



BEFORE THE STATE BOARD OF. EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
ROBERT G. AND JO ANN ARMSTRONG)

Appearances:

For Appellants: Robert G. Armstrong, in pro. per.

For Respondent: Karl F. Munz
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 Robert G. and Jo Ann Armstrong against proposed assessments of additional personal income tax in the amounts of \$114.25 and \$1,587.18 for the years 1967 and 1969, respectively.

This appeal was consolidated, for purposes of hearing and decision, with the Appeal of Frank and Elsie M. Bartlett, decided this day. The facts and the issue in this matter are, for all practical

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purposes, identical with those in Bartlett. Therefore, we find that the instant appeal is controlled by our decision in Bartlett and we adopt the findings and conclusions set forth therein. They are summarized below.

The appellants in Bartlett were stockholders in a corporation from 1963 until the corporation terminated its existence in 1969. During that period the corporation elected to be taxed as a Subchapter S corporation for federal income tax purposes. Thus, at the federal level the Bartletts were taxed on their proportionate share of all the corporate earnings whether distributed or not. However, California, which has no equivalent of a Subchapter S corporation, taxes shareholders only on the amount of corporate earnings actually distributed by the corporation as dividends.

During the years 1963 through 1969, the Bartletts reported all their proportionate share of corporate income for California income tax purposes for each year whether distributed or not. Since the corporation distributed only part of its earnings while accumulating the rest during most of its existence, the Bartletts overpaid state taxes for most of the years 1963 through 1968. However, when the corporation distributed its accumulated earnings in addition to its entire annual income in 1969, there was a substantial underpayment of **state income tax**.

When the Bartletts' 1969 return was audited in 1972 and respondent discovered the error, the statutory four-year period for filing claims for refund had expired for the years 1963 through 1966. However, claims for refund were allowed for the open years 1967 and 1968. Additionally, respondent applied section 19053.9 of the Revenue and Taxation Code which allows certain overpayments otherwise barred by the statute of limitations to be offset against existing deficiencies. Thus, the overpayments of tax for 1964, 1965 and 1966 were applied as offsets against the 1969 deficiency. However, since section 19053.9 specifically prohibits the allowance of offsets after the expiration of seven years from the due date of the return on which the overpayment was determined, the 1963 overpayment was not offset against the 1969 deficiency.

The sole issue in Bartlett was whether respondent had properly refused to allow the offset of the 1963 overpayment against

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the 1969 deficiency. We held that respondent's action was proper. In so holding, we found that, contrary to the Bartletts' assertion, a schedule attached to their 1969 return could not be construed as a timely assertion of their right to offset. We also held that the doctrine of equitable recoupment was not applicable since the situation was not one where a single transaction or taxable event had been subjected to two taxes on inconsistent legal theories.

Appellants, in the instant proceeding, were shareholders in the same corporation. Beginning in 1963 appellants reported more income than they actually received from the corporation. As a result of this erroneous reporting, appellants overreported their California income for the years 1963 through 1966 and for 1968. However, they underreported income for the years in question, 1967 and 1969. Respondent allowed appellants' claim for refund for 1968 and applied the overpayments for 1964 and 1965 as offsets against the deficiencies pursuant to section 1905 3.9. Appellants maintain that, notwithstanding the seven-year limitation period contained in section 19053.9, the 1963 overpayment should also be applied as an offset against the 1969 deficiency.

Appellants argue, as did the appellants in Bartlett, that a schedule attached to their 1969 return should be construed as a timely assertion of their right to offset. They also urge that the doctrine of equitable recoupment should be applied to allow the offset of the 1963 overpayment against the 1969 deficiency. However, as stated above, this matter is controlled by our decision in Appeal of Frank and Elsie M. Bartlett, decided this day. Accordingly, for the reasons set forth therein, we hold that the schedule attached to appellants' 1969 return, which was identical in form to the schedule attached to the Bartletts' return, cannot be construed as a timely assertion of their right to offset. We also hold that the doctrine of equitable recoupment is not applicable for the reasons set forth in Bartlett.

Appellants advance one additional argument in support of their position. They maintain that the deficiencies which are the subject of the instant appeal relate back to a prior audit of appellants' 1968 return and that their right to offset should have been recognized at that time. However, the prior audit was concerned only with appellants' right to income average for 1968. As part of that

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inquiry it was determined that appellants' income for 1967, one of the base years associated with income averaging, was overstated. When asked to explain this discrepancy, appellants stated that it resulted from reporting all their proportionate share of certain corporation profits for 1967 when they should have reported only the dividends actually received. Appellants did not indicate that this error in reporting was other than an isolated event. Therefore, respondent accepted the information without question and made the necessary adjustments which were not challenged by appellant. It was not until the audit of the 1969 return that it was discovered that the 1967 error was not an isolated event, but that appellants had been making such errors since 1963. Under these circumstances it cannot be concluded that appellants' right to offset should have been recognized at the earlier date.

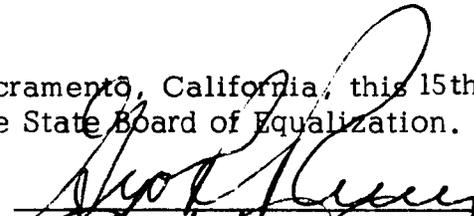
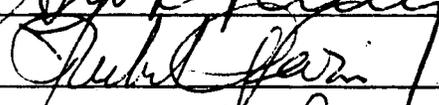
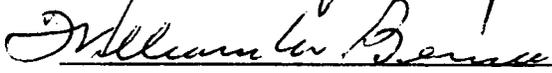
Accordingly, we conclude that respondent's action in this matter must be sustained.

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 Robert G. and Jo Ann Armstrong against proposed assessments of additional personal income tax in the amounts of \$114.25 and \$1,587.18 for the years 19 67 and 1969, respectively, be and the same is hereby sustained .

Done at Sacramento, California, this 15th day of
May, 1974, by the State Board of Equalization.

 , Chairman
 , Member
 , Member
_____, Member
_____, Member

ATTEST:  , Secretary