

BEFORE THE STATE BOARD OF EQUALIZATION  
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of )  
 ) No. 94A-0520  
Don L. and Marilu Eddlemon )  
 )

Representing the Parties:

For Appellant: Henry G. Wykowski, Attorney

For Respondent: John Penfield, Counsel

Counsel for Board  
of Equalization: Sophia H. Chung, Staff Counsel

OPINION

This appeal is made pursuant to section 19045 (formerly section 18593)<sup>1</sup> of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Don L. and Marilu Eddlemon against proposed assessments of additional personal income tax in the amounts of \$6,951 and \$8,595 for the years 1979 and 1980, respectively.<sup>2</sup>

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

<sup>2</sup> Respondent has conceded that its notice of proposed assessment for 1980 was untimely and should be withdrawn. Therefore, this opinion will only address issues raised with regard to the 1979 taxable year.

The primary issue presented is whether respondent's notice of proposed assessment for the 1979 taxable year is barred by the applicable statute of limitations.

The Internal Revenue Service (IRS) audited appellants' 1979 federal tax return. On March 29, 1988, appellants signed IRS Form 870-AD (Offer of Waiver of Restrictions on Assessment and Collection of Deficiency in Tax and of Acceptance of Overassessment) pursuant to Internal Revenue Code (I.R.C.) section 6213, subdivision (d),<sup>3</sup> for the 1979 taxable year. The Form 870-AD, executed by appellants, was apparently signed by the IRS sometime thereafter. On December 26, 1988, the IRS assessed the additional federal tax for the 1979 taxable year.

Respondent received information from the IRS regarding the deficiency for the 1979 taxable year. On June 22, 1992, based on the information it received from the IRS, respondent issued a notice of proposed assessment (NPA) for 1979. Appellants protested the NPA, contending that the NPA was barred by the statute of limitations. The protest was denied and respondent issued a notice of action affirming its NPA, from which this timely appeal followed.

Generally, respondent must issue an NPA within four years from the date on which a return is filed. (Rev. & Tax. Code, § 18586, subd. (a), amended and renumbered as § 19057, subd. (a), operative Jan. 1, 1994.) However, when the IRS changes a taxpayer's reported gross income or deductions, and such change affects the tax owed to the state, the taxpayer is required to report the change to the Franchise Tax Board within 90 days of the final federal determination. (Rev. & Tax. Code, § 18451, amended and renumbered as § 18622, operative Jan. 1, 1994.) If the taxpayer fails to report the federal change within 90 days, as in the present case, the Franchise Tax Board has four years after the change, correction, or amended return is reported to or filed with the federal government in which to issue its NPA.<sup>4</sup> (Rev. & Tax. Code, § 18586.2, renumbered as § 19060, operative Jan. 1, 1994.)

This board has previously held that the four-year statute of limitations under section 18586.2 begins to run on the date that the federal determination becomes final. (See Appeal of Ralph F. Lewis,

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<sup>3</sup> I.R.C. section 6213, subdivision (d), provides that the taxpayer may offer to waive the restrictions provided in I.R.C. section 6213, subdivision (a), on the assessment and collection of the whole or any part of the deficiency. I.R.C. section 6213, subdivision (a), provides that no assessment or collection of tax shall be made for the 90-day period following the issuance of a notice of deficiency. During the 90-day period, the taxpayer may file a petition for redetermination of deficiency in the tax court. If a petition has been timely filed by taxpayer with the tax court, IRS is prohibited from assessing or collecting the deficiency until the decision of the tax court becomes final.

<sup>4</sup> Effective January 1, 1993, section 18586.2 provides that if a taxpayer fails to report a change as required by section 18451, the Franchise Tax Board may issue a notice of proposed assessment resulting from the adjustment at any time after the change, correction, or amended return is reported to or filed with the federal government.

95-SBE-010, Aug. 31, 1995.) California Code of Regulations, title 18, section 18586.3, subdivision (e), defines a final determination as "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."

In the Appeal of Ralph F. Lewis, supra, decided by this board on August 31, 1995, we held that a Form 870-P settlement agreement, executed by both the taxpayer and the IRS, constitutes a final federal determination with respect to partnership items. Form 870-P is a statutory settlement agreement authorized under I.R.C. section 6224, subdivision (c).<sup>5</sup> (Alexander v. United States, 44 F.3d 328 (5th Cir. 1995).) In Lewis, we determined that Form 870-P settlement agreements are closely analogous to closing agreements authorized under I.R.C. section 7121.<sup>6</sup> Therefore, like closing agreements, the mutual execution of an 870-P settlement agreement commences the running of the statute of limitations under section 18586.2.

However, unlike an 870-P settlement agreement or a closing agreement, federal courts have determined that Form 870-AD is an informal, non-statutory settlement agreement which is not in itself binding on the parties.<sup>7</sup> (Uinta Livestock Corp. v. United States, 355 F.2d 761 (10th Cir. 1966) (citing Botany Worsted Mills v. United States, 278 U.S. 282 [73 L.Ed. 379] (1928).) In Botany Worsted Mills v. United States, 278 U.S. 282 [73 L.Ed. 379] (1928), the Supreme Court held that an

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<sup>5</sup> I.R.C. section 6224 provides:

**(c) Settlement agreement.**

In the absence of a showing of fraud, malfeasance, or misrepresentation of fact--

(1) **Binds all parties.** A settlement agreement between the Secretary and 1 or more partners in a partnership with respect to the determination of partnership items for any partnership taxable year shall (except as otherwise provided in such agreement) be binding on all parties to such agreement with respect to the determination of partnership items for such partnership taxable year. . . .

<sup>6</sup> I.R.C. section 7121 provides:

**Sec. 7121. Closing agreements.**

**(a) Authorization.**

The Secretary is authorized to enter into an agreement in writing with any person relating to the liability of such person . . . in respect of any internal revenue tax for any taxable period.

**(b) Finality.**

If such agreement is approved by the Secretary . . . such agreement shall be final and conclusive, and, except upon a showing of fraud or malfeasance, or misrepresentation of a material fact . . . .

<sup>7</sup> In Aronsohn v. Commissioner, 988 F.2d 454, 455 (3rd Cir. 1993), the Court of Appeals stated that "Form 870-AD expedites the settlement of deficiencies by virtue of the taxpayer's waiver of certain IRS restrictions in order to spare the taxpayer additional penalties and interest, but does not per se preclude an action for refund, as is the case when the taxpayer executes a formal closing agreement."

agreement between a taxpayer and the IRS which does not comply with the statutory requirements set forth in the Internal Revenue Code for a formal compromise is not binding on the government or the taxpayer.<sup>8</sup> Therefore, because Form 870-AD is not a binding contract and does not, standing alone, preclude the taxpayer from filing a claim for refund, a Form 870-AD, executed by both the taxpayer and the IRS, does not constitute a final federal determination.<sup>9</sup>

Instead, we conclude that, where a Form 870-AD has been mutually executed by the IRS and the taxpayer, the date the deficiency is assessed by the IRS is the final federal determination date. This conclusion is consistent with California Code of Regulations, title 18, section 18586.3, subdivision (e), which specifically provides that an example of a final federal determination is "[t]he assessment of a deficiency pursuant to a waiver filed under section 6213(d) of the Internal Revenue Code of 1986 where no 90-day deficiency notice is issued." Accordingly, as appellants have filed an 870-AD waiver under I.R.C. section 6213, subdivision (d), the date of the assessment of the deficiency constitutes the final federal determination date, from which the four-year statute of limitations under section 18586.2 is calculated.

We conclude that the four-year statute of limitations under section 18586.2 commenced to run on December 26, 1988, the date the IRS assessed the additional federal tax for the 1979 taxable year. Therefore, respondent timely issued the NPA for 1979 on June 22, 1992, and its action must be sustained.

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<sup>8</sup> In Botany, the Supreme Court considered the predecessor of the current provision for closing agreements under I.R.C. section 7121 and compromises under I.R.C. section 7122.

<sup>9</sup> Although a Form 870-AD waiver is not a binding contract, federal courts have in some cases precluded refund actions by applying the doctrine of equitable estoppel. (See Whitney v. United States, 826 F.2d 896 (9th Cir. 1987).) However, "[t]he estoppel doctrine does not convert the Form 870-AD into a binding contract, but merely operates to avoid injustice." (Elbo Coals, Inc. v. United States, 763 F.2d 818, 821 (6th Cir. 1985).)

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 Don L. and Marilu Eddlemon against proposed assessments of additional personal income tax in the amounts of \$6,951 and \$8,595 for the years 1979 and 1980, respectively, be and the same is hereby modified to reflect the withdrawal by the Franchise Tax Board of the proposed assessment of additional personal income tax in the amount of \$8,595 for the year 1980. In all other respects, the action of the Franchise Tax Board is hereby sustained.

Done at Sacramento, California, this 12th day of December, 1995, by the State Board of Equalization, with Board Members Mr. Klehs, Mr. Andal, Mr. Dronenburg, Mr. Sherman, and Mr. Halverson present.

Johan Klehs, \_\_\_\_\_, Chairman

Dean F. Andal \_\_\_\_\_, Member

Ernest J. Dronenburg, Jr. \_\_\_\_\_, Member

Brad Sherman \_\_\_\_\_, Member

Rex Halverson\* \_\_\_\_\_, Member

\*For Kathleen Connell, Per Government Code section 7.9.