BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeals of)
) Nos. 84A-1062 and
SIMCAL CHEMICAL COMPANY) 84A-1326-KP

For Appellant: Gordon C. Smith
Senior Vice President

For Respondent: Paul J. Petrozzi
Counsel

OPINION

These appeals are made pursuant to section 25666 1/ of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protests of Simcal Chemical Company against proposed assessments of additional franchise tax in the amounts of $18,012.75 and $759.25 for the income year ended September 30, 1980,

1/ Unless otherwise specified, all section references are to sections of the Revenue and Taxation Code as in effect for the income year in issue.

Appeals of Simcal Chemical Company

The issues presented by these appeals are: (1) whether appellant has shown that respondent incorrectly applied the tax benefit rule to a recovery of overpayments appellant made for natural gas in prior' years; (2) whether interest attributed to the overpayments was properly included as income during the income year at issue; and (3) whether respondent correctly apportioned income and interest attributable to 1980.

Appellant is a chemical company engaged in the manufacture of fertilizer. Appellant does business both within and without California and files its franchise tax returns on a unitary basis. Appellant utilizes the accrual method of accounting in maintaining its books of account.

The principal ingredient in appellant's fertilizer is ammonia, which is derived from natural gas. Appellant's major supplier of natural gas during the years prior to 1980 was a California gas company. In 1980, the California Public Utilities Commission (PUC) determined that the gas company had overcharged appellant for its natural gas purchases for a number of years. On July 2, 1980, it was determined that appellant was due a refund of $1,883,497, plus interest. The refund was not actually paid until January 1981, but interest continued to accrue until payment.

In reporting this refund during the income year at issue, appellant divided the funds among four prior time periods. Some of the income years included in the four periods were loss years for appellant. Apparently, appellant applied the tax benefit rule to exclude from 1980 income any of the refund attributable to overpayments made in periods which included any portion of a loss year. Appellant further excluded- from 1980 income any of the interest accumulated prior to October 1, 1979, and any income accrued in income year 1981, Finally, appellant reported the interest allocated to the prior profit years by apportioning it as if it had been earned -in those years rather than in 1980.

Respondent audited appellant's return for the income year at issue and determined that appellant had made mistakes in its apportionment of income among the -profit and loss years. Respondent requested a complete listing of refund amounts allocated by income years rather than the four general time periods but was informed by appellant such a breakdown was not possible. Respondent then requested the same information from the

PUC. While awaiting that information, respondent made its own calculations as to the proper allocation of the refund between the profit and loss years which differed from appellant's formula. Respondent also disapproved of appellant's reporting of the interest payments and the apportionment. An assessment was issued which was affirmed by respondent subsequent to appellant's protest. Following the protest hearing, respondent received a list from the PUC which detailed, by income year, each of the overpayments made by appellant. Respondent discovered that its original breakdown of the refund was incorrect and that it had issued an assessment that was too low. Another assessment was issued for the remainder of the tax asserted to be due for income year 1980. Both assessments were appealed to this board, where they were consolidated for purposes of this opinion.

The rationale for the tax benefit rule was stated in the Appeal of H. V. Management Corporation, decided by this board on July 29, 1981:

> Taxpayers who recover or collect items that have previously been deducted are ordinarily taxed on the amount received unless the prior deduction was of no "tax benefit" because it did not reduce the taxpayer's tax liability. [Citation.] . . . While the courts have developed differing theories to explain the inclusion in income of a recovery that does not constitute an economic gain in the ordinary sense, these divergent views have in common the rationale that such a recovery is taxable because it is linked to a prior tax deduction which reduced the taxpayer's tax liability. [Citation.] Conversely, where a recovery, or portion thereof, has not resulted in a prior tax benefit, it is excluded from income. [Citation.].

Section 24310 is a codification of the "tax benefit rule" and is substantially similar to Internal Revenue Code section 111; therefore, federal cases and regulations interpreting the federal statute are highly persuasive as to the interpretation of section 24310. <See Andrews v. Franchise Tax Board, 275 Cal.App.2d 653 [80 Cal.Rptr. 403] (1969); see also Cal. Admin. Code, tit. 18, reg. 26422.) That section excludes from a corporation's gross income any amount-received which is attributable to the recovery of a bad debt, prior tax, or delinquency amount to the extent that the deduction or

credit allowed on account of the debt, tax, or delinquency amount did not reduce the corporation's tax. (Rev. & Tax. Code, § 24310, subd. (a).) The regulations provide that this rule is not limited to the losses specified in the statute, and that it applies equally to all other losses, expenditures, and accruals which are the basis of deductions except for depreciation, depletion, amortization, and amortizable bond premiums. (Treas. Reg. § 1.111-1(a) (1960).) Deductions which give rise to recovery exclusions under the tax benefit rule include rebates for supplies purchased and accrued in loss years. (Western Adjustment and Inspection Co. v. Commissioner, 45 B.T.A. 721 (19[redacted].)

Neither appellant nor respondent quarrels with the application of the tax benefit rule to the present appeal. The differences between the parties revolve around the amount of the refund that should be allocated to the loss years. Respondent's determination of the facts supporting application of the tax benefit rule is presumed correct and it is appellant's burden to prove that it is entitled to use the tax benefit rule to a greater extent than allowed by respondent, (See Appeal of H. V. Management Corporation, supra; A e.g. Appeal of Centennial Equities Corporation, Cal. St. Bd. of Equal., June 27, 1984.) As stated above, respondent's ultimate determination was based upon the actual rebate schedule of overpayments issued by the PUC. As appellant has not provided us with evidence nor argument to refute that determination, it has failed to satisfy its burden of proof. Consequently, respondent's determination as to the amount of the rebate attributable to the loss years will be upheld.

We turn to the second issue which asks if appellant may apportion the interest generated from the refund to years other than income year 1980. Appellant argues that the PUC ruling relates back to the years appellant was actually overcharged and that the interest accrued from the *moment* of overpayment. Therefore, the majority of the interest would be excluded from 1980's income as it accrued prior to October 1, 1979. Further, appellant contends that since the interest which accrued after the PUC order was not received until January 1981, appellant should not have to report any interest generated after September 30, 1980, the closing date of *its* income year, as income for income year 1980.

Appellant's initial argument is misguided. It is well established that income accrues to- an accrual

basis taxpayer when all events have occurred which fix the right to receive such income and the amount thereof can be determined with-reasonable accuracy. (Spring City Foundry Co. v. Commissioner, 292 U.S. 182 [78 L.Ed. 1200] (1934); Helvering v. Enright, 312 U.S. 636 [85 L.Ed. 1093] (1941).) The date of physical receipt of the income is irrelevant to the accrual basis taxpayer (Spring City Foundry Co, v. Commissioner, supra.) Appellant did not have the right to receive the refund, nor the interest thereon, until the PUC made its final determination on July 2, 1980. The ruling was the final event which determined the amount of the refund with reasonable accuracy. Consequently, the interest that accumulated prior to July 2, 1980, was properly included in 1980's income.

In response to appellant's second argument, we note that respondent's determination is presumed to be correct and that the taxpayer bears the burden of proving by competent evidence that respondent's position is incorrect. (Appeal of Guild Savings and Loan Association, Cal. St. Bd. of Equal., Feb. 2, 1985.) An unsupported assertion that respondent is incorrect in its determination does not satisfy the taxpayer's burden. (Appeal of Guild Savings and Loan Association, supra.) The only evidence presented to indicate that respondent included the post-September 30, 1980, interest as income in income year 1980, is appellant's figures in its brief. As appellant has failed to provide support for its calculations, we find it has not satisfied its burden of proving that respondent's determination is incorrect.

The last issue to be considered is appellant's attempt to apportion the refund according to the apportionment factors for the year of overcharge rather than those applicable to 1980. Appellant's argument is not unprecedented, given the treatment accorded income from certain long-term construction contracts. (See Appeal of Donald M. Drake Company, Cal. St. Bd. of Equal., Feb. 3, 1977.) It is crucial to realize, however, that the authority to allow such a deviation from the Uniform Act comes from section 25137. Section 25137 comes into play only in exceptional circumstances. (Appeal of Donald M. Drake Company, supra.) Section 25137 does not authorize deviation from UDITPA's normal provisions simply because the taxpayer purports to have found a better approach to apportioning business income. (Appeal of Kikkoman International, Inc., Cal. St. Bd. of Equal., June 29, 1982.) In order to insure that the Act is applied as uniformly as possible, the party who seeks to use

extraordinary apportionment methods bears the burden of proving that such exceptional circumstances are present. (Appeal of New York Football Giants, Cal. St. Bd. of Equal., Feb. 3, 1977.) Mere allegations of distortion are insufficient to persuade us that the normal factors should not be used. (Appeal of New Home Sewing Machine Company, Cal. St. Bd. of Equal., Aug. 17, 1982.) Appellant has failed to provide any evidence, such as the possibility of double taxation, to show that exceptional circumstances existed so as to allow any deviation from the normal formula.

In summary, we find respondent's application of the tax benefit rule proper. Further, we find that respondent properly included all of the interest that accrued prior to September 30, 1980, as income for the 1980 income year. Finally, we find that appellant was incorrect in its attempt to apportion the refund income from the profit years as if it had accrued during those past years. Accordingly, respondent's action in this matter will be sustained,

O R D E R

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

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section 25667 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protests of Simcal Chemical Company against proposed assessments of additional franchise tax in the amounts of $18,012.75 and $759.25 for the income year ended September 30, 1980, be and the same is hereby sustained.

Done at Sacramento, California, this 10th day Of- September, 1986, by the State Board of Equalization, with Board Members Mr. Nevins, Mr. Collis, Mr. Dronenburg and Mr. Harvey present.

Richard Nevins, Chairman

Conway H. Collis, Member

Ernest J. Dronenbura, Jr., Member

Walter Harvey*, Member

, Member

*For Kenneth Cory, per Government Code section 7.9