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CALIFORNIA FRANCHISE TAX BOARD

Legal Ruling No. 247

October 30, 1959

INCOME YEAR OF TAXABILITY RECOUPMENT – OFFSET OF OVERPAYMENTS AGAINST BARRED DEFICIENCIES

Syllabus:

(1) The income realized on the cancellation of a note is not taxable in a year other than the year in which the note was cancelled.

(2) The barred deficiency can be offset against an overpayment.

Taxpayers acquired stock, in equal interest, in X Corporation, for cash; however, the stock was subject to a preexisting note executed by seller. In 1945 taxpayers sold the stock. During 1945 the corporation made payments on the note and the taxpayers each reported income in their 1945 returns on account of said payments. During 1946 the corporation paid the balance on the note. Neither taxpayer reported income from the latter transaction on their 1946 return.

On December 23, 1953, this Board issued a Notice of Proposed Assessment on taxpayers' 1949 return increasing the income reported on the return in the amount of taxpayers' one-half share of the payment on the note. The Board withheld money from taxpayers' bank account, most of which was applied to the 1949 proposed additional assessment.

Both the statute of limitation for proposing assessments and the extended statute of limitation for omission of more than 25% of income had expired on both the 1945 and 1946 returns on the date the proposed additional assessment was issued.

(1) An attempt to tax an item of gross income in one year because the taxpayer had erroneously failed to report it in an earlier year was rejected by the Federal courts. Ross v. Com'r., 169 F.2d 483. Each year's return, so far as practicable, both as to gross income and deductions therefrom, should be complete in itself. Since the note was cancelled by the corporate payment in 1946 the income was realized in 1946 and should have been reported in 1946. A Notice of Proposed Additional Assessment (Art. 2, Ch. 18 PIT) could have been made within four years after the 1946 return was filed but no proposed deficiency could be made with respect to 1946 unless the notice was mailed within said four year period or the period otherwise fixed.

(2) The principal of recoupment as distinguishable from estoppel involves the

tax itself rather than the computation of tax liability. The U.S. Supreme Court has stated that the principal of recoupment may be invoked if an overpayment arises at the same time out of the same transaction as a barred deficiency.

The ultimate question presented for decision upon a claim for refund is whether the taxpayer has overpaid his tax. This involves a redetermination of the entire tax liability. While no new assessment can be made after the barring of the statute, the taxpayer, nevertheless, is not entitled to a refund unless he has overpaid his tax. The action to recover on the claim for refund is in the nature of an action for money had and received and it is incumbent upon the claimant to show that the State has money which belongs to him. Although the statutes of limitation may bar assessment and collection of a deficiency it does not obliterate the right of the State to retain payments already received when they do not exceed the amount which might have been properly assessed and demanded.

The barred deficiency and the claimed overpayment all relate to the same transaction and the same taxable year although erroneously assessed in a later taxable year.

It has been ruled that an overpayment of tax may be credited against interest and penalties barred from assessment for the same taxable year and the same type of tax; Revenue Ruling 56-492, IRB 1956-40, 14.

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