STATE BOARD OF EQUALIZATION

Appeal Name: Michael John Klemp

Case ID: 568733 ITEM #. B3

Date: March 20, 2012 Exhibit No: 3.3

TP FTB DEPT PUBLIC COMMENT

IRS LETTERS

INFO TO BOARD

Michael John Klemp

Case ID No. 568733

RE: Timeline of Internal Revenue Letters numbered 1- 4

Letter Number 1:

Dated August 9th, 2010. Informing me that the overpayment of $101.00 on my 2006 Federal Tax Return is now being credited to my 2003 Tax Year taxes due.

Letter Number 2:

Dated August 9th, 2010. Informing me that there is still a balance of $39.58 due for the Tax Year 2003

Letter Number 3:

Informing me that due to a change or correction made by the IRS, the overpayment of $39.58 made in August of 2010 will now be applied to the 2005 Tax Year

Letter Number 4:

Informing me that the IRS has made another change or correction to adjust my Gross Income to negative $2,485.00

TAXPAYER EXHIBIT
B3
March 20, 2012
Michael John Klemp
568733

B067554

95602 IRS USE ONLY SB N 0 0 17

Department of the Treasury
Internal Revenue Service
Ogden, UT 84201-0025

Letter #1

For assistance, call:
1-800-829-8374
Your Caller ID: [redacted]

Notice Number: CP49
Date: August 9, 2010

Taxpayer Identification Number:
[redacted]

Tax Form: 1040A
Tax Year: December 31, 2006

097558.734573.0309.008 1 AT 0.357 694

MICHAEL J KLEMP
[redacted]

097558

Overpaid Tax Applied to Other Taxes You Owe

We applied $101.00 of the overpaid tax on your 2006 tax return to the unpaid balance of other federal taxes which our records show you owe.

You may still be due a refund if we applied only part of your overpayment to other taxes. You also may be due a refund if you recently made a payment against the other taxes that we had not credited when we applied your overpayment. In either case, you will receive a check for any refund due to you as long as the amount is greater than one dollar. You must request a refund of less than one dollar. If you have any questions, please call us at the number listed above.

The figures below show our calculation:

How We Applied Your Overpayment

Amount of Overpaid Tax on Your Return	$101.00
Amount of Interest You Earned on Overpayment	$.00
Total Amount Due You	$101.00
Total Amount Applied	$101.00
Amount to be refunded Unless You Owe Other Obligations	$.00

(Your refund may include interest. Please be aware that interest you receive on tax refunds is taxable income to you in the year you receive it. Please retain this notice for your records.)

Where We Applied Your Overpayment

Form(s)	Tax Period(s)	Amount(s) Applied	Balance Remaining
1040A	December 31, 2003	$101.00	$39.58

The following information may pertain to you if you are currently married or were previously married. Did we use your refund to pay for income taxes that you and a former (or current) spouse owe? If you file a claim, you may be eligible to receive relief from having to pay your former (or current) spouse's income tax debt. A successful claim for relief could change the tax you have to pay. You may not owe anything at all. You could receive your refund or other payments back.

005687 200312 SBN

IRS Department of the Treasury
Internal Revenue Service
OGDEN, UT 84201-0025

Letter #2

Notice Number: CP 501
Notice Date: 08-09-2010

SSN/EIN: [redacted]
Caller ID: [redacted]

100365.759016.0372.008 1 AT 0.357 705

MICHAEL KLEMP
[redacted]

552049662101

100365

Reminder

We show you still owe $39.58 .

According to our records, you haven't paid all you owe for tax period 12-31-2003 . To avoid additional penalty and interest, please pay the full amount you owe within ten days from the date of this notice. We ca file a Notice of Federal Tax Lien if your balance owed is not paid within 10 days from the date of this notice If you already paid your balance in full or arranged for an installment agreement, please disregard this notice

Account Summary

Form: 1040A	Tax Period: 12-31-2003

Current Balance:	$39.58
Includes:	
Penalty:	$0.00
Interest:	$0.00
Last Payment:	$0.00

For information on your penalty & interest computations, you may call 1-800-829-8374

Questions? call us at **1-800-829-8374**
Please mail this part with your payment, payable to United States Treasury.

Notice Number: CP 501
Notice Date: 08-09-201

write on your check:

1040A	12-31-2003	[redacted]

Amount Due: $39.58

Find information about filing and paying taxes at: www.irs.gov
Enter Keyword: filing late (or) paying late

Internal Revenue Service
OGDEN, UT 84201-0025

MICHAEL KLEMP
[redacted]

552049662 OV KLEM 30 0 200312 670 00000003958

95602 IRS USE ONLY SB T 0 0 17

Department of the Treasury
Internal Revenue Service
Ogden, UT 84201-0025

Letter #3

For assistance, call:
~~1-800-829-8374~~
Your Caller ID: [redacted]

Notice Number: CP49
Date: September 13, 2010

Taxpayer Identification Number:
[redacted]

Tax Form: 1040A
Tax Year: December 31, 2003

028905.780020.0101.003 1 AT 0.357 630

MICHAEL KLEMP
[redacted]

028905

Overpaid Tax Applied to Other Taxes You Owe

We applied $39.58 of the overpaid tax on your 2003 tax return to the unpaid balance of other federal taxes which our records show you owe.

You may still be due a refund if we applied only part of your overpayment to other taxes. You also may be due a refund if you recently made a payment against the other taxes that we had not credited when we applied your overpayment. In either case, you will receive a check for any refund due to you as long as the amount is greater than one dollar. You must request a refund of less than one dollar. If you have any questions, please call us at the number listed above.

The figures below show our calculation:

How We Applied Your Overpayment

Amount of Overpaid Tax on Your Return	$39.58
Amount of Interest You Earned on Overpayment	$.00
Total Amount Due You	$39.58
Total Amount Applied	$39.58
Amount to be refunded Unless You Owe Other Obligations	$.00

(Your refund may include interest. Please be aware that interest you receive on tax refunds is taxable income to you in the year you receive it. Please retain this notice for your records.)

Where We Applied Your Overpayment

Form(s)	Tax Period(s)	Amount(s) Applied
1040	December 31, 2005	$39.58

The following information may pertain to you if you are currently married or were previously married. Did we use your refund to pay for income taxes that you and a former (or current) spouse owe? If you file a claim, you may be eligible to receive relief from having to pay your former (or current) spouse's income tax debt. A successful claim for relief could change the tax you have to pay. You may not owe anything at all. You could receive your refund or other payments back.

IRS Department of the Treasury
Internal Revenue Service
P.O. BOX 9019
HOLTSVILLE NY 11742-9019

Letter # 4

In reply refer to: 0135135144
Oct. 20, 2010 LTR 288C 0
[redacted] 200312 30
00001878
BODC: SB

MICHAEL KLEMP
[redacted]

005056

Taxpayer Identification Number: [redacted]
Tax Period(s): Dec. 31, 2003

Form: 1040

Dear Taxpayer:

Thank you for your amended return for the tax period listed above received on August 09, 2010.

We have adjusted your account to reflect the Adjusted Gross Income of negative $2,485.00 as reflected on the return received.

If you have any questions, please call us toll free at 1-800-829-8374.

If you prefer, you may write to us at the address shown at the top of the first page of this letter.

Whenever you write, please include this letter and, in the spaces below, give us your telephone number with the hours we can reach you. Keep a copy of this letter for your records.

Telephone Number ( )_____ Hours_____

We apologize for any inconvenience we may have caused you, and thank you for your cooperation.

California Revenue and Taxation Code Sections 19311:

19311. (a) (1) If a change or correction is made or allowed by the Commissioner of Internal Revenue or other officer of the United States or other competent authority, a claim for credit or refund resulting from the adjustment may be filed by the taxpayer within two years from the date of the final federal determination (as defined in Section 18622), or within the period provided in Section 19306, 19307, 19308, or 19316, whichever period expires later.

(2) Within two years of the date of the final determination (as defined in Section 18622) or within the period provided in Section 19306, 19307, or 19308, whichever period expires later, the Franchise Tax Board may allow a credit, make a refund, or mail to the taxpayer a notice of proposed overpayment resulting from the final federal determination.

(b) The amendments made by the act adding this paragraph shall apply, without regard to taxable year, to federal determinations that become final on or after the effective date of the act adding this paragraph.

LAW SUMMARY
FEDERAL ADJUSTMENTS OR CHANGES

1. Deficiency assessments or refunds based on federal changes or corrections.

The California Personal Income Tax Law and Corporation Tax Law are largely based on the federal Internal Revenue Code. Therefore, determinations of the Internal Revenue Service (IRS) on the same issue generally apply to California tax liabilities (*Calhoun v. FTB* (1978) 20 Cal.3d 881; *Holmes v. McColgan* (1941) 17 Cal.2d 426).

2. Statutes of limitations for deficiency assessments and claims for refund resulting from federal changes or corrections.

When a federal examination of a federal return or amended return adjusts or changes an item of gross income or deduction, exceptions to the general California statute of limitations apply. (See sections 3 and 4, below.)

A California adjustment results from a federal determination where the change in California tax liability is due to the application of a specific change in California income, deduction or credit amounts that was also changed by the IRS. (Revenue and Taxation (Rev.. & Tax.) Code section 18622(a); *Montgomery Ward & Co. v. Franchise Tax Bd.*, 6 Cal. App. 3d 149.)

3. Statute of limitations for deficiencies resulting from federal changes or corrections.

a. General statute of limitations on notices of proposed deficiency assessments.

The statute of limitations found in Rev. & Tax. Code section 19057 provides that except in a case of a false or fraudulent return and except as otherwise provided, a notice of proposed deficiency assessment shall be mailed to the taxpayer within four years after the return was filed. When there has been a federal adjustment or change to an item of gross income or deduction, other statutes of limitations may apply. Therefore, in some circumstances section 19057 does not control the date on which the Franchise Tax Board (FTB) must propose the deficiency assessment (i.e., mail the Notice of Proposed Assessment (NPA)). (See *Ordlock v. FTB* (2006) 38 Cal.4th 897.)

b. Statute of limitations on proposed deficiency assessments following final federal adjustments or changes.

If the IRS makes a change or correction that must be reported in accordance with Rev. & Tax Code section 18622, the applicable statute of limitations is set out in section 19059 or 19060.

Reporting Requirement. Rev. & Tax. Code section 18622 requires a taxpayer to report the federal changes or corrections within six months after the date of the final federal determination. The taxpayer's report of the federal changes must include federal documents and/or other information in sufficient detail to allow recalculation of the California tax liability. Though business entity taxpayers must report any change or correction, individual taxpayers need only report a change or correction to FTB when the federal adjustments increase the taxpayer's California tax liability for any year.

The phrase "for any year" in Rev. & Tax. Code section 18622 (a) and (b) means that a federal change or correction must be reported even where there is no tax change for the year of the change, but where the change in the adjustment year would result in a change in tax for another taxable year. (See section 5 – Differences in state and federal law.)

Any taxpayer filing a federal amended return shall also file within six months thereafter an amended return with the FTB. The state amended return shall contain sufficient information to inform FTB of the contents of the federal amended return. (Rev. & Tax. Code section 18622(b).) For more information on reporting federal adjustments see FTB Pub. 1008, available at ftb.ca.gov/forms/misc/1008.pdf).

Statutes of Limitations. If the federal changes are properly reported by the taxpayer or the IRS within six months after the final federal determination date, FTB may issue a notice of deficiency within the later of the general four year statute of limitation or two years from the date of the taxpayer's notice or the date the taxpayer files an amended return with FTB to issue a notice of proposed deficiency

assessment. (Rev. & Tax. Code section 19059.) If the taxpayer reports the federal changes late (after the six months), FTB has four years from the date of the taxpayer's notice or the date that the taxpayer files an amended return with FTB to propose the deficiency assessment. (Rev. & Tax. Code section 19060(b).)

If the taxpayer fails to report the changes at all, or fails to file an amended return with the FTB, the FTB has an unlimited amount of time to propose the deficiency assessment. (Rev. & Tax. Code section 19060(a).)

4. Statute of limitations for claims for refund or credit resulting from federal changes or corrections.

a. General statute of limitations on claims for refund.

Rev. & Tax. Code section 19306 provides that no refund or credit may be allowed unless the taxpayer files a claim for refund within four years of the date a timely return was filed or within one year from the date of the overpayment, whichever period expires later.

b. Statute of limitations on claims for refunds following final federal adjustments or changes.

As discussed above, Rev. & Tax. Code section 18622 does not require an individual taxpayer to report a final federal adjustment if application of that adjustment would result in a California refund rather than additional California tax. Instead, Rev. & Tax. Code section 19311 provides that a taxpayer has the later of the general statute of limitations period or two years from the date of the final federal determination to file a claim for refund **resulting from** a federal adjustment or change.

c. Resulting from a federal determination.

For Rev. & Tax. Code section 19311 to apply, there must be a federal change or correction to an item shown on the original or amended California return previously filed with FTB.

5. Differences in federal and state law – tax effect in different years.

The FTB can follow federal adjustments only to the extent allowable under California law. (*Appeal of Edwin R. and Joyce E. Breitman*, 75-SBE-018, March 18, 1975.)

In some cases, differences in state and federal law or amounts will result in a California tax liability in a taxable year different than the year for which the federal adjustment was made. For example, where a taxpayer has a net operating loss for federal purposes but not state purposes, or a California-only credit, the California adjustment is often made in a different taxable year. In that case, the California deficiency is proposed or credit or refund will be allowed in the year of the California tax change. (See *Appeal of Jackson Appliance, Inc.*, 70-SBE-037, November 6, 1970; *Appeal of Douglas J. White* 76-SBE-047, April 5, 1976; *Appeal of Solomon and Eleanor Schalman*, 78-SBE-090, September 27, 1978.)

6. Statute of limitations for deficiencies and claims based on state or federal waivers

a. Proposed Deficiency Assessments.

Where a taxpayer executes a state waiver before the statute of limitations has expired, FTB may issue a notice of proposed assessment during the waiver period. (Rev. and Tax. Code section 19067.)

If the taxpayer has signed a federal waiver, FTB may issue a notice of proposed assessment on any issue for that taxable year (not limited to federal issues) at any time until six months after the federal waiver expires. (Rev. & Tax. Code section 19065.)

Where the statute of limitations is open because of a federal waiver, FTB is not limited to adjusting the same issues as adjusted by the IRS, but may adjust any issue. (*Montgomery Ward v. FTB* (1972) 6 Cal.App.3d 149.)

b. Refund Claims

The taxpayer may file a claim for refund, or FTB may allow a refund/credit of an overpayment during the same period as allowed for proposed assessments where there is a state or federal waiver in effect (Rev. & Tax. Code section 19308). As with proposed deficiency assessments, a claim for refund may be filed during the waiver period and the grounds of the claim need not result from the federal determination.

7. Date of the final federal determination.

Under California law, the date of each final federal determination is the date on which each federal adjustment or resolution is "assessed" to the federal account by the IRS. (Rev. & Tax. Code section 18622(d).) This assessment can be a refund, deficiency or "no change" determination for the same or a different federal taxable year. (See section 4 and California FTB Legislative Change Notice 10/10/1999 No. 99-42, pages 7-8.)

8. Burden of proof - federal adjustments or changes.

The law requires taxpayers to concede the accuracy of the federal changes or state wherein the changes are erroneous. (Rev. & Tax. Code section 18622.) If the taxpayer challenges the validity of the federal adjustments, he or she has the burden of proving that the federal adjustments are in error.

The State Board of Equalization (SBE) has consistently held that the FTB's determination is presumed correct when it is based upon a final federal determination. It is also a firmly established rule that the burden is on the taxpayer to overcome the presumption of correctness that attaches to a federal determination. Unless the taxpayer provides documentation or other evidence to establish an error in the federal adjustment or change, FTB's assessment that is based on the federal adjustments is presumed correct. (*Appeal of Frank J. and Barbara D. Burgett*, 83-SBE-127, June 21, 1983; *Appeal of Freemon and Dorothy Thorpe*, 87-SBE-072, October 6, 1987, citing *Todd v. McColgan* (1949) 89 Cal.App.2d 509 [201 P.2d 414].)

SBE has consistently held that unsupported assertions are not sufficient to satisfy the taxpayer's burden of proving that the FTB's deficiency assessment was in error. (See *Appeal of Aaron and Eloise Magidow*, 82-SBE-274, November 17, 1982; *Appeal of Horace H. and Mildred E. Hubbard*, 61-SBE-073, December 13, 1961.) The mere assertion of the incorrectness of the federal determination does not shift the burden to the FTB to justify the deficiency assessment or its correctness. (*Appeal of Thomas William Nichols*, 80-SBE-064, May 21, 1980.)

SBE has consistently held that the taxpayer's motivation for accepting a federal adjustment has no bearing on whether the federal determination was correct. For example, the allegation that taxpayers accepted a federal determination because it did not result in substantial federal tax liability due to a net operating loss carryback has no bearing on whether the federal determination was correct. (See *Appeal of Jackson Appliance, Inc.*, 70-SBE-037; November 6, 1970; *Appeal of Douglas J. White*, 76-SBE-047, April 5, 1976; *Appeal of Solomon and Eleanor Schalman*, 78-SBE-090, September 27, 1978.)

Similarly, a taxpayer's claim that he or she acquiesced to a federal adjustment because of economic reasons <u>only</u> explains the taxpayer's motivation; it has no bearing on whether the federal determination was correct. (*Appeal of Jackson Appliance, Inc.*, 70-SBE-037, November 6, 1970; *Appeal of Robert J. and Evelyn A. Johnston*, 75-SBE-030, April 22, 1975.)

Finally, it a is well-settled principle that deductions and credits are a matter of legislative grace, and the taxpayer bears the burden of establishing his or her entitlement to the claimed deductions. To overcome the presumed correctness of the FTB's findings, a taxpayer must point to an applicable statute and show by credible evidence that he or she comes within its terms. When the taxpayer fails to support his or her assertions with such evidence, the FTB's determinations must be upheld. (See *New Colonial Ice Co. v. Helvering* (1934) 292 U.S. 435 [78 L.Ed. 1348]; *Sliwa v. Commissioner* (9th Cir. 1988) 839 F.2d 602 [88-1 USTC ¶9184]; *Appeal of Robert R. Telles*, 86-SBE- 061, March 4, 1986; *Appeal of James C. and Monablanche A. Walshe*, 75-SBE-073, October 20, 1975; *Segel v. Comm'r*, 89 T.C. 816, 842 (1987), citing to *Interstate Transit Lines v. Commissioner,* 319 U.S. 590, 593 (1943).)

9. Burden of proof - federal penalties.

As explained in Section 8 above, the determination by the FTB is presumptively correct, and the burden is on the taxpayer to prove that it is erroneous. This rule also applies to a California penalty that is based on a federal audit. (*Appeal of David A. and Barbara L. Beadling*, 77-SBE-021, February 3, 1977; *Appeal of Myron E. and Alice Z. Gire*, 69-SBE-029, September 10, 1969.)

TAX LAWS SUBJECT TO STRICT CONSTRUCTION

Tax laws are clearly in derogation of personal rights and property interests and are, therefore, subject to strict construction, and any ambiguity must be resolved against imposition of the tax. In *Billings v. U.S.*, 232 U.S. 261, 34 S.Ct. 421 (1914), the Supreme Court clearly acknowledged this basic and long-standing rule of statutory construction:

> **"Tax statutes . . . should be strictly construed, and, if any ambiguity be found to exist, it must be resolved in favor of the citizen.** *Eidman v. Martinez*, 184 U.S. 578, 583; *United States v. Wigglesworth*, 2 Story, 369, 374; *Mutual Benefit Life Ins. Co. v. Herold*, 198 F. 199, 201, aff'd 201 F. 918; *Parkview Bldg. Assn. v. Herold*, 203 F. 876, 880; *Mutual Trust Co. v. Miller*, 177 N.Y. 51, 57."
>
> (Id at p. 265, emphasis added)

Again, in *United States v. Merriam*, 263 U.S. 179, 44 S.Ct. 69 (1923), the Supreme Court clearly stated at pp. 187-88:

> "On behalf of the Government it is urged that taxation is a practical matter and concerns itself with the substance of the thing upon which the tax is imposed rather than with legal forms or expressions. **But in statutes levying taxes the literal meaning of the words employed is most important, for such statutes are not to be extended by implication beyond the clear import of the language used. If the words are doubtful, the doubt must be resolved against the Government and in favor of the taxpayer.** *Gould v. Gould*, 245 U.S. 151, 153."
>
> (emphasis added)

And again, in *United States v. Goldenberg*, 168 U.S. 95, the court also held:

> "The primary and general rule of statutory construction is that the intent of the lawmaker is to be found in the language that he has used. He is presumed to know the meaning of the words and the rules of grammar"

This rule of strict construction against the taxing authority was reiterated in *Tandy Leather Company v. United States*, 347 F.2d 693 (5th Cir. 1965), where Judge Hutcheson of our 5th Circuit eloquently and unequivocally proclaimed at p. 694-5:

> ". . . In ruling as he did, that the taxpayer had the obligation to show that sales of the articles in suit were not subject to the excise taxes collected, the district judge was misled by the erroneous contention of the tax collector into misstating the rule of proof in a tax case. This is: that the burden in such a case is always on the collector to show, in justification of his levy and collection of an excise tax, that the statute plainly and clearly lays the tax; that, in short, the fundamental rule is that taxes to be collectible must be clearly laid.
>
> "The Government's claim and the judge's ruling come down in effect to the proposition

that the state of construction of appellants' kits had reached such an advanced level that the tax levied on the finished products could be collected on their sale, though none had been clearly laid thereon by statute. Shades of Pym and John Hampden, of the Boston tea party, and of Patrick Henry and the Virginians! There is no warrant in law for such a holding. *Gould v. Gould*, 245 U.S. 151, at p. 153, 38 S.Ct. 53, 62 L.Ed. 211. In 51 American Jurisprudence, "Taxation", Sec. 316, "Strict or Liberal Construction", supported by a great wealth of authority, it is said:

> 'Although it is sometimes broadly stated either that tax laws are to be strictly construed or, on the other hand, that such enactments are to be liberally construed, this apparent conflict of opinion can be reconciled if it is borne in mind that the correct rule appears to be that where the intent of meaning of tax statutes, or statutes levying taxes, is doubtful, they are, unless a contrary legislative intention appears, to be construed **most strongly against the government and in favor of the taxpayer or citizen**. Any doubts as to their meaning are to be resolved against the taxing authority and in favor of the taxpayer. * * *'

"The judgment was wrong. It is, therefore, reversed and the cause is remanded with directions to enter judgment for plaintiffs and for further and not inconsistent proceedings."

(emphasis is the Court's)

See also: *Gould v. Gould*, 245 U.S. 151, 38 S.Ct. 53, 153 (1917); *Royal Caribbean Cruises v. United States*, 108 F.3d 290 (11th Cir. 1997); *B & M Company v. United States*, 452 F.2d 986 (5th Cir. 1971); *Kocurek v. United States*, 456 F. Supp. 740 (1978); *Norton Manufacturing Corporation v. United States*, 288 F. Supp. 829 (1968); *Grays Harbor Chair and Manufacturing Company v. United States*, 265 F. Supp. 254 (1967); *Russell v. United States*, 260 F. Supp. 493 (1966).

Thus, as we enter into the labyrinth of the Internal Revenue Code and its related regulations, we must do so mindful that the courts have repeatedly recognized **as indisputable** certain "canonized" **standards of legal construction,** as in *Commonwealth Natural Resources, Inc. v. Commonwealth*, 219 Va. 529, 536, 248 S.E. 2d 791 (1978), at pg. 795:

> "A cardinal rule of statutory construction is that **a statute be construed from its four corners and not by singling out a particular word or phrase**."

The hornbook rule reminds us that tax laws are strictly construed, and that when the letter of the law is subject to more than one interpretation, it must be construed against the imposition of the tax, the rule of interpretation of taxes being:

> **"that the burden in such a case is always on the collector to show, in justification of his levy and collection of an excise tax, that the statute <u>plainly and clearly</u> lays the tax; that, in short, the fundamental rule is that <u>taxes to be collectible must be clearly laid</u>."** *Tandy Leather Company*, supra, at 694.

(emphasis added)