instant appeal all dividends received by appellants and reported as gross income in their returns for the years in question were cash dividends paid out of Tsumeb Corporation's earnings. That cash dividends paid out of corporate earnings are income within the ambit of our revenue laws is, of course, elementary, (See Eisner v. Macomber, *supra*, 252 U.S. at 209; Lynch v. Hornby, 247 U.S. 339, 344 [62 L. Ed. 1149, 1151].)

However, appellants contend that a fair reading of the South West African Income Tax Act, either in its entirety or solely with respect to the nonresident share-

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holders* provisions, leads to the conclusion that the taxation of capital constitutes an integral part of the act. Therefore, conclude appellants, the tax is not a tax "on or according to or measured by income or profits" and is deductible.

In support of their position appellants advance two arguments. First, the South West African Income Tax Act includes as taxable income the full amount of annuity payments which include, in part, a return of capital. Since a return of capital is taxed by this procedure, reason appellants, the entire South West African income tax structure is infected with this defect and, therefore, cannot be considered as levying a nondeductible tax on income.

Next appellants argue that the nonresident shareholders' tax is a deductible tax on specific items of gross receipts since it is imposed not only on cash dividends but also upon stock dividends which constitute a return of capital and not gross income. As authority for this proposition appellants rely on Anneal of Georgica Guettler, Cal. St. Bd. of Equal., April 1, 1953, and Appeal of Edward Meltzer and Frieda Liffman Meltzer, Cal. St. Bd. of Equal., April 1, 1953. In Guettler and Meltzer the Canadian Income War Tax Act was held to be a gross receipts tax and not an income tax on the basis of a provision which taxed gross receipts from the sale of property without a deduction for cost of goods sold as well as from royalties and rents. In neither Guettler, involving royalties, nor Meltzer, concerning rents, was any tax withheld from the sale of property. Nevertheless, a deduction was allowed on the basis that the law imposed a tax upon specific items of gross receipts since where such payments were consideration for the sale of property, part of the receipts represented a return of capital.

Whether certain provisions of the South West African Income Tax Act purport to tax gross receipts or a return of capital as appellants allege in the case of annuities or stock dividends, matters which we are not required to determine here, is not controlling in view of the fact that in this appeal the specific tax for which a deduction is claimed is a tax on cash dividends paid out of earnings. Such a tax is clearly a tax on income.

In conclusion it is held that the South West African nonresident shareholders' tax, as applied to the appellants in the instant matter by taxing the receipt of cash dividends paid out of corporate earnings, constitutes

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a tax "on or according to or measured by income or profits" within the meaning of section 1720⁴ of the Revenue and Taxation Code and is not deductible. To the extent that the decisions in Guettler and Meltzer are inconsistent with this holding they are overruled.

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 protest of Charles T. and Mary R. Haubiel against proposed assessments of additional personal income tax in the amounts of \$1,466.39, \$3,663.26, \$3,655.91, and \$5,279.69 for the years 1964, 1965, 1966 and 1967, respectively, be and the same is hereby sustained.

Done at Sacramento, California, this 16th day of January, 1973, by the State Board of Equalization.

William G. Zorn, Chairman
Geoffrey, Member
John W. Pugh, Member
Paul Davis, Member
_____, Member

ATTEST: W. W. Dunlop, Secretary