BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
PHILIP F. AND AIDA SIFF)

For Appellants: Philip F. Siff, in pro. per.

For Respondent: Bruce W. Walker
Chief Counsel

Noel J. Robinson
Counsel

OPINION

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 Philip F. and Aida Siff against a proposed assessment of additional personal income tax in the amount of $200.60 for the year 1969.

Appellants are California residents. On their 1969 joint state income tax return they reported gross income from cash dividends received by Philip F. Siff, hereafter "appellant." Some of the income constituted dividends paid by foreign corporations from which certain amounts were withheld in accordance with the tax laws of the various foreign nations. On a schedule attached to.the return, appellant disclosed the gross foreign dividends ($13,046.35), and subtracted the sums withheld ($2,010.09), reporting as gross income only the net foreign dividends ($11,036.26).

The amounts withheld in the various countries were as follows:

United Kingdom	$ 957.30
Canada	556.94
Netherlands	178.37
Japan	96.88
South Africa	29.81
Australia	9. 74
Not Specified	181.05
Total	$2.

Respondent restored the $2,010.09 to gross income. Its denial of appellant's subsequent protest gave rise to this appeal. Appellant contends that the amounts withheld should not be included in gross income because they were never received.1/

Thus, we must determine whether the sums withheld were properly excludable from gross income. If not properly excludable, the second issue is whether they were, nevertheless, deductible from gross income by statute, inasmuch as the result would be equally beneficial to appellant.

1/ Appellant further emphasized that pursuant to federal law and regulations, he included the amounts withheld in gross income for federal income tax purposes, but was thereby entitled to credit them against the federal income tax due. However, unlike federal law, California does not provide for a credit against tax liability for foreign taxes paid.

In resolving the first issue, the fact that the amounts were not received is not controlling. If the sums withheld were foreign taxes imposed upon appellant, the discharge of his tax liability through the withholding of such amounts was a benefit to him constituting gross income. (See Old Colony Trust Co. v. Commissioner, 279 U. S. 716 [73 L. Ed. 918]; I.T. 2762 XIII-1 Cum. Bull. 64 (1934).) Moreover, the taxation of amounts withheld for the payment of taxes at the source is not a novel concept. For example, individuals paying California income taxes do not receive federal income taxes that are withheld but pay state income tax on such income nevertheless.

If, however, the legal incidence of a foreign tax is upon the foreign corporation, and the amounts retained merely represent economic reimbursement to the corporation for its own tax liability, such sums would properly be excludable from the gross income of the appellant stockholder. (See Biddle v. Commissioner, 302 U. S. 573 [82 L. Ed. 431].) Thus, the critical inquiry with respect to the first issue is whether, under criteria adopted under our own revenue laws and decisions, the particular foreign tax was imposed upon the appellant stockholder or the corporation. (See Biddle v. Commissioner, supra.)

With respect to the second issue, i. e. , the deductibility question, section 17204 of the Revenue and Taxation Code provides that all taxes paid or accrued within the taxable year 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;. ..

Accordingly, if the amounts withheld were foreign taxes imposed upon appellant, they were not deductible provided they constituted taxes "on' or according to or measured by income or profits, " under our own standards. In this connection, if foreign taxes are paid because of receiving cash dividends out of corporate earnings, as contrasted with foreign.taxes paid because of a return or partial return of capital from a corporation, such taxes are clearly nondeductible income taxes, (Appeal of Charles T. and Mary R. Haubiel, Cal. St. Bd. of Equal. , Jan. 16, 1973; Appeal of William E. and Esperanza B. Mabee, Cal. St. Bd. of Equal. , Jan. 4, 1966.)

With reference to the first issue, respondent has treated the taxes as imposed upon appellant and not upon the foreign corporations. Respondent's position with regard to the second issue is that the amounts withheld were taxes "on or according to or measured by income or profits, " and, thus, not deductible. Since resolution of the issues depends upon the effect of foreign laws and not merely on the interpretation of California or federal law, the burden is on appellant to show error. (See Bank of America National T. & S. Ass'n v. United States, 459 F. 2d 513, cert. denied, 409 U. S. 949 [34 L. Ed. 2d 220].) Appellant has not provided us with any source material concerning the foreign taxes. We have, however, reviewed certain source material relating to the foreign taxes. Cur conclusions with respect to the taxability of the amounts withheld in each country are discussed separately below.

United Kingdom

By the enactment of the United Kingdom Finance Act of 1965, the United Kingdom adopted a two tiered tax system similar to the one employed in the United States, whereby profits were taxed to the corporation when earned, and then to the stockholder when distributed as dividends. Pursuant to that act, the amount withheld from such dividend distributions in the United Kingdom was an income tax directly imposed upon the stockholder, collected by the corporation, and paid over to the taxing authority. (See Appeal of Philip B. and Rachael A. Prather, Cal. St. Bd. of Equal. , June 3, 1975; Arthur Andersen & Co., Tax & Trade Guide, United Kingdom (2d ed., Oct. 1969) § 8.01.) We understand that this was the state of the law in the United Kingdom during 1969. Consequently, the amounts withheld represented taxes upon appellant, and were also taxes "on or according to or measured by income or profits." Thus, they were neither excludable nor deductible from gross income. 2/

Canada

In the Appeal of Lloyd W. and Ruth Bochner, decided May 15, 1974, the taxpayers therein received cash dividends in **1969** from which amounts were withheld by a foreign corporation or corporations located in Canada. We held, under the Canadian Income Tax Act as it read in 1969, that the taxes retained were "on or according to or measured by income or profits, " and, therefore, not deductible. Accordingly, we find that our decision in Bochner, supra, compels a determination that the dividends in question in the present appeal are also not deductible.

In Bochner, there was no mention of any allegation, or discussion, concerning whether the sums withheld constituted amounts retained by corporations for reimbursement of their own tax liability rather than taxes imposed upon the stockholders. However, we note statements in two editions of the same authoritative source on Canadian income tax law (one concerned with pre-1969 Canadian law, the other with the state of the law after 1969) explaining that a nonresident person is subject to tax on amounts received as dividends from a resident corporation of Canada. (See C. C. H. , Canadian Master Tax Guide, A Guidebook to Canadian Income Tax, ¶ 2110, 24th & 27th eds.) Based upon this authority, we conclude that the amounts withheld in 1969 from appellant's dividends represented taxes imposed upon him and not merely reimbursement to the corporation for its own tax liability. Therefore, they were not excludable from gross income.

2/ The United Kingdom's income tax law was radically changed by the Income and Corporation Taxes Act of 1970. Under those provisions, the corporation accounts for advance corporation tax on dividends. Cash dividends are not technically subject to withholding but apparently the stockholder bears the ultimate burden pursuant to a "credit" system. (See Haskins & Sells, International Tax & Business Service, Taxation in the United Kingdom (Nov. 1974 ed.) §§ 3.02, 4.01, 5.02, 6.04, 9.01.) We find, however, that 1969 dividends were governed by the earlier law. We express no opinion on the tax consequences had the amounts in question been "credits" under the 1970 act.

Netherlands

During 1969, under the Netherlands income tax system, corporations paid an income tax based on their profits as that term is generally understood here; dividends were payable out of corporate profits, and stockholders were liable for tax on dividends which was withheld at the source by corporations located in the Netherlands. (See Foreign Tax Law Ass'n, Inc., Netherlands Income Tax Service (Nov. 1969 ed.) pp. 1, 3, 11, 12, 28, 29, 43, 44, 45, 46.) Consequently, we conclude that the amounts withheld represented taxes imposed upon appellant and were taxes "on or according to or measured by income or profits." Thus, these sums were neither excludable nor deductible from gross income.

Japan

We have reviewed the comments concerning Japanese income taxes in Haskins & Sells., International Tax & Business Service, Taxation in Japan (May 1971 ed.), hereafter "Haskins". This authoritative source explains that Japan levies an income tax on corporations, (See Haskins, § 3.01.) Corporations pay this tax on their distributed and undistributed income: (See Haskins, § 3.03.) The tax laws of Japan provide no comprehensive definition of corporate income, but the basic principle of Japanese tax law is to tax nearly all revenue over and above the expenses used to produce it. (See Haskins, § 6.01,) Therefore, corporations are liable for what is an income tax, under our criteria. Income tax is also withheld from dividends, the latter being distributions from corporate profits; however, this is an income tax imposed upon the stockholder and not the corporation. (See Haskins, §§ 5.02, 5.03, 6.03.) We also find that the same pattern of taxation existed prior to 1969. (See Arthur Andersen & Co. , Tax. & Trade Guide, Japan (1968 ed.) §§ 6.18, 6.102.)

Consequently, it is our view that during 1969 there was a two tiered income tax structure, with a separate tax imposed upon the stockholder by withholding which was "on or according to or measured by income or profits." Accordingly, the sums withheld were again neither excludable nor deductible from gross income.

South Africa

Pursuant to the codified text of the South African Income Tax Law, corporations pay a normal tax on their taxable income: nonresident shareholders not carrying on a business in the Republic are specifically liable for the separate nonresident shareholders' tax which is withheld from dividends at the source. (See Foreign Tax Law Ass'n, Inc. , South African Income Tax Service (Codified text of Income Tax Law to Aug. 1, 1973) pp. 14, 102, 103, 106.) Broadly speaking, the gross income of corporations is defined in the basic statutory authority (Income Tax Act No. 58 of 1962) a's the total amount, in cash or otherwise, received or accrued from a source within the Republic, excluding receipts or accruals of a capital nature. (See Haskins & Sells, International Tax & Business Service, Taxation in South Africa (Jan. 1971 ed.) § 6.01, hereafter "Haskins".) In determining their taxable income, corporations are allowed certain deductions from gross income, and then pay the normal tax at a flat rate on such income. (See Haskins, §§ 3.01, 7.01.) Therefore, corporations pay an income tax that is entirely distinct from the tax they withhold. Thus, the amounts withheld reflected taxes imposed on appellant and were not excludable from gross income.

While cash dividends are paid out of corporation "profits' earned in the Republic, under the terminology in the codified text, apparently such dividends from "profits" may or may not be of a capital nature. (See Foreign Tax Law Ass'n, Inc. , South African Income Tax Service, supra, p. 3; Haskins, § 5.02.) As already indicated, however, nothing has been offered by appellant to establish that the dividends represented a return of capital. Since the burden of showing error is on appellant, we conclude that the dividends in 1969 reflected a distribution of corporate earnings. Under such circumstances, the dividends were income and the amounts withheld constituted a tax "on or according to or measured by income or profits. " Thus, the sums withheld were not deductible from gross income.

Australia

Under Australian tax law, corporations pay a tax on "assessable income" less expenses incurred in earning it and less other deductions. (See Haskins & Sells, International Tax & Business Service, Taxation in Australia (June 1969 ed.) § 6.01, hereafter "Haskins".) It is explained in section 6.01 of Haskins that, subject to specific statutory modifications, a corporation's receipts are not income to it if they represent a return of capital. Thus, it appears that corporations are liable for what is essentially an income tax, under our standards.

Corporations withhold from dividends a separate tax imposed on nonresident stockholders not engaged in business in Australia. (See Haskins, § 5.02.) Cash distributions reflecting a. return of capital, rather than earnings, are apparently not taxable thereunder. (See Haskins, § 9.04.) In any event., we have not been shown that because of some, statutory modification, receipts of the corporation constituting a return of capital were distributed to appellant.

Thus, we conclude that the sum withheld reflected a tax imposed upon appellant, and was a tax "on or according to or measured by income or profits. " Therefore, it was neither excludable nor deductible from gross income.

Summary

No material has been presented establishing that the various amounts withheld were other than foreign taxes imposed upon appellant; nor that they were taxes other than "on or according to or measured by income or profits, " under our standards. Our research indicates, in fact, that the sums retained were income taxes imposed upon appellant. Therefore, we conclude that all the amounts withheld were neither excludable nor deductible from gross income. Accordingly, we must sustain respondent's action.

Appeal of Philip F. and Aida Siff

ORDER

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 Philip F. and Aida Siff against a proposed assessment of additional personal income tax in the amount of $200.60 for the year 1969, be and the same is hereby sustained.

Done at Sacramento, California, this 19 day of August 1975, by the State Board of Equalization.

John W. Lynch, Chairman

William M. Bennett, Member

George R. Reilly, Member

Richard Nevins, Member

________________, Member

ATTEST: W. W. Dunlop, Executive Secretary