

## Proposal #5: Final Federal Determination Definition

### PROPOSAL

The FTB should sponsor legislation to further define the term “final federal determination” (FFDD) with respect to a taxpayer’s obligation to report to the FTB federal changes and the tolling of the statute of limitations period.

### CURRENT LAW

Currently, California Revenue and Taxation Code section 18622(d) defines the FFDD as "the date on which each adjustment or resolution resulting from an Internal Revenue Service examination is assessed pursuant to Section 6203 of the Internal Revenue Code."

Internal Revenue Code section 6203 states that an "assessment shall be made by recording the liability of the taxpayer in the office of the Secretary in accordance with rules or regulations prescribed by the Secretary. Upon request of the taxpayer, the Secretary shall furnish the taxpayer a copy of the record of the assessment." Thus, a federal determination is final on the date on which the adjustment resulting from an Internal Revenue Service examination is assessed. (Rev. & Tax. Code section 18622, subdivision (d); Internal Revenue Code section 6203.)

The federal assessment is made by recording the liability of the taxpayer in accordance with IRS rules or regulations. (Treas. Reg. § 301.6203-1.) The record of assessment must provide identification of: (1) the taxpayer; (2) the character of the liability assessed; (3) the taxable period, if applicable; and (4) the amount of the assessment. (Treas. Reg. § 301.6203-1.) An Individual's Master File (IMF) or Business Master File (BMF) transcript of a taxpayer's account contains all of the information required under Treas. Reg. § 301.6203-1.

Thus, California law states that the date that the federal assessment is entered on the taxpayer's Master File transcript is the final federal determination date.

### ANALYSIS

The relevance of the FFDD is that it triggers the reporting requirement set out in section 18622 of the Revenue and Taxation Code. When, or if, the taxpayer reports a federal change or correction determines which statute of limitations applies. 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. 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.

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 limitations or two years from the date of the taxpayer's notice or the date the taxpayer files an amended return with FTB. (Rev. & Tax. Code section 19059.) If the taxpayer or the IRS reports the federal changes late (after the six months), FTB has four years from the date of the taxpayer's or the IRS'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 and IRS fail to report the changes at all, or the taxpayer 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).)

Obviously, the clearest possible definition of the final federal determination date is in the best interest of the taxpayer and the FTB. Enactment of SB 1229 as it relates to section 18622 was intended to provide a clearer definition of the FFDD. Whether or not that definition can be further clarified is the current question.

The goal in SB 1229 was to identify and define a FFDD in a way that lets the taxpayer know when a federal action must be reported and permits FTB to identify when a federal action has become final in the event that a taxpayer fails to report that change as required. As explained in the Senate Bill 1229 analysis, dated April 12, 1999:

"Through reciprocity arrangements with the IRS, the department generally receives directly from the IRS copies of examination reports of individuals with California addresses. Department staff reviews the reports and issues applicable assessments, not waiting for notice from the taxpayer. However, the department does not always receive copies of examination reports for bank and corporation taxpayers with business locations in multiple states or with out-of-state addresses."

In the discussion of policy considerations, the SB 1229 analysis explained:

"The date that each adjustment or resolution resulting from an IRS examination is assessed pursuant to IRC Section 6203 is a fixed date that can easily be determined by both the taxpayer and the department. Using this date for the final federal determination date would clarify when the statute of limitations begins and ends."  
[Emphasis added.]

Under implementation considerations, the Senate Analysis of SB 1229 states:

The federal adjustments provision would reduce disputes between taxpayers and the department by defining the final federal determination date. Taxpayers can easily identify the date since the taxpayer receives an assessment, refund or "no change" report once the adjustment or resolution is assessed pursuant to IRC Section 6203 (commonly known as the "23C date"). The department can identify this date by

checking for corresponding entries on the IRS Master File. Taxpayers and the department can verify the date by requesting a copy of Form 23C (or its equivalent) from the IRS."

In SB 1229, the Legislature chose to define the FFDD in a way that could be easily discovered by both the taxpayer and the FTB. As acknowledged by Spidell, the 1999 amendments have significantly reduced the number of disputes related to the reporting requirement and the running of the statutes of limitation.

The Spidell request cites to the State Board of Equalization decision in the *Appeal of LSI Logic, Corporation and Subsidiaries*, Case No. 402104, adopted on January 21, 2009, and proposes that FTB sponsor legislation to further define the term "final federal determination," presumably as it relates to closing agreements. No clarifying definition has been provided.

In the *LSI* case, the dispute was whether the taxpayers' notification was within six months of the final federal determination. The FTB argued that the final federal determination was November 11, 2002, the date that the IRS posted the transaction code 300 entry to assess \$1,578,271.98 additional tax pursuant to an examination. The taxpayers argued that the final federal determination date was not the date that the amount was actually assessed, but a later date, when they executed a closing agreement (form 906) on December 6, 2002.

Spidell's argument relies primarily on the old regulatory definition of a "closing agreement", which was listed as one example of a final federal determination. Spidell also argues that, based on a letter from the IRS to LSI Logic, the IRS' interpretation of "recording the liability" is consistent with the taxpayer's interpretation on appeal.

#### DIFFICULTIES WITH SPIDELL'S ANALYSIS

Spidell applies the incorrect definition of a FFDD in its analysis. As the State Board of Equalization correctly held in the *LSI Logic* decision, the definition of a FFDD in Regulation section 19059 was superseded by the enactment of SB 1229. See FTB Notice 99-9.

In reciting the facts of the *LSI* case, Spidell sets out several dates: the date the taxpayers agreed with the IRS and consented to assessment and collection by completing IRS Form 870; the date the IRS posted the adjustment to the taxpayers' master file; the date the taxpayers entered into a closing agreement by completing IRS Form 906 and the date the IRS posted the closing agreement to the master file transcript without altering the deficiency assessment previously posted. That several actions occur at the federal level during the course of the examination precisely points out the problem with the previous definition of a

FFDD in regulation section 19059, applicable to final federal determinations occurring before January 1, 2000.<sup>1</sup>

While it is true that California could have adopted any one of these actions by the IRS to identify the FFDD date, the Legislature did not. Rather, they adopted the definition set out in Revenue and Taxation Code section 18622(d), which references "the date on which each adjustment or resolution resulting from an Internal Revenue Service examination is 'assessed' pursuant to Section 6203 of the Internal Revenue Code." Likewise, the "23C" date as defined by IRC section 6203 specifically states that an "assessment shall be made by recording the liability of the taxpayer in the office of the Secretary in accordance with rules or regulations prescribed by the Secretary." Thus, the action that identifies a FFDD is the date the additional tax liability is assessed.

Of the various actions that occurred in the *LSI* case, the "23C" date is the only one that both "taxpayers and the department can verify by requesting a copy of Form 23C (or its equivalent) from the IRS."

## CONCLUSION

Undoubtedly, the Legislature and FTB want to provide the clearest possible guidance as to when a taxpayer must report a federal change or correction. Consistent with the desire for clarity, FTB welcomes any proposals that would accomplish that goal. In this instance, however, Spidell has not submitted a proposal that would afford greater clarity. And, FTB is

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<sup>1</sup> Section 19059(e) of title 18 of the California Code of Regulations defines a final federal determination as "an irrevocable determination or adjustment of a taxpayer's federal tax liability from which there exists no further right of appeal either administrative or judicial. For example:

(1) a closing agreement made under Section 7121 of the Internal Revenue Code of 1986 finally and irrevocably adjusting and settling a taxpayer's tax liability.

(2) The 90-day deficiency notice pursuant to Section 6213(a) of the Internal Revenue Code of 1986 is a final determination, unless a timely petition to redetermine the deficiency is filed in the Tax Court of the United States, in which event the judgment of the court of last resort affirming the deficiency, or the redetermination of the deficiency pursuant to a judgment of the court of last resort is the final determination. But the determination does not become final until the time for petitioning for a rehearing or appealing to a higher court has expired.

(3) The assessment of a deficiency pursuant to a waiver filed under Section 6213(d) of the Internal Revenue Code of 1986 where no 90-day deficiency notice is issued."

not presently aware of a definition that would provide greater clarity than the existing statute.