75-SBE-043

BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
PHILIP B. AND)
RACHAEL A. PRATHER)

For Appellants: Colin C. Hutcheon
Public Accountant

For Respondent: Crawford H. Thomas
Chief Counsel

Paul J. Petrozzi
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 B. and Rachael A. Prather against a proposed assessment of additional personal income tax in the amount of $979.80 for the year 1965.

The question presented is whether appellants are entitled to offset certain overpayments for the years 1963-1965 against a deficiency for 1965.

Appellants are California residents. From 1960 through 1965 they received dividends from one or more United Kingdom corporations. During those years the United Kingdom imposed a withholding tax ("standard tax") on the gross amount of declared dividends. Although appellants were entitled to exclude this tax from the amount of dividend income reported for California income tax purposes, they reported the gross amount of the dividends in their returns for the years 1963-1965.

In 1969 the Internal Revenue Service issued an audit report concerning appellants' federal income tax liability for the years 1965-1967. In, 1971, based upon that report, respondent issued notice of a proposed assessment against appellants for 1965. Certain adjustments were subsequently made and a revised notice of action was mailed in 1972. On April 14, 1972, appellants appealed the revised assessment and for the first time raised the question of overpayments for 1963, 1964 and 1965.

It is undisputed that overpayments for 1963 and 1964 resulted from appellants' failure to exclude the United Kingdom standard tax from the amount of dividend income reported for those years. (A similar overpayment may have occurred for 1965, a point which we will consider separately below.) Prior to certain changes enacted in 1965 in the United Kingdom tax structure, respondent had permitted such exclusion on the basis of Biddle v. Commissioner, 302 U. S. 573 [82 L. Ed. 431], where the Court held that since the standard tax was imposed upon and paid by the corporation, the shareholders could claim neither a foreign tax credit nor a deduction for the tax. In so holding the Court implicitly sustained the Commissioner's position that the shareholders should not have included the tax in their gross income in the first place.

Since respondent has conceded that appellants overpaid their 1963 and 1964 California income taxes, they now seek to recover those overpayments by offsetting them against the deficiency for 1965. Respondent contends, however, that any

recovery of the overpayments is barred by the statute of limitations contained in Revenue and Taxation Code section 19053. That section provides generally that a claim for refund must be filed within four years from the last day prescribed for filing the return or within one year from the date of the overpayment, whichever period expires the later. Appellants do not contend that they filed refund claims for 1963 and 1964 within the statutory period, but rather that those years are still open because the federal audit included a recomputation of their foreign tax credits for the years 1960-1965.[1] No authority has been cited for this proposition, however, and we believe it cannot prevail against the explicit mandate of section 19053. As we have held on previous occasions, statutes of limitations are to be strictly construed, (Appeal of Maurice and Carol B. Hyman, Cal. St. Bd. of Equal., Feb. 26, 1969; Appeal of Estate of James A. Craig, Deceased, and Viola F. Craig, Cal. St. Bd. of Equal., July 7, 1967) and a taxpayer's failure to file a claim within the statutory period, for whatever reason, bars him from seeking recovery of the overpayment at a later date. Therefore, appellants may not now offset their overpayments for 1963 and 1964 against the deficiency for 1965.

On their return for 1965, appellants again failed to exclude the standard tax from the United Kingdom dividend income. they reported for state income tax purposes. Respondent became aware of this when it reviewed the federal audit report to determine if any changes were called for in appellants' state tax liability for that year. Accordingly, in computing the amount of the present deficiency, which arose primarily from an increase in capital gains, respondent allowed an offset for the standard tax to the extent it thought the Biddle case was still applicable. Apparently, respondent

1/ By treaty between the United States and the United Kingdom subsequent to the Biddle decision, a U. S. shareholder was permitted to claim a credit against his federal income taxes for the standard tax, if he elected to include it in his gross income? (Rev. Rul. 54-533, 1954-2 Cum. Bull. 210.)

believed that the rationale of the Biddle case was destroyed during 1965 by the enactment of the United Kingdom Finance Act of 1965, which adopted a two tier tax system similar to the one employed in the United States. (See FTB LR 347, March 30, 1971.) Under the new two tier system, the amount withheld from dividends became a tax directly imposed upon the stockholder, collected by the corporation, and paid over to the taxing authority. (Foreign Tax Law Ass'n, Inc. , United Kingdom Income Tax Service, p. 352.) However, while this change in the law was enacted in 1965, it took effect only with respect to dividends paid after April 5, 1966. (Arthur Andersen & Co., Tax & Trade Guide, United Kingdom (2d Ed.), § 8.76, p. 132; Foreign Tax Law Ass'n, United Kingdom Income Tax Service, pp. 367-368.) Thus, the rationale of the Biddle case remained valid for dividends paid during 1965, and the deficiency assessment should be revised to the extent that it fails. to reflect total exclusion of the standard tax from appellants' dividend income for that year.

ORDER

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

Appeal of Philip B. and Rachael A. Prather

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 B. and Rachael A. Prather against a proposed assessment of additional personal income tax in the amount of $979.80 for the year 1965, be and the same is hereby modified to reflect exclusion of the standard tax from appellants' dividend income for 1965. In all other respects the action of the Franchise Tax Board is sustained.

Done at Sacramento, California, this 3rd day of June, 1975, by the State Board of Equalization.

John W. Lynch, Chairman

_____, Member

_____, Member

_____, Member

_____, Member

ATTEST: W. W. Dunlop, Executive Secretary