

Appeal of Frederick and Carol Engelbrecht

The question presented for our decision is whether respondent's proposed assessment of additional tax for 1977 was barred by the applicable statute of limitations.

In 1982, the Internal Revenue Service conducted an audit of appellant's federal income tax return for 1977. On September 15, 1982, an examiner from the San Francisco district office of the Internal Revenue Service determined that it was necessary to make an adjustment of \$16,394 to appellant's 1977 federal income. The adjustment was documented on a Form 4549 entitled, "Income Tax Examination Changes." (Resp. Br., Ex. A.) This federal audit report indicates that the examiner discussed the adjustments with a certified public accountant apparently representing appellants.

Four months later, on January 28, 1983, the Franchise Tax Board received a copy of the federal audit report from the Internal Revenue Service. In a letter dated March 14, 1983, respondent informed appellants that it had received the federal audit report and that the statute of limitations for issuance of a proposed deficiency assessment is extended where a taxpayer fails to report any federal adjustments within 90 days of the final federal determination. Respondent also advised appellants that it was unable to locate their 1977 state tax return and requested that they forward a copy.

On April 11, 1983, appellants dispatched a letter to the Franchise Tax Board, stating that an \$8,197 federal income tax assessment was made by the Internal Revenue Service for 1977 and that the date of this final federal determination was February 14, 1983. The Franchise Tax Board replied that it had already received the information from the federal authorities. Respondent informed appellants that their original 1977 California return had been destroyed and requested again a copy of the return.

On June 3, 1983, appellants apprised the Franchise Tax Board that their copy of the 1977 return had also been destroyed. In addition, appellants declared that the statute of limitations for assessing additional taxes for 1977 had expired since they had informed respondent of the federal adjustment on April 11, 1983, which, appellants asserted, was within 90 days of the date of the final federal determination. Consequently, appellants argued, they did not owe any additional tax for the year in question. In response, the Franchise Tax

Appeal of Frederick and Carol Engelbrecht.

Board notified appellants that, if they were unable to provide a copy of their 1977 return, an assessment would be issued based on information available to it.

On June 7, 1984, respondent issued the notice of proposed assessment of additional tax in the amount corresponding to the additional income disclosed by the federal audit report. Appellants filed a written protest against the proposed deficiency assessment, but respondent affirmed the assessment in a subsequent notice of action. Appellants thereupon filed this timely appeal.

The basic statute of limitations for proposed deficiency assessments is set forth in section 18586, which provides:

Except in case of a fraudulent return and except as otherwise expressly provided in this part, every notice of a proposed deficiency assessment shall be mailed to the taxpayer within four years after the return was filed. No deficiency shall be assessed or collected with respect to the year for which the return was filed unless the notice is mailed within the four-year period or the period otherwise fixed.

Where the Internal Revenue Service has made changes to a taxpayer's gross income or deductions, however, this four-year statute of limitations is replaced by two alternative statutes whose application depends upon whether or not the taxpayer reported the federal change in his taxable income. (Appeal of Aaron and Eloise Magidow, Cal. St. Bd. of Equal., Nov. 17, 1982.)

Under section 18451, a taxpayer is required to report a federal change or correction in his gross income or deductions to the Franchise Tax Board within 90 days of the final determination of such change or correction by the federal government. (Appeal of William and Betty Hillyer, Cal. St. Bd. of Equal., June 22, 1976.) If the taxpayer complies with section 18451 by reporting the federal adjustment in his gross income or deductions within the **90-day** period, the Franchise Tax Board must mail a notice of the proposed deficiency assessment resulting from the adjustment within six months from the date that the taxpayer made his report. (Rev. & Tax. Code, § 18586.3; Appeal of Anthony C. and Cecilia I. Rossi, Cal. St. Bd. of Equal., Jan. 6, 1981.) On the other hand, if the taxpayer fails to report the federal

Appeal of Frederick and Carol Engelbrecht

adjustment as required by section 18451, respondent may issue a notice of proposed deficiency assessment based on the federal action at any time within four years after the change or correction was made by the federal authorities. (Rev. & Tax. Code, § 18586.2; Appeal of George F. and Aida R. Aymann, Cal. St. Bd. of Equal., May 4, 1976.) These alternative statutes of limitations under sections 18586.3 and 18586.2 come into play whenever the taxpayer **is** required to report a federal adjustment notwithstanding the expiration of the basic four-year limitations period under section 18586. (Appeal of Howard A. Gebler, Cal. St. Bd. of Equal., Aug. 18, 1980; Cal. Admin. Code, tit. 18, reg. 18586.3, subd. (c).)

It is well settled that a deficiency assessment based on a federal audit report is presumptively correct, and the burden is on the taxpayer to prove that respondent's determination is **erroneous**. (Appeal of John M. and Linda S. McCrary, Cal. St. Bd. of Equal., May 19, 1981; Appeal of Donald D. and Virginia C. Smith, Cal. St. Bd. of Equal., Oct. 17, 1973.) Here, since appellants did not provide the requested copy of their 1977 California return, the Franchise Tax Board had no choice **but to** estimate their reported income from their net tax liability and then add the income adjustment indicated in the federal audit report to calculate the deficiency assessment. Appellants do not dispute, however, the correctness of either respondent's determination or the federal audit report. Rather, appellants contend that the Internal Revenue Service adjustment to their federal income tax liability became final on February 14, 1983. They assert that **their** letter of April 11, 1983, constituted timely and adequate notice of this federal **adjustment** under section **18451**. It is appellants' position, therefore, that the applicable statute of limitations is section 18586.3, which would mean that respondent's assessment must have been issued no later than six months after receipt of the April 11 letter.

The "final determination" that section 18451 speaks of is the final determination of changes or corrections in gross income or deductions. (Appeal of William and Betty Hillyer, supra.) Respondent's regulations further explain that "[a] final determination is an irrevocable determination or adjustment of a taxpayer's federal tax liability from which there exists no further right of appeal either administrative or judicial." [Cal. Admin. Code, tit. 18, reg. 18586.3, subd. (e).] In order for a taxpayer to then meet the reporting requirements of section 18451, respondent's regulations

Appeal of Frederick and Carol Engelbrecht

specifically provide that the taxpayer must mail the original or a copy of the final determination of the final adjustment and any other data on which such final determination is based. (Cal. Admin Code, tit. 18, reg. 18586.3, subd. (a).) "The notification must be given by the taxpayer regardless of whether he believes any modification of his tax liability will be required." (Cal. Admin. Code, tit. 18, reg. 18586.3, subd. (a).)

With respect to appellants' contention that the final determination was made on February 14, 1983, we observe that they have not submitted any evidence to prove this claim. In their letter of April 11, 1983, appellants **state** that the federal authorities assessed an additional \$8,197 in taxes for 1977 on February 13, 1983, but they failed to furnish the original or a copy of any document showing that this adjustment in their federal tax liability became irrevocable on that date. Moreover, appellants did not indicate in the letter the amount or character of the income that was adjusted or the calculations made by the Internal Revenue Service in determining the underpayment of federal taxes. This board has previously held that a taxpayer must report the substance of the federal adjustment, not merely the fact that a **change** was made, to satisfy the reporting requirements under section 18451. (Appeal of Bert and Hermia Kaplan, Cal. St. Bd. of Equal., July 26, 1982; see also Appeal of Market Lessors, Inc., Cal. St. Bd. of Equal., Sept. 12, 1968.) Appellants' letter clearly did not constitute proper notification of federal changes under section 18451 and the regulations. Since appellants have not given us any reason to believe otherwise, we must then conclude that the federal audit report dated September 15, 1982, was the final determination of the federal changes in appellants' income and corresponding tax liability.

Since appellants failed to report this final determination within 90 days as required by section 18451, it follows under section 18586.2 that respondent had four years from September 15, 1982, to mail a proposed deficiency assessment based on said federal action. (Appeal of David B. and Dolores Y. Gibson, Cal. St. Bd. of Equal., Apr. 22, 1975; Appeal of Mary R. Encell, Cal. St. Bd. of Equal., Apr. 21, 1959.) The deficiency assessments in question were mailed on June 7, 1984, well within the four-year statute of limitations under section 18586.2. Accordingly, respondent's action in this matter must be sustained.

Appeal of Frederick and Carol Engelbrecht

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 Frederick and Carol Engelbrecht against a proposed assessment of additional personal income tax in the amount of **\$1,803.37** for the year 1977, be and the same is-hereby sustained.

Done at Sacramento, California, **this 4th** day Of February , **1986**, by the State Board of Equalization, with Board Members Mr. Nevins, Mr. Collis, Mr. Bennett, Mr. Dronenburg and Mr. Harvey present.

<u>Richard Nevins</u>	, Chairman
<u>Conway H. Collis</u>	, Member
<u>William M. Bennett</u>	, Member
<u>Ernest J. Dronenburg, Jr.</u>	, Member
<u>Walter Harvey*</u>	. Member

*For Kenneth Cory, per Government Code section 7.9