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QUESTIONS PRESENTED

What is the correct calendar year for issuing a Form 1099G Information Return in the factual situations below?

FACTS and DISCUSSION

1). On 4/10/02, taxpayer files 1998, 1999 and 2000 amended refund returns. The tax year refunds were all placed on hold due to over \$50,000 for each year. On 12/20/02, all three tax year holds were released for refund. On 12/21/02, our 1099 program selected these refund records for IRS reporting for calendar year 2002. FTB's Fiscal Department submitted the refund tape to the State Controller's Office (SCO) with a schedule date of 1/02/03 and issue date of 1/09/03.

Question: Should the established credit date, refund schedule date or refund issue date be used for determining the correct calendar year to be used to report this refund of tax to the IRS?

Answer: Ideally, the date the check is received by the taxpayer should be used. However, since we do not have that information, the issue date is the best approximation of the received date from the choices above since the check can be received no earlier than the issue date. See the discussion of when state tax refund income is recognized under federal law in the *Jamerson* case below.

2). Taxpayer filed the 2000 (refund) tax return on 5/21/02. On 6/24/02, the return was updated and his refund was transferred (per his request on return) to his 2001 tax year as an estimate payment transfer. On 7/15/02, a user did a FILE DATE CHANGE command. This command changed his file date from 5/21/02 to 4/15/01. User now wants to send a corrected 1099-g notice changing the calendar year for reporting to the IRS from 2002 to 2001.

Question: What is the correct calendar year to be used?

Answer: the correct year is 2002 since that was when the year 2000 refund was credited to satisfy a liability for a different year. The effective date of the payment for purposes of crediting estimate tax payments is not relevant here.

3). Taxpayer filed 1999 amended refund return on 8/27/02. Return updated on 10/02/02 and refund issued on 10/03/02. Refund was returned (unclaimed) on 1/21/03 and re-issued on 2/10/03. We sent a 1099G record to IRS for calendar year 2002. User now wants to change the calendar year from 2002 to 2003.

Question: Should we send IRS a correction notice to change 2002 to 2003 because of returned refund warrant?

Answer: the answer would depend on whether the warrant was properly mailed to the taxpayer's last known address. If so, then it is deemed received within a reasonable time after it was mailed and the amount should be included in the 2002 1099G. If not, and it was FTB's fault that it was sent to the wrong address, then it should be included on the 1099G for the year it was properly mailed. This is the same result as whether interest is payable on the second warrant.

APPLICABLE LAW

Internal Revenue Code section 6050E imposes a reporting requirement on state and local entities that issue income tax refunds.

The section states:

(a) "Every person who, with respect to any individual, **during any calendar year** makes payments of refunds of State or Local income taxes (or allows credits or offsets with respect such taxes) aggregating \$10 or more shall make a return according to forms or regulations prescribed by the Secretary setting forth the aggregate amount of such payments, credits or offsets, and the name and address of the individual with respect to whom such payment, credit, or offset was made."

As explained in Rev. Rul. 86-140, 1986-2 C.B. 195:

For purposes of computing taxable income for federal income tax purposes, section 164(a) of the Code permits a deduction for state and local income taxes for the taxable year within which paid or accrued, according to the taxpayer's method of accounting. In addition, under section 1.164-1(a) of the regulations, state and local income taxes that are paid or accrued within the taxable year in carrying on a trade or business or an activity described in section 212 (relating to expenses for the production of income) are permitted as deductions.

The refund, credit, or offset of state or local income taxes that were deducted (with a resulting tax benefit) in a prior year is includible in a taxpayer's gross income. See section 111 of the Code. Section 6050E was enacted to assure that any individual taxpayer, whether or not engaged in a trade or business, who deducted a state or local income tax and later received a refund of any portion of those taxes deducted, would include that amount in gross income in the year in which the refund occurs. See S. Rep. No. 97-494 (Vol. 1), 97th Cong., 2d Sess. 250 (1982).

In *Jamerson v. Comm.*, T.C. Memo 1986-302, Virginia tax refund checks were dated December 27, 1983, but deposited by the taxpayer on January 6, 1984. The court held that because the taxpayers were individuals who used the cash basis of accounting, the income is recognized when actually received, not when the checks were dated or mailed. The court held that because IRS could not prove the actual mail date, the IRS did not show that the checks should have been received in 1983, and so held for the taxpayer that the income was includable in the 1984 tax year.

The "constructive receipt" rules of Treas. Reg. 1.451-2 do not apply in this situation to change the result for a cash basis taxpayer. These would apply if we credited the refund to a bank account, for example, and it was available to the taxpayer to write a check against before the end of the year. But in a paper-check refund situation, the taxpayer cannot spend the money until an actual check is received.

Payments that are transferred from another tax year are effective as of the date the payments are transferred. (See RTC §19383, *Commissioner v. Lundy* (1996) 516 U.S. 235, 133 L.Ed.2d 611.) Therefore, even though for purposes of computing estimated tax and interest, credit amounts can receive a retroactive effective date (See TAM 2002-0353, September 12, 2002), for all other purposes they are deemed paid when FTB actually transfers the money.

Revenue Ruling 76-74, 1976-1 C.B. 388, holds that no interest is allowable for the period that a refund check is undelivered without fault of the government. Interest is allowed where the check is shown to have been erroneously drawn, misaddressed or excessively offset against another agency's claim. Situation 2 of Rev. Rul. 76-74 states, in relevant part: "The issuance of a substitute check to a taxpayer provides no basis for further interest . . ." where there was no defect in the original check that would have prevented it from being negotiable by the taxpayer. (See also *Fenlen v. United States* (D.C. Kansas 1989) 89-2 USTC ¶13,816 (representative lost check); *General Instrument Corp. v. United States* (Ct. Cl. 1995) 33 Fed.Cl. 4; schedule date is date of overpayment.)

This same rationale applies here. Interest is payable on an overpayment from the date the overpayment arises until a date based on the date a valid refund check is issued (IRC §6611). A misdirected check is not treated as "issued" for purposes of computing interest, and so would also not be treated as "received" for purposes of 6050E.

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