STATE OF CALIFORNIA
FRANCHISE TAX BOARD
Legal Branch

Technical Advice Memorandum – 2001-1292
November 1, 2001
Reversal of Final Action on Claim

Requested By:	Dale Isaac, Director Multistate Tax Audit Bureau
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Request Date:	October 9, 2001
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QUESTION PRESENTED

Whether FTB or FTB staff has the authority to allow a refund after a change in law, where final action had occurred on a claim for the same issue.

CONCLUSION

No. FTB or FTB staff are without authority to allow a refund where action on a prior claim for the same issue has become final. FTB staff cannot make a "business decision" to allow such refunds in violation of law.

Facts

According to the facts presented, several taxpayers filed claims for refund with FTB, which FTB denied pursuant to Revenue and Taxation Code (RTC) section 19323. The taxpayers appealed the claim denial pursuant to RTC §19324. During the pendency of the appeals, the Board of Equalization issued a formal opinion in the *Appeal of Blaine B. and Bobbi J. Quick*, 99-SBE-004, April 22, 1999. That opinion held that basis in S corporation stock may not be increased by cancellation of debt (COD) income that was excluded from gross income at the corporate level under RTC section 23800, which incorporates Internal Revenue Code (IRC) section 108(a).

As the taxpayers' appeals involved the same issue, they voluntarily requested dismissal of their appeals pursuant to 18 Cal. Code Regs. §5076.1(a), and on September 8, 1999 the SBE issued notices of determination dismissing the appeals, sustaining denial of the claims. The taxpayers did not file a petition for rehearing pursuant to RTC §19334 within 30 days of the notice or a suit for refund within 90 days of the notice pursuant to RTC §19384, so action on the claims became final. On March 27, 2000 the taxpayers filed second claims on the same COD basis issue after discovering that the U.S. Supreme court was considering a federal case on the same issue. For tax years 1995 and 1996, these second claims were made within four years of the original due date of the returns.

Subsequently, the U.S. Supreme Court issued its opinion in *David A. Gitlitz* v. *Commissioner* (2001) 531 U.S. 206, holding that under corresponding federal law, excluded COD income can increase basis in S corporation stock.

Applicable Law

RTC §19321 provides that a refund claim upon which action has become final shall not thereafter be considered a refund claim within the meaning of Section 19306 except to the extent it has been allowed.

18 Cal. Code regs. §5076.1 provides that an appeal from an action by FTB may be voluntarily dismissed at any time at the written request of the taxpayer. A dismissal is a "determination" of the SBE that starts the time for filing suit under RTC §19384.

RTC §19334 provides that the determination of the SBE on an appeal is final upon the expiration of 30 days from the date of determination unless a petition for rehearing is filed.

RTC §19802 provides that in the determination of any case arising under RTC Part 10.2, including refund claims, SBE appeals and litigation, the rule of res judicata is applicable only if the liability is for the same year as another case previously determined.

Appeal of Blaine B. and Bobbi J. Quick, 99-SBE-004, April 22, 1999, held that a shareholder could not increase basis in S corporation stock by cancellation of debt (COD) income that was excluded from income under IRC §108(a).

Gitllitz v. *Commissioner* (2001) 531 U.S. 206, held that a shareholder could increase basis in S corporation stock by COD income that was excluded from income under IRC §108(a).

Opinion No. 53-198, 25 Ops.Cal.Atty.Gen. 119 (1955) considered whether FTB had the authority to reverse its action denying a refund claim. The opinion held that FTB could reverse or revise its action on the refund claim under former RTC § 19057 (now §19324) only before the action became final, i.e., before 90 days from the mailing of the notice of action. After the 90-day period, FTB has no authority to modify its action to allow the claim.

FTB v. *Superior Court, ex. rel. Kvamme* (1998) 63 Cal.App.4th 794, held that a taxpayer who failed to file a suit in court within 90 days of the SBE's order denying a petition for rehearing was barred from filing suit because the action on the claim had become final. See also *Thomas Nast* v. *State Board of Equalization* (1996) 46 Cal.App.4th 343.

In *Appeal of Rietz Manufacturing Company,* Cal.St. Bd. of Equal., February 28, 1984, the SBE held that a deficiency Notice of Action could be withdrawn by FTB before it became final, preventing it from becoming a "determination" within the meaning of former §26424 (now §19802).

In *Heather Preston* v. *SBE* (2001) 25 Cal. 4th 197, the California Supreme Court reviewed the exhaustion of administrative remedies doctrine, holding that the "grounds" of a claim implied from contentions explicitly raised are sufficiently stated for purposes of exhaustion so that the same ground was raised on appeal as in the claim.

Appeal of Chromalloy American Corporation, Cal. St. Bd. of Equal. February 3, 1977, applied the federal doctrine of variance enunciated by the U.S. Supreme Court in *U.S.* v. *Andrews* (1938) 302 U.S. 517, to California franchise tax. Where a second claim is filed *after* the normal statute of limitations period, but *before* final action on the first claim, it can be considered a timely amendment of the first claim only where the second claim involves the same issues and facts. See also *United States* v. *Memphis Cotton Oil Co.* (1933) 288 U.S. 62, holding that a claim could be amended only before it is formally allowed or denied; *Allstate Insurance Company* v. *U.S.* (Ct. Cl. 1977) 550 F.2d 629, holding that only the new elements of a second claim could be considered.

Appeal of Frank Joseph Rossiter , Cal. St. Bd. of Equal. January 5, 1982, held that once action has become final on a refund claim, the filing of an identical second claim is a nullity. The board explained: "In effect, appellant's entitlement to relief from this board, if any, was extinguished when he allowed the denial of his first claim for refund to become final..." This principle has been consistently followed in subsequent unpublished decisions (see, e.g., *Appeal of JFC International, Inc.* May 2, 1991*; Appeal of Richard and Eleanor Young*, May 8, 2001) and by the State Board of Equalization in sales and use tax cases. (Sales and Use Tax Annotation 465.0120, March 13, 1968.)

Huettl v. *United States* (9th Cir. 1982) 675 F.2d 239, considered the effect of an intervening court opinion that directly contradicted the IRS action on the first claim. The court held that only where the second claim is based on different facts or legal theories than those contained in the first, can the second claim be considered independently (citing *Charlston Realty Co*. v*. United States* (1967) 384 F.2d 434). Under this standard, an intervening change in the law between final action on the first claim and the second claim is insufficient basis to distinguish the two claims. (See also *Yuen* v. *Comm.* (1999) 112 T.C. 123, applying this same principle to a duplicative interest abatement request re-filed after a statutory change; *Appeal of Belle V. Baptista*, Cal. St. Bd. of Equal., December 7, 1982, holding that a second claim claiming a different amount and presenting different theories was sufficiently different as not to be barred.)

Analysis and Discussion

The first issue is whether final action occurred on the first claim. From the facts presented, the taxpayers filed timely claims with the FTB that FTB denied. Appellants properly filed appeals from the denial to the State Board of Equalization pursuant to RTC §19324. During the appeal process, the taxpayers asked that the appeals be dismissed based on the SBE's opinion in *Quick.* The dismissal of an appeal constitutes a final "determination" of the appeal by the SBE (RTC §19384.) The taxpayer's sole remedy at

that point was to file a suit in court within the period set forth in §19384. See *Nast* v. *SBE*, above.

The second issue is whether the filing of the second claim raising the additional authority of *Gitlitz* is a claim based on "different facts or legal theories." Here, *Huettl* v. *U.S.* is directly on point. In the second claim, the taxpayer did not raise any additional facts, and the only additional argument is the intervening Supreme Court decision, which was decided on exactly the same arguments they raised in their original unsuccessful claim. Legally, the second "claim" was not a different claim at all, but a request that the action on the first claim be reversed.

Therefore, in this case, as action on the first claim had become final, and the second claim raised the same issues and arguments as the first claim, FTB has no authority to allow the second claim because such an allowance would be a reversal of FTB's action on the first claim after the time for doing so has expired. This is the *exact question* considered by the 1955 Attorney General opinion above. Under that opinion, allowance of the second claim would be an impermissible reversal of a final action on the first claim.

The analysis presented with your request recognizes the general principle of res judicata, (claim preclusion) but suggests that there is no precedent indicating that the principle of res judicata applies to cases that have not been decided by the courts or the State Board of Equalization. The memo then goes on to conclude without citation to any authority that FTB staff can therefore make a "business decision" to allow these claims.

This is simply incorrect. It is important to note that the reason that the taxpayers withdrew their appeal and allowed it to be dismissed was that the *Quick* opinion resolved the only issue presented in their appeal. Had they maintained their appeal instead of withdrawing, it almost certainly would have been decided against them based on *Quick*. At that point, they could have chosen to pursue their administrative or judicial remedies by filing a petition for rehearing or a suit in court. They chose not to do this, deliberately withdrawing their appeal so that it would be dismissed and the claim denial would become final. They cannot now argue that they should receive more favorable treatment than a taxpayer who properly pursued available administrative and judicial remedies, and was barred by administrative res judicata (see *Appeal of Williams*, Cal. St. Bd. of Equal. 2/28/84, *Appeal of Weissman* SBE unpublished decision 1/4/01).

As the California Court of Appeal explained in *Farrar* v. *FTB* (1993) 15 Cal.App.4th 10, citing the California Supreme Court decision in Woosley *v. State of California* (1992) 3 Cal.4th 758, "the lesson of *Woosley* we take to be that statutes governing administrative tax refund procedures, backed as they are by a plenary constitutional authority, are to be strictly enforced. [fn9]"

In the associated footnote 9, the court went on to state "As this court has particular reason to know, two months after *Woosley* the Supreme Court made it clear that it takes an equally dim view of attempts by the state to avoid strict compliance with the

administrative machinery established to consider refund claims. (See *Title Ins. Co. v. State Board of Equalization* (1992) 4 Cal.4th 715, 729-730.) "

This same concept, that the strict adherence to the administrative claim process is an inherent part of the judicial claim process, and that both the state and the taxpayer must strictly comply with statutory provisions, was again reinforced in the companion cases of *Agnew v. SBE*, (1999) 21 Cal.4th 310 and *Roy Chen* v. *Franchise Tax Board* (1998) 75 Cal.App.4th 1110, holding that the language in the statutes requiring payment of "tax" before commencement of a refund action in court related back to the validity of the initial administrative refund claim. This analysis was reiterated and followed in *Heather Preston*, *supra*, where the California Supreme Court affirmed that the grounds set forth in the original administrative claim and considered during the administrative claim process frame and restrict the issues that may be considered in court. In other words, taxpayers must strictly follow the statutory administrative claim process, including all the deadlines and requirements, for FTB to have the authority to allow the claim.

In the case presented, the plain language of the statutes prohibits allowance of the "second" or amended claim: The withdrawal and dismissal of the SBE appeal was a "determination" under RTC §19334, and became a "final determination" upon the expiration of 30 days. Under RTC §19321, a claim upon which action has become final is no longer a claim under RTC §19306, so FTB is prohibited from allowing a refund, making a credit or issuing a Notice of Proposed Overpayment based on that claim. Finally, under RTC §19802, consideration or allowance of a second claim involving the same grounds is barred by the doctrine of res judicata, which in this case is *extended by statute* to administrative determinations "arising under" Part 10.2 of the Revenue and Taxation Code, including FTB claim denials and dismissals of SBE appeals.

FTB has no power to authorize as valid a claim that does not meet the essential statutory criteria as set forth in the Revenue and Taxation Code (*Roy Chen*, *supra,* at 1121, *Shiseido, supra,* at 489.) Therefore, FTB cannot make a "business decision" to allow these claims in violation of law.

Tax Counsel

Attachment: Opinion of Attorney General to FTB, No. 53-189, 2/09/55