

CALIFORNIA FRANCHISE TAX BOARD

Legal Ruling No. 371

January 15, 1974

DEDUCTIONS: DEDUCTIBILITY OF HAWAIIAN GROSS INCOME FROM CALIFORNIA INCOME FOR TAX PURPOSES

Syllabus:

Where a trust located in Hawaii pays its Hawaiian gross income tax liability, but fails to pay its California tax liability, trust beneficiaries who reside in California are required to report as California income their share of the entire trust income, when it is distributed or becomes distributable to them, with no deduction allowable for the payment of this Hawaiian tax.

Advice has been requested as to whether the beneficiaries of a trust located in Hawaii can deduct from trust income received the amount of Hawaiian gross income tax paid by the trust before distribution, for income tax purposes. The taxpayers herein are residents of California, as are the three other beneficiaries of the trust. The taxable years in question are 1969, 1970, 1971 and 1972. The taxpayers reported their share of the distribution as income in each of these years, excluding the amount of Hawaiian gross income tax paid by the trust.

(1) Under Sections 17742 and 17745(a) of the Revenue and Taxation Code, a trust is liable for California taxes on its entire taxable income if a beneficiary resides in California, and if for some reason the trust fails to pay this tax, the trust income shall be taxable to the beneficiary when it becomes distributable to him, to the extent of his distributive share thereof. (Section 17744). See McCulloch v. Franchise Tax Board, 61 Cal.2d 186, 192, 37 Cal.Rptr. 636, 390 Pac.2d 412 (1964).

In the instant case, the taxpayers-beneficiaries are residents of California and, since the trust did not pay California income taxes for its 1969, 1970, 1971 and 1972 taxable years, this tax is payable by the beneficiaries who reside in California, when the trust income is distributed to these beneficiaries.

(2) It is stated in Appeal of L.N. Jesson and L.N. Jesson, as Executor of the Will of Mrs. L.N. Jesson, Cal. St. Bd. of Equal., June 24, 1957, CCH 200-731, P-H 58,109, that "Gross receipts taxes are those imposed upon capital as well as income." It is this factor, that capital be included in taxable receipts, that has been of prime concern in all decisions as to the deductibility of foreign taxes paid. Appeal of Georgica Guettler, Cal. St. Bd. of Equal., April 1, 1953, CCH 200-212, P-H 58,079; Appeal of Edward and Frieda L. Meltzer, Cal. St. Bd. of Equal., April 1, 1953, CCH 200-213, P-H 58,081.

The decisions of Guettler, supra, and Meltzer, supra, stated basically that if the language of the foreign taxing statute involved could be construed to include within "gross receipts" the amount which represents the return of capital, then the payment of this foreign tax will be allowed as a deduction from California gross income. The Appeal of Charles T. and Mary R. Haubiel, Cal. St. Bd. of Equal., January 16, 1973, CCH 204-882, P-H 58,017-D, reversed Guettler and Meltzer to the extent that the language of the statute of the foreign state or country which imposes the tax is not controlling. The controlling factor is whether the specific tax imposed and for which deduction is claimed is a tax on income exclusively.

Section 17071(a)(15) of the Revenue and Taxation Code specifically classifies income from a trust as an item of gross income. Therefore, under California law, the Hawaiian gross income tax imposed on these receipts was clearly on income, not capital. No deduction from California income can therefore be allowed for the payment of this Hawaiian gross income tax in the situation here presented.