

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
) No. 93A-0755
Glenver and Joy Myers)
)

Representing the Parties:

For Appellants: Carleton S. Mills, Attorney

For Respondent: Richard Gould, Counsel

Counsel for Board of Equalization: Tommy Leung, Staff Counsel

OPINION

This appeal is made pursuant to section 19045 (formerly section 18593)^{1/} of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Glenver and Joy Myers against a proposed assessment of additional personal income tax in the amount of \$24,381 for the year 1986.

^{1/} Unless otherwise specified, all section references hereinafter in the text of this opinion are to sections of the Revenue and Taxation Code as in effect for the year in issue.

The issue to be decided in this appeal is whether appellants have satisfied the 60-day limitation of Internal Revenue Code (I.R.C.) section 408 in order to qualify for tax-free treatment of an IRA distribution.

On August 20, 1986, Glenver Myers (appellant) received a distribution from his 401(k) plan (IRA-1), which was deposited into his PaineWebber account (IRA-3); on August 29, 1986, appellant received a distribution from his pension plan (IRA-2), which was also deposited in IRA-3. On November 4, 1986, appellant received a distribution of \$180,596.90 from IRA-3.

Appellant combined the November 4, 1986, distribution with other funds (for a total of \$251,263) and invested the sum with Steve Rice (Rice), d/b/a Coast Financial Associates (Coast). In December 1986, appellants claim, Coast issued a check in the amount of \$180,596.90 payable to PaineWebber, which was deposited in IRA-3 on January 2, 1987.^{1/} The Coast check was subsequently returned for insufficient funds. Appellant contacted Rice and was told to re-deposit the check. During this period, appellant's daughter was employed by Rice and/or Coast. When the check was again returned for insufficient funds, appellant contacted the police, who informed him of Rice's previous history of embezzlement.

Appellant's IRA-3 statement shows a debit of \$180,596.90 on January 2, 1987 (described as a roll-over adjustment), and a credit for the same amount on January 5, 1987 (described as a roll-over). Appellants submitted a written statement memorializing a conversation their representative had with a PaineWebber employee, wherein the January 2, 1987, entry was described as an erroneous one and the January 5, 1987, entry was made in an attempt to correct it.

Appellants originally included the IRA-3 distribution on their 1986 California personal income tax return, along with a casualty loss deduction of \$251,263. In 1989, appellants filed amended 1986 and 1987 returns claiming that the \$180,596.90 distribution and the casualty loss were incorrectly reported on their 1986 return, instead of on their 1987 return. Similar amended returns were filed with the Internal Revenue Service (IRS), which appellants contend were accepted. Respondent agreed to move the casualty loss to 1987 because that was when the incident was discovered, but disputed the treatment of the IRA-3 distribution. Respondent believes the IRA-3 distribution was not properly rolled over into a qualified vehicle within the 60-day period as required by I.R.C. section 408(d)(3). Consequently, a notice of proposed assessment was issued with respect to the \$180,596.90 IRA-3

^{2/} A copy of the canceled check shows it was drawn on Zoe Enterprises, Inc., and bears PaineWebber's endorsement dated December 31, 1986; apparently, the delay was due to the holidays. At the hearing, appellant testified that Zoe Enterprises, Inc., was the same as Coast.

distribution, along with a 2.5 percent premature withdrawal penalty (as provided for by Revenue and Taxation Code section 17082).

In order to qualify for a roll-over, a distribution from an existing IRA must be paid into another IRA. Otherwise, such a distribution must be included in gross income in the year of receipt. (I.R.C. §§ 408(d)(1) and 408 (d)(3)(A).)

Appellants argue the January 2, 1987, deposit qualifies as a "transfer" under I.R.C. section 402(a)(5) and is, thus, a tax-free roll-over of the IRA-3 distribution. They claim the term "transfer" is not defined in the Internal Revenue Code and, hence, state law should govern. Appellants point out that California's version of the Uniform Commercial Code essentially defines a "transfer" as entailing delivery and endorsement of a check in a manner such that the transferee is vested with the same rights as the transferor. (See Com. Code §§ 3201(1), 3202, and 3207(1).) Therefore, they argue, it is irrelevant that the check is subsequently dishonored.

We do not believe appellants' reading of the IRA roll-over rules is correct. Under appellants' interpretation, the mere issuance and endorsement of a draft (rubber or otherwise) within the statutory 60-day period would be sufficient to effectuate an IRA roll-over. Thus, a taxpayer could avoid paying any tax and penalties on a premature withdrawal from his IRA by simply writing a check without any concurrent payment of value. Faced with such a consequence, we decline to accept appellants' position on this issue.

Moreover, in a situation similar to the facts presented herein, the IRS has issued a private letter ruling concerning a taxpayer who wrote a check, for the entire amount of his IRA distribution, payable to an individual who posed as a certified financial planner, with instructions to invest such funds in a qualified plan. The individual failed to do so, and the taxpayer discovered this after the 60-day roll-over period had elapsed.^{1/} Under such circumstances, the IRS ruled that a transfer of funds to an individual, as opposed to an IRA, does not constitute a complete and timely roll-over. (See Priv. Ltr. Rul. 88-15-036 (Jan. 20, 1988).)

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

^{3/} The funds were apparently "misappropriated."

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 19047 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of Glenver and Joy Myers against a proposed assessment of additional personal income tax in the amount of \$24,381 for the year 1986 be and the same is hereby sustained.

Done at Sacramento, California, this 26th day of October, 1995, by the State Board of Equalization, with Board Members Mr. Klehs, Mr. Dronenburg, Mr. Andal, Mr. Sherman and Mr. Halverson present.

Johan Klehs _____, Chairman

Ernest J. Dronenburg, Jr. _____, Member

Dean F. Andal _____, Member

Brad J. Sherman _____, Member

Rex Halverson* _____, Member

*For Kathleen Connell, per Government Code section 7.9.