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7 **BOARD OF EQUALIZATION**

8 **STATE OF CALIFORNIA**

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10 In the Matter of the Appeal of:) **HEARING SUMMARY**
11) **PERSONAL INCOME TAX APPEAL**
12 **SHERRY DONNELLY¹**) Case No. 474206
13)

14
15 Year Claim
2000 \$3,788
16

17 Representing the Parties:

18 For Appellant: Sherry Donnelly
19 For Franchise Tax Board: Brian A. Van Slyke, Tax Counsel III
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21 QUESTION: Whether appellant is entitled to a refund of taxes paid for taxable year 2000 on severance
22 pay income that she may have been required to repay to her employer in 2007.

23 HEARING SUMMARY

24 Background

25 On June 15, 2008, appellant filed a claim for refund with the Franchise Tax Board (FTB
26 or respondent) by filing an amended California return for the 2000 tax year. The amended California
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28 ¹ Appellant resides in Los Angeles County.

1 return reduced appellant's federal adjusted gross income (AGI) by \$40,000, and a statement on the
2 amended return indicated that:

3 Taxpayer had to refund \$40,000 of Focus Media W-2 income from
4 lawsuit settled, see attached. Amending year in which the income was
received as money should never have been distributed by employer.

5 In December 2008, the FTB denied appellant's claim for refund as barred by the statute
6 of limitations periods (the four-year and one-year periods) set forth in Revenue and Taxation Code
7 (R&TC) section 19306.

8 The basis of appellant's claim for refund arises from her employment at Focus Media,
9 Inc. (employer). As indicated in appellant's appeal letter, and court documents attached thereto,
10 appellant was the accounting manager for her employer. An involuntary petition for relief under
11 Chapter 7 was filed against appellant's employer in Bankruptcy Court on October 6, 2000. Appellant
12 apparently received post-petition payments in the amount of \$42,532.81, and the bankruptcy trustee
13 (trustee) filed a complaint against appellant seeking recovery of those payments. After lengthy
14 bankruptcy proceedings, a settlement agreement was drafted. The settlement agreement provided that
15 appellant was to pay \$40,000 to the trustee on behalf of the bankruptcy estate. The agreement was to be
16 effective upon a final order of the Bankruptcy Court approving the settlement agreement; absent such a
17 final order, the settlement agreement was to be null and void. The appeal record does not contain a copy
18 of any final order from the Bankruptcy Court or documentary evidence that appellant paid the \$40,000
19 to the trustee in 2007.

20 After reviewing the facts set forth above, the FTB denied appellant's claim for refund.
21 Appellant filed this appeal.

22 Contentions

23 Appellant appears to argue that the statute of limitations periods set forth in R&TC
24 section 19306 should be tolled during her employer's bankruptcy proceedings (including the adversarial
25 action concerning her severance pay), which were apparently not resolved (pursuant to the settlement
26 agreement) until 2007. Appellant contends she was thus prevented from filing her refund claim at an
27 earlier date. In addition, appellant argues that she should be entitled to a refund for tax year 2000 (when
28 she was in a higher tax bracket) and is not limited to taking a deduction in the year of repayment (2007)

1 as the FTB alleges. Appellant does not provide legal authority supporting this position.

2 On appeal, the FTB makes three arguments: First, the FTB argues that appellant's claim
3 for refund is barred by the four-year and one-year statute of limitations periods set forth in R&TC
4 section 19306.

5 Second, the FTB argues that even if appellant's claim for refund was timely filed,
6 appellant still is not entitled to a refund of taxes she paid in 2000 because she received the payments
7 from her employer in 2000 and she retained those funds throughout that year. Thus, the FTB argues that
8 under the claim of right doctrine, appellant is required to report the payments from her employer in the
9 year of receipt (2000) and she is limited to taking a deduction in the (alleged) year of repayment (2007).

10 Finally, the FTB asserts that appellant has not shown that the Bankruptcy Court ever
11 approved the settlement agreement or that appellant ever paid \$40,000 settlement to the trustee in 2007.
12 Thus, the FTB asserts that until appellant provides such evidence, she is not entitled to take a deduction
13 in the (alleged) year of repayment (2007).

14 Applicable Law

15 *Statute of Limitations*

16 The general statute of limitations for filing a refund claim is set forth in R&TC section
17 19306. Under that section, the last day to file a claim for refund is the later of:

- 18 1. Four years from the date the return was filed, if filed within the extended due date;
- 19 2. Four years from the due date of the return, without regard to extensions; or
- 20 3. One year from the date of the overpayment.

21 Withholding payments are deemed paid on the last day prescribed for filing the return pursuant to
22 R&TC section 19002, subdivision (c)(1).

23 The language of the statute of limitations is explicit and must be strictly construed.
24 (*Appeal of Michael and Antha L. Avril*, 78-SBE-072, Aug. 15, 1978.)² The statute of limitations is
25 "strictly construed and . . . a taxpayer's failure to file a claim for refund, for whatever reason, within the
26 statutory period bars him from doing so at a later date." (*Appeal of Earl and Marion Matthiessen*, 85-
27 SBE-077, July 30, 1985.) It is a taxpayer's responsibility to file a claim for refund within the timeframe

28 ² Board of Equalization cases are generally available for viewing on the Board's website (www.boe.ca.gov).

1 prescribed by law. (*Appeal of Earl and Marion Matthiessen, supra.*) Federal courts have stated that
2 fixed deadlines may appear harsh because they can be missed, but the resulting occasional harshness is
3 redeemed by the clarity of the legal obligation imparted. (*Prussner v. United States* (7th Cir. 1990) 896
4 F.2d 218, 222-223; *United States v. Locke* (1985) 471 U.S. 84; *United States v. Boyle* (1985) 469 U.S.
5 241, 249].)

6 R&TC section 19316 contains the only exception to the statute of limitations under
7 California law. R&TC section 19316 tolls the statute of limitations during a period of “financial
8 disability,” meaning the taxpayer was unable to manage his or her financial affairs due to a medically
9 determinable physical or mental impairment that is expected to be a terminal impairment or is expected
10 to last for a continuous period of not less than 12 months. (Rev. & Tax. Code, § 19316, subd. (b)(1).)
11 In order to demonstrate the existence of a financial disability, a taxpayer must submit a signed affidavit
12 from a physician that explains the nature and duration of the taxpayer’s physical or mental impairments.
13 (*Appeal of James C. and Florence Meek*, 2006-SBE-001, Mar. 28, 2006.) In addition, the taxpayer must
14 show that she satisfies the strict definition of “financial disability” such that the taxpayer could not
15 manage his or her financial affairs; it is not sufficient to show that the taxpayer could not engage in a
16 regular occupation. (*Ibid.*)

17 Federal courts have held that the statute of limitations for filing a claim for refund is not
18 tolled when a taxpayer files a petition for bankruptcy. (See *Valory v. United States* (1997) 80 AFTR 2d
19 6083; *United States v. Neary* (5th Cir. 2000) 206 F.3d 465). In addition, this Board has held that the
20 FTB has no duty to discover an overpayment made by a taxpayer (*Appeal of Manuel and Ofelia C.*
21 *Cervantes*, 74-SBE-029, Aug. 1, 1974); nor does the FTB have a duty to inform a taxpayer of the time
22 within which a claim for refund must be filed in order to avoid application of the statute of limitations.
23 (*Appeal of Earl and Marion Matthiessen, supra.*)

24 *Claim of Right*

25 The claim of right doctrine holds that if a taxpayer receives property under an
26 unrestricted claim of right, then that property is included in the taxpayer’s gross income in the year of
27 receipt, without regard to whether the taxpayer is required to pay back the property or its equivalent in a
28 later year. (*Appeal of J. H. McKnight Ranch, Inc.*, 86-SBE-136, July 29, 1986; *North American Oil*

1 *Consolidated v. Burnet* (1932) 286 U.S. 417, at 424.) If the taxpayer is subsequently required to pay
2 back the property or its equivalent, then the taxpayer may be able to deduct the payment in the year of
3 repayment. (*Appeal of J. H. McKnight Ranch, Inc., supra; United States v. Lesoine* (9th Cir. 1953) 203
4 F.2d 123.) An exception to the claim of right doctrine exists where the taxpayer discovers a mistaken
5 overpayment, renounces her claim to it, and recognizes her obligation for repayment, all in the same
6 taxable accounting period. (*Appeal of J. H. McKnight Ranch, Inc., supra*) These facts are not present in
7 this appeal.

8 *Burden of Proof*

9 The FTB's determination of tax is presumed to be correct, and a taxpayer has the burden
10 of proving error. (*Todd v. McColgan* (1949) 89 Cal.App.2d 509; *Appeal of Michael E. Myers*, 2001-
11 SBE-001, May 31, 2001.)

12 STAFF COMMENTS

13 Statute of Limitations

14 As discussed above, under R&TC section 19306, a taxpayer must file a claim for refund
15 within four years of the last date prescribed for filing the return, or within one year from the date of
16 overpayment, whichever period expires later. Here, appellant's 2000 return was due on April 15, 2001.
17 Four years from that date was April 15, 2005. Therefore, appellant's claim for refund (the amended
18 return), filed on June 15, 2008, is barred under the four-year statute of limitations. Appellant made her
19 last payment on April 15, 2001, through her withholding payments.³ One year from that date was
20 April 15, 2002. Therefore, appellant's claim for refund, filed on June 15, 2008, is also barred under the
21 one-year statute of limitations.

22 At the oral hearing, appellant should indicate whether she was suffering from a "financial
23 disability" that might have tolled the statute of limitations. As stated above, R&TC section 19316 tolls
24 the statute of limitations during a period of "financial disability," meaning the taxpayer was unable to
25 manage his or her financial affairs due to a medically determinable physical or mental impairment that is
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27 ³ In its Opening Brief, the FTB states (in part) that "The withholding credits appellant reported on her amended return for tax
28 year 2000 are deemed applied on the original due date for the return, April 15, 2001. [The FTB] has no record of any
additional payments being applied to appellant's 2000 tax year."

1 expected to be a terminal impairment or is expected to last for a continuous period of not less than 12
2 months. (Rev. & Tax. Code, § 19316, subd. (b)(1).) In order to demonstrate the existence of a financial
3 disability, a taxpayer must submit a signed affidavit from a physician that explains the nature and
4 duration of the taxpayer's physical or mental impairments. (*Appeal of James C. and Florence Meek,*
5 *supra.*) In addition, the taxpayer must show that he or she satisfies the strict definition of "financial
6 disability" such that the taxpayer could not manage his or her financial affairs; it is not sufficient to
7 show that the taxpayer could not engage in a regular occupation. (*Ibid.*) We note that appellant did not
8 allege in her appeal briefs that she was suffering from a "financial disability."

9 As stated above, federal courts have held that the statute of limitations for filing a claim
10 for refund is not tolled when a taxpayer files a petition for bankruptcy. (See *Valory v. United States,*
11 *supra;* *United States v. Neary, supra.*) In addition, this Board has held that the FTB has no duty to
12 discover an overpayment made by a taxpayer (*Appeal of Manuel and Ofelia C. Cervantes, supra*); nor
13 does the FTB have a duty to inform a taxpayer of the time within which a claim for refund must be filed
14 in order to avoid application of the statute of limitations. (*Appeal of Earl and Marion Matthiessen,*
15 *supra.*) Based on the foregoing authorities, it appears that her employer's bankruptcy filing on
16 October 6, 2000, does not toll the statute of limitations. At the oral hearing, appellant should be
17 prepared to demonstrate that the statute of limitations should be tolled or does not apply.

18 Claim of Right

19 Where a taxpayer receives property under an unrestricted claim of right, that property is
20 included in the taxpayer's gross income in the year of receipt, without regard to whether the taxpayer is
21 required to pay back the property or its equivalent in a later year. (*Appeal of J. H. McKnight Ranch,*
22 *Inc., supra.*) If the taxpayer is subsequently required to pay back the property or its equivalent, then the
23 taxpayer may be able to deduct the payment in the year of repayment. (*United States v. Lesoine, supra.*)

24 Here, appellant received the payments from her employer in the 2000 tax year, and she
25 retained those funds through the end of 2000. Accordingly, the fact that appellant may have been
26 required to repay those funds in 2007 does not appear to entitle her to a refund in 2000. In short, it
27 appears that appellant is not entitled to reopen the 2000 tax year and, instead, must take a deduction in
28 the year of alleged repayment (2007). At the oral hearing, appellant should be prepared to demonstrate

1 that the claim of right doctrine does not apply to the facts at hand. Also, appellant may wish to show
2 that: (i) the Bankruptcy Court approved appellant's settlement agreement with the bankruptcy trustee;
3 and (ii) appellant actually paid the \$40,000 settlement to the trustee in 2007.

4 Pursuant to California Code of Regulations, title 18, section 5523.6, appellant should
5 provide any additional evidence to Board Proceedings at least 14 days prior to the oral hearing.⁴

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⁴ Evidence exhibits should be sent to: Claudia Madrigal, Appeals Analyst, Board Proceedings Division, State Board of Equalization, P.O. Box 942879 (MIC:80), Sacramento, California, 94279-0080.