74-SBE-019

BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
FRANK AND ELSIE M. BARTLETT)

Appearances:

For Appellants: Oliver Q. Foust
Public Accountant

For Respondent: Paul J. Petrozzi
Counsel

OPINION

This appeal is made pursuant to section 18594 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Frank and Elsie M. Bartlett against a proposed assessment of additional personal income tax in the amount of $1,113.03 for the year 19 69.

During the years 1963 through 1969 appellants owned 24 percent of the stock of Fidelity Title Company of Roseville, California. In December 1969 the corporation was merged into

Transamerica Title Co. and ceased independent existence. During its existence the corporation elected to be treated as a Subchapter S corporation for federal income tax purposes. For practical purposes, this election resulted in the shareholders being taxed, at the federal level, on their proportionate share of all the corporate earnings whether distributed or not. Generally speaking, California, which has no equivalent of a Subchapter S corporation, taxes shareholders only on the amount of corporate earnings actually distributed by the corporation as dividends in the year of receipt.

Over the years, appellants' California personal income tax returns were prepared by an independent accountant. For some unexplained reason the accountant included all of appellants' proportionate share of corporate income in their gross income for each year whether distributed or not. The effect was that appellants reported their California income as if California provided for the equivalent of the Subchapter S election. However, during most of its existence the corporation distributed only part of its earnings while accumulating the rest. Therefore, its retained earnings account increased over the years. In 1969, as a result of the merger, the corporation distributed substantially all of its accumulated earnings in addition to its annual income. Throughout this period the appellants reported as their income an amount which would have been their portion of the corporation's income had the corporation distributed all its earnings, and paid California income tax on that amount. This resulted in appellants overpaying state taxes for most of the years 1963 through 1968; However, for the year 1969, the year the corporation distributed its accumulated earnings in addition to its annual income, there was a substantial underpayment of state income tax.

Section 19053 of the Revenue and Taxation Code prohibits the refund of an overpayment of tax where the claim for refund is made more than four years after the last day prescribed for filing the return, associated with the overpayment. When respondent concluded its audit during which the incorrect Subchapter. S treatment was discovered, the statutory four-year period had expired for the years 1963 through 1966. Claims for refund were allowed for the open years, 1967 and 1968, however.

Although claims for refund are not allowed after the four-year period has expired, section 19053.9 of the Revenue and Taxation Code does allow the offset of overpayments otherwise

barred by the running of the statute of limitation resulting from the transfer of items of income or deductions between years. Accordingly, respondent allowed the overpayments of tax for 19 64, 1965 and 1966 in the total amount of $33 6.33 to be applied against the 19 69 deficiency, thereby reducing the deficiency by that amount.

Section 19053.9 specifically provides that offsets shall not be allowed after the expiration of seven years from the due date of the return on which the overpayment was determined. In view of this prohibition, respondent determined that the $787.90 overpayment of tax for 1963 could not be offset against the 1969 deficiency since the overpayment was not discovered until more than seven years had elapsed after the last filing date for the 1963 return. Notwithstanding the seven-year limitation, appellants maintain that fairness and equity require that the 1963 overpayment be offset against the 1969 deficiency.

Section 1905 3.9 of the Revenue and Taxation Code provides:

> Notwithstanding any statute of limitations provided in this part, any overpayment due a taxpayer for any year which results from a transfer of items of income or deductions or both to or from another year for the same taxpayer. .. shall be allowed as an offset in computing any deficiency in tax from any other year resulting from the transfer of such income or deductions or both, but no refund shall be allowed unless before the expiration of the period set forth in Section 19053 a claim therefor is filed by the taxpayer. ...
>
> The offset provided herein, however, shall not be allowed after the expiration of seven years from the due date of the return on which the overpayment is determined.

Respondent's action in not applying the offset of the 1963 overpayment against the 1969 deficiency appears proper unless appellants can establish that they asserted their right to offset prior to April 15, 1971, when the seven-year limitation period contained in section 19053.9 expired. Appellants allege that sufficient timely

information was presented so that respondent knew, or should have' known , that they were asserting their right to offset. Specifically, they urge that a schedule attached to their 1969 return constituted a timely informal claim for refund or, alternatively, the timely assertion of their right to offset the 1963 overpayment.

It is readily apparent that the schedule does not constitute a timely claim for refund since it was submitted more than four years after April 15, 1968, the last day for filing a claim for refund for 1963. (Rev. & Tax. Code, § 19053.) Furthermore, an examination of the schedule in light of the entire record indicates that it could' not be construed as a timely assertion of appellants' right to offset. (A Appeal of Paritem and Janie Poonian, Cal. St. Bd. of Equal., Jan. 4, 1972.)

Next, we turn to appellants' argument that fairness and equity require that the 1963 overpayment be offset against the 1969 deficiency. Apparently, appellants are suggesting that we invoke the doctrine of equitable recoupment or setoff. The doctrine of equitable recoupment is limited to situations where a single transaction or taxable event has been subjected to two taxes on inconsistent legal theories. In such event, what was mistakenly paid may be recouped against what is correctly due. (Bull v. United States, 295 U.S. 247 [79 L. Ed. 1421]; Rothensies v. Electric Storage Battery Co., 329 U.S. 296 [91 L. Ed. 296].)

Respondent has suggested that this board, not being a court of general jurisdiction, does not have equitable jurisdiction and may not apply the doctrine of equitable recoupment. For example, the United States Supreme Court has held that the United States Tax Court, which also is not a court of general jurisdiction, does not possess equitable powers and may not apply the doctrine. (Commissioner v. Gooch Milling & Elevator Co., 320 U.S. 418 [88 L. Ed. 139].)

We do not find it necessary to decide the question of jurisdiction since, in any event, the doctrine, does not apply in this case. (Appeal of Floyd E. and Hilda Howes , Cal. St. Bd. of Equal., Oct. 24, 1972.) In this matter, the items of income involved were not derived from a single transaction. Each year the corporation declared dividends based upon its profit or loss experience for that year. Thus, it is evident that the declaration

and payment of dividends for each year constituted a single and separate transaction. Furthermore, there was no inconsistency in the theory or method of taxation of the dividend income. The tax was applied on the basis of the income received in each taxable year. Thus, the 1963 income, as well as the income for all the other years, was taxed as ordinary income in the year of receipt. The fact that appellants' underreported and over-reported income in different taxable years does not constitute inconsistent theories of taxation .

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

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 18595 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of Frank and Elsie M. Bartlett against a proposed assessment of additional personal income tax in the amount of $1,113.03 for the year 1969, be and the same is hereby sustained.

Done at Sacramento, California, this 15th day of May, 1974, by the State Board of Equalization.

_____, Chairman

_____, Member

_____, Member

_____, Member

_____, Member

ATTEST: _____, Secretary