



BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
MECHANICS & MERCHANTS NATIONAL BANK)

Appearances:

For Appellant: Arthur Andersen & Co., Accountants (by brief)

For Respondent: Chas. J. McColgan, Franchise Tax Commissioner
(by brief)

O P I N I O N

This appeal is made pursuant to Section 27 of the Bank and Corporation-Franchise Tax-Act (Chapter 13, Statutes of 1929, as amended) from the action of the Franchise Tax Commissioner in disallowing under date of October 29, 1941, claims for refund of taxes overpaid in the amounts of \$39.37 and \$161.98 for the taxable years ended December 31, 1938, and December 31, 1940, respectively, based upon the income of the bank for the years ended December 31, 1937, and December 31, 1939, respectively.

In computing taxable income for the income years ended December 31, 1935, and December 31, 1936, Appellant claimed as deductions from gross income the amounts of \$532.12 and \$2,202.21 for the respective years. Each of these deductions, concededly erroneous, was taken as a proportionate write-off of premiums on bonds which Appellant believed could be written off over the period remaining prior to maturity of the bonds. By reason of these erroneous deductions which were not disallowed Appellant obtained reductions in the tax measured by the income year ended December 31, 1935, in the amount of \$42.57, and in the amount of \$176.18 in the tax measured by the income year ended December 31, 1936.

Appellant having sold certain bonds during the income years 1937 and 1939, computed gain or loss upon such sales as being the difference between amounts received therefor and the amortized costs thereof, i.e., original cost less amount of premium written off. Thereafter, on July 28, 1941, Appellant filed its claims for refund and alleged therein that in computing gain or loss on the sale of the bonds, the original cost basis should have been used rather than the amortized cost which was used by Appellant in computing income on franchise tax returns as filed.

Respondent concedes that Appellant overpaid its taxes in the amount claimed but disallowed the claim because the previous underpayments of tax exceeded the overpayments, relying upon the doctrine of recoupment.

Appeal of Mechanics & Merchants National Bank

Section 24(d), as amended by the Statutes of 1939, page 2961, provides, in part, as follows:

"When the correction of an erroneous inclusion or deduction of an item in the computation of income of any year results in an overpayment for one year and a deficiency for another year, the overpayment, if the period within which credit for the overpayment may be allowed has not expired, shall be credited on the deficiency. if the period within which the deficiency may be proposed has not expired and the balance, if any, shall be credited or refunded as provide: in Section 27...." (Emphasis added)

In this case there was an erroneous inclusion in two years, and an erroneous deduction in two other years involving the same bonds and arising out of the same mistake in the manner of computing income and loss on the bonds. The period within which a deficiency might be proposed had already expired and, therefore, the Commissioner was not authorized by this section to credit the overpayments against the underpayments.

Section 27, as amended by the Statutes of 1939, page 2965, provides, in part, as follows:

"If, in the opinion of the Commissioner, or the Board of Equalization, as the case may be, there has been an overpayment of tax, penalty or interest by a taxpayer for any year for any reason, the amount of such overpayment shall be credited against any taxes then due from the taxpayer under this act, and the balance shall be refunded to the taxpayer ...
." (emphasis added)

Section 25, as amended by the Statutes of 1939, page 2962, provides, in part, as follows:

". . . . When a deficiency has been determined and the tax has become final under the provisions of this section, the commissioner shall mail notice and demand to the taxpayer for the payment thereof, and such tax shall be due and payable at the expiration of ten days from the date of such notice and demand. . . ." (emphasis added)

We are mindful of the fact that the word "due" has a double meaning. It does not mean invariably that the money is immediately payable. It is sometimes so used, but it is also used to refer to an existing obligation which may be payable at some future time. (People v. Bucklas, 57 A.C.A. 89, 92.) We deem it unnecessary, however, to decide in what sense the word "due" is used in Section 27. Insofar as the problem now before us is concerned, Section 24(d) is the more specific and indicates the intention of the Legislature that an overpayment may not be credited on a deficiency if the period within which the deficiency may be proposed has expired.

Appeal of Mechanics & Merchants National Bank

Since 1928, the Federal Income Tax Law has been somewhat similar in substance although not in form, to the above-quoted provisions of Section 24(d). (Revenue Act of 1928, Sections 607 and 609). In McEachern v. Rose, 302 U.S. 56, the court held that the Government could not do what the Franchise Tax Commissioner here is attempting to do, saying in part:

"We may assume that, in the circumstances, equitable principles would preclude recovery in the absence of any statutory provisions requiring a different result. But Congress has set limits to the extent to which courts might otherwise go in curtailing a recovery of overpayments of taxes because of the taxpayer's failure to pay other taxes which might have been but were not assessed against him. Section 607 of the 1928 Act declares that any payment of a tax after expiration of the period of limitation shall be considered an overpayment and directs that it be 'credited or refunded to the taxpayer if claim therefor is filed within the period of limitation for filing such claim;' and section 609(a) of the 1928 Act provides that 'Any credit against a liability in respect of any taxable year shall be void if any payment in respect of such liability would be considered an overpayment under section 607.' These provisions preclude the Government from taking any benefit from the taxpayer's overpayment by crediting it against an unpaid tax whose collection has been barred by limitation."

One of the cases relied on by Respondent is Stone v. White, 301 U.S. 532. That case, however, has been distinguished in McEachern v. Rose (supra), Lyeth v. Hoey, 112 Fed. (2d) 4, 7, and Lynchburg Coal and Coke Co. v. U.S., 47 Fed. Supp. 916, 921. In Lynchburg Coal and Coke Co. v. U.S., the court said:

"The case of Josephine V. Hall v. U. S., 43 F. Supp. 130, 95 Ct. Cl. 539, recently decided by this court, is directly in point. The Hall case followed McEachern v. Rose, 302 U. S. 56, and that case is likewise controlling here. Plaintiff urges that the case of Stone v. White, 301 U. S. 532, should control this case. But the statutory provisions directly applicable here were not applicable in Stone v. White. There trustees paid a tax upon income of a trust, which tax should have been paid by the beneficiary. It was timely, though erroneously assessed against the trustees before, and paid by them after, the statute had run against collection from the beneficiary. The Court, because of the trustee-beneficiary relation, treated the payment as if it had been made by the beneficiary herself, as it was made from her funds, though the amount was less than it would have been if assessed against her. So the beneficiary was really suing to get back money which she had in fact owed and which had been paid out of her funds by her trustee. It was a clear case for the

Appeal of Mechanics & Merchants National Bank

equitable doctrine of recoupment in the absence of a controlling statute. The court held that since the collection from the trustees, though erroneous, was not barred by limitation, section 607, which relates only to overpayments barred by limitation, was not applicable. In the instant case, sections 608 and 609 are applicable, and we cannot disregard them." (emphasis added)

In this case it was the government that relied on the statute and the taxpayer who sought a recoupment on the authority of Bull v. United States, 297 U. S. 247. The government's contention was sustained.

In Lyeth v. Hoey (supra) the court said:

"Recoupment of a barred claim was allowed in Stone v. White, 301 U. S. 302, but the court distinguished that decision in McEachern v. Rose, supra, on the ground that in Stone v. White a credit could not have been taken under either sections 607 or 609(a), or under section 322 of the Act of 1932, 26 U. S. C. A. Int. Rev. Acts, page 571, for the reason that rights of different taxpayers were there involved. As the case did not fall within sections 607 and 609(a) the court was free to apply the general equitable doctrine of recoupment."

It is our opinion that these cases support the position of Appellant and that the Appellant is entitled to the refunds claimed.

Lewis v. Reynolds, 284 U. S. 281, cited by Respondent, unlike the present appeal, involved taxes for only one year. There was, in fact, no overpayment of tax for that year and, accordingly, that decision is not in point. Attorney General's Opinion No. 8452 cited by Respondent was issued prior to, and did not involve, the amendment of 1939 to Section 24(d).

Respondent calls attention to the fact that Section 24 is a section dealing with interest and additions to the tax. While it deals principally with those subjects it is not limited to them. The section heading and subheadings which appear in some publications containing the Act are not a part of the Act itself.

The Commissioner should proceed to have the refund made.

O R D E R

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 that the action of Chas. J. McColgan, Franchise Tax Commissioner, in disallowing

Appeal of Mechanics & Merchants National Bank

refunds in the amounts of \$39.37 and \$161.98 of tax overpaid for the taxable years ended December 31, 1938, and December 31, 1940, respectively, measured by the income for the years ended December 31, 1937, and December 31, 1939, respectively, pursuant to Chapter 13, Statutes of 1929, as amended, be and the same is hereby reversed. Such action is hereby set aside and the Commissioner is hereby directed to proceed in conformity with said opinion.

Done at Sacramento, California, this 15th day of July 1943,
by the State Board of Equalization.

R. E. Collins, Chairman
J. H. Quinn, Member
Geo. R. Reilly, Member

ATTEST: Dixwell L. Pierce, Secretary