



STATE OF CALIFORNIA  
**FRANCHISE TAX BOARD**  
PO Box 1720  
Rancho Cordova, CA 95741-1720  
Telephone (916) 845-3066  
FAX (916) 843-2122

JOHN CHIANG  
Chair

BETTY T. YEE  
Member

MICHAEL C. GENEST  
Member

Date: April 23, 2007

Technical Advice Memorandum: 2007-01

Requested By: Elizabeth Johnson  
Requested Date: 09/19/2006  
TAM Author: Suzanne L. Small  
Phone Number: (916) 845-3066  
Fax Number: (916) 843-2122

SUBJECT: Application of Statutes of Limitation Provisions to Overcollected Amounts Received by the Franchise Tax Board Through Involuntary Collection Action

### **QUESTION PRESENTED**

1. Are there situations where the expiration of the applicable statute of limitations does not bar the Franchise Tax Board (FTB) from returning an "overcollection" on a taxpayer's account?
2. Is interest allowed on amounts returned as overcollection?

### **CONCLUSION**

Generally, the statute of limitations bars a refund of overpayment amounts when a claim for refund is not filed within the time limit provided by law. However, there is a narrow exception where the statute of limitations provisions do not apply to the return of payments that exceed what FTB is legally allowed to collect and were the result of "overcollection."

1. An "overcollection" occurs when the amount collected exceeds the amount actually due under the law as the result of clerical or mechanical error. An "overcollection" can be returned even if the statute of limitations for filing a claim for refund has expired.
2. Interest is not allowed on the return of an "overcollection" of tax because the "overcollection" is not an overpayment of tax.

## **ANALYSIS AND DISCUSSION**

### 1. Return of "Overcollections"

If a taxpayer fails to pay any liability imposed under the Personal Income Tax Law when the liability becomes due and payable, the amount due and payable becomes a perfected and enforceable state tax lien, subject to chapter 14, commencing with section 7150, of Division 7 of Title 1 of the Government Code. FTB is authorized to secure and release liens (§ 19221). This authority only extends to liability for income tax.

Based on FTB's various compliance programs, it is often compelled to make an assessment of tax based on available information when a taxpayer appears to have received income in excess of the filing requirement and has failed to file a timely tax return. This information includes records from the Employment Development Department, the Internal Revenue Service, and various other reliable sources. When that assessment becomes final, FTB has the authority to pursue collection of the tax, interest, any applicable penalties, and any applicable fees, that are final balances due on a taxpayer's account. (Revenue and Taxation Code §19221.)

In situations where a taxpayer either files a return or provides other information that establishes a lesser liability than the amount imposed, there may be an overpayment created due to FTB's collection of the amounts imposed. The general time limit for a taxpayer to file a claim for credit or refund of an overpayment of California state income and franchise taxes is provided by section 19306 of the Revenue and Taxation Code.

Section 19306 states that no credit or refund shall be allowed after four years from the original due date of the return, four years from the date the return was filed (if filed within the extension period), or one year from the date of the overpayment, whichever is later, unless before the expiration of that period a claim is filed by the taxpayer.

However, there are a very limited number of situations in which amounts are "overcollected" as opposed to overpaid, which can be returned to the taxpayer after the statute of limitations has expired for claiming a refund. The provisions for such a return of payments are very narrow and applied infrequently. Such a situation occurs if the amount collected by the FTB exceeds the amount actually due under the law. This is considered an "overcollection" as there was no authority to collect that amount. An "overcollection" is characterized as an amount collected as a result of some clerical or mechanical error. The following are examples of an "overcollection." Each of the examples involves overcollections that resulted from clerical or mathematical error by the FTB.

EXAMPLE 1. FTB utilizes an Earnings Withholding Order for Tax (EWOT) to collect an outstanding liability through direct payments from the taxpayer's employer. At some point, the full tax liability is satisfied but the employer sends one or more payments before the EWOT is withdrawn. Those

payments over the amount of the tax liability are the result of overcollection and not barred by the statute of limitations from later being returned to the taxpayer. This was a type of clerical error in that there was no intent to collect the additional amounts; it was just an error in notification to the employer's payroll personnel.

EXAMPLE 2. FTB receives information from EDD indicating a taxpayer received wages in the amount of \$50,000.00 and a dividend payment of \$20.00. The Notice of Proposed Assessment is issued showing the correct amounts. However, in calculating the final tax due as a result of the proposed assessment, there is a mathematical error and the tax assessment is finalized based on income of \$50,220.00 rather than the correct amount of \$50,020.00. The amount collected over tax actually due on income in the amount of \$50,020.00 is an "overcollected" amount. This is due to the mathematical error that resulted in the overcollection and the return of that amount is not barred by the applicable statute of limitations.

EXAMPLE 3. FTB receives information from EDD indicating a taxpayer X, Social Security number XXX-XX-XXXX, received wages in the amount of \$50,000.00. FTB issues a proposed assessment based on that amount of income. The assessment becomes final and FTB proceeds with collection action against taxpayer Y, Social Security number XXX-XX-XXXX. After the applicable statute of limitations has expired, taxpayer Y establishes that the assessment was not based on information that pertained to him/her. Thus, the amounts collected were based on a clerical mistake regarding the transposing of the last two numbers in the Social Security number of the taxpayers involved. These amounts may be returned to the taxpayer as they were the result of an overcollection.

EXAMPLE 4. The following are situations that do not constitute overcollection. Thus, the refunds are barred by the applicable statute of limitations. These situations involve overpayments that are a result of actions or mistakes by some party other than the FTB, and such overpayments are subject to the applicable statute of limitations. FTB received income information indicating that taxpayer received \$60,005.00 in income during the 2005 tax year. When the taxpayer failed to file a return, FTB issued an assessment for \$3,164.00 in tax based on that income and pursued collection, completely satisfying the assessment. However, after the statute of limitations has expired, the taxpayer files a tax return indicating multiple deductions and credits, which was accepted by the FTB and reduced the tax liability to \$2,000.00. The \$1,164.00 FTB collected over the final liability was not an overcollection. FTB properly based the assessment on correct information. It was the taxpayer's failure to file a timely return that resulted in the overpayment, not a mistake by the FTB.

EXAMPLE 5. FTB received information from EDD that Maxy, a retailer, filed a W-2 indicating it paid taxpayer Y \$80,000.00 in wages during 2000. When taxpayer Y failed to file a tax return for 2000, a proposed assessment was issued to taxpayer Y based on the \$80,000.00 of income. The assessment thereafter became final and FTB pursued collection activity, collecting all tax, penalties and interest. After the applicable statute of limitations has expired, taxpayer Y establishes that the W-2 was incorrect and taxpayer Y had actually only been paid \$18,000.00. The tax due on the \$18,000.00 is substantially less than that assessed on the \$80,000.00 reported to EDD and the account is adjusted accordingly. However, the resulting overpayment is not an "overcollection." FTB made no mistakes in this situation. FTB was authorized to estimate and assess the tax when taxpayer failed to file a return. The assessment was in good faith when it was made and, therefore, the collection was not an overcollection. It was the taxpayer's failure to file a timely return that resulted in the FTB being barred from refunding the overpayment.

EXAMPLE 6. FTB received information indicating that taxpayer X has a valid real estate license for the 2000 tax year but has failed to file a tax return. FTB ascribed income to taxpayer X based on the real estate license, using the calculated average business income of real estate brokers.<sup>1</sup> FTB issued an assessment, which was collected after it went final. After the statute of limitations had expired, taxpayer X files a tax return establishing that only \$3.00 of income was earned during 2000. The tax is adjusted by FTB, resulting in an overpayment, which is barred from being refunded by the statute of limitations. This amount was not the result of an "overcollection" as the FTB collected the appropriate amount based on a valid and final assessment. There was no mistake by the FTB as it used a method for estimating income that has been upheld by the courts. It was the taxpayer's failure to file a timely return that resulted in the barred overpayment.

The basic rule utilized in distinguishing between an "overcollection" and a barred overpayment is whether amounts collected were based on an assessment that was accurate based on the information available to the FTB at the time the assessment was made. Collection of amounts pursuant to a valid assessment will never result in an "overcollection" situation.

## 2. No Authority for Payment of Interest on Overcollections

The provision allowing interest on overpayments does not apply to the return of overcollected amounts. This is because that provision, Revenue and Taxation

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<sup>1</sup> This was calculated by using the average of relevant business income amounts shown on the tax returns of real estate brokers, adjusted by the California Consumer Price Index percentage change for the year of the proposed assessment.

Code section 19340, applies to any . . . "overpayment in respect of any tax" . . . .  
An overcollection is not an overpayment of tax and therefore the provisions allowing interest on refunds do not apply to the return of sums that were overcollected.

Further, Revenue and Taxation Code section 19349 specifically prohibits the payment of interest on payments not made "incident to a bona fide and orderly discharge of an actual liability or one reasonably assumed to be imposed by law."

For additional reference in this area of the law see the following TAM's: TAM EM-96-0643 (3/17/97) agency offsets of overcollected amounts, TAM EM-97-0306 (8/5/97), disposition of suspense payment balances, and TAM CM-90-689, typographical errors and erroneous refunds.

If you have any questions, please contact Suzanne Small at (916) 845-3066.

Tax Counsel III