

**STATE BOARD OF EQUALIZATION**

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December 3, 1993

BURTON W. OLIVER
Executive Director

Mr.--- N---, C.P.A.
Attorney and Counselor at Law
XXXX --- ---, XX Floor
--- ---, CA XXXXX

Re: **R--- C---, Inc.**
S- -- XX-XXXXXX

Dear Mr. N---:

This is in response to your April 29, 1993 letter to the board regarding the audits of your client, R--- C---. According to the information in your letter and our files, the facts are as follows:

The board audited R--- for the period April 1, 1986 through June 30, 1989, determined a deficiency for this period in the amount of \$63,910.90, and issued a notice of determination on December 14, 1990. R--- filed a petition for redetermination and on June 10, 1992 had a conference with an appeals attorney. R--- also filed a claim for refund for this period, asserting that it had paid tax on exempt transactions. Pursuant to the recommendation of the appeals attorney, the staff performed a reaudit in which it eliminated the penalty included in the notice of determination and reduced the tax deficiency to \$61,415.23. You have requested that the appeals attorney reconsider his recommendation.

Because of oral discussions with the auditor during the above-referenced audit, R--- began to charge sales tax reimbursement on certain retainer fees and reported tax on these fees to the board. Subsequently, the board determined that the fees were not taxable. On December 3, 1990, R--- filed with the board a claim for refund for the periods February 1, 1990 to January 31, 1991 and indicated its willingness to return excess tax reimbursement to its customers. The board granted the refund in the amount of \$27,697.59, paid it to R---, but denied credit interest on the refund. After holding a conference on June 10, 1992, the appeals attorney recommended that the board refund the credit interest. The Sales and Use Tax Department did not request reconsideration or a hearing before the board.

On January 13, 1993, the Department wrote a letter to you indicating that the amount of credit interest was \$4,186.00 but that the credit would be applied to R---'s outstanding balance of \$29,233.32 for the periods April 1, 1986 through June 30, 1989.

Finally, in response to several claims for refund the Board performed an audit for the periods July 1, 1989 through June 30, 1992. The auditor disallowed claimed exempt sales totaling \$134,239 for the third and fourth quarter of 1989 and made adjustments totaling \$22,297 for ex tax purchases for these two quarters. In addition, the auditor determined that R--- was entitled to tax paid purchases resold deductions totaling \$366,910 beginning with the third quarter in 1989. The auditor also determined that R--- had overstated taxable sales in quarters other than the third and fourth quarter of 1989. The total overstatement of taxable sales was \$136,355. After netting these four adjustments, the auditor determined that R--- was entitled to a refund in the amount of \$27,115.61, which includes interest.

You have raised the following issues in your April 29, 1993 letter:

A. Hearing on Application of Credit

In a letter dated January 18, 1993 to the appeals attorney, you requested a hearing before the board on the issue of the staff's application of the refund on the credit interest to the outstanding balance for the periods April 1, 1986 through June 30, 1989. In your April 29, 1993 letter you ask whether such a hearing will be granted.

The board grants hearings on claims for refunds in which there is a substantive sales and use tax issue. Your request for a hearing relates to a procedural matter, and therefore no hearing will be scheduled.

B. Application of Credit

With respect to this issue, in your April 29, 1993 letter you state:

“Following the Appeals Conference, a reaudit was prepared which reduced the audit liability for the period April 1, 1986 through June 30, 1989 by approximately \$10,000. In crediting overpayments from subsequent periods, the Board is withholding an amount equal to the original determination, rather than the lower amount reflected on the reaudit. Is it your position that the Board is authorized to withhold an amount in excess of the taxes ‘due and unpaid’?”

The Petitions Section calculated the balance in R---'s account. The calculations included offsets of overpayments against underpayments and used the figures from the reaudit for the period April 1, 1986 through June 30, 1989. As of November 30, 1993, R--- is entitled to a refund of \$10,345.04. We have requested that this refund be processed. Copies of the Petition Section's calculations are enclosed.

In addition, it is your position that the board may not apply the credit interest and the overpayments made by R--- for the audit period July 1, 1989 through June 30, 1992 against the outstanding liability for the period April 1, 1986 through June 30, 1989 because no final determination has been made with respect to this latter liability.

Revenue and Taxation Code section 6901 provides:

“If the board determines that any amount, penalty, or interest has been paid more than once or has been erroneously or illegally collected or computed, the board shall set forth that fact in the records of the board and shall certify to the State Board of Control the amount collected in excess of the amount legally due and the person from whom it was collected or by whom paid. If approved by the State Board of Control the excess amount collected or paid shall be credited by the board on any amounts then due and payable from the person from whom the excess amount was collected or by whom it was paid under this part, and the balance shall be refunded to the person, or his or her successors, administrators, or executors.

“The board, however, without obtaining approval of the State Board of Control may credit the amount on any amounts then due and payable under this part from the person by whom the amount was paid and may refund the balance to the person or his or her successors, administrators, or executors, if . . .

“(a) an amount of tax, interest, or penalty not exceeding fifty thousand dollars (\$50,000) was not required to be paid.” (Emphasis added.)

The dispute has centered around the meaning of the phrase “any amounts then due and payable” in the first paragraph of section 6901. We do not believe, however, that the meaning of this phrase has any bearing on the issue before us because the first paragraph of section 6901 only applies to refunds and credits which are approved by the Board of Control. In this case, the overpayments have not been approved by the Board of Control and are not required to be approved since they are less than \$50,000.

The applicable portion of section 6901 is the second paragraph which states that the board "may credit" the refund and "may refund" the balance. Since this language is not mandatory, section 6901 does not prohibit the proposed offset.

Revenue and Taxation Code section 6483 provides:

"Offsets. In making a determination the board may offset overpayments for a period or periods, together with interest on the overpayments, against underpayments for another period or periods, against penalties, and against the interest on the underpayments. The interest on underpayment and overpayments shall be computed in the manner set forth in Sections 6591 and 6907."

Section 6481 of the Code authorizes the Board to "compute and determine" a person's proper tax liability and issue a determination based on the computation. Section 6563 allows the Board to decrease or increase the determination (subject to certain limitations) at any time before the determination becomes final. Thus, the phrase "making a determination" in section 6483 does not refer simply to the issuance of a notice of determination, but rather to an ongoing process which continues at least until the Board has made a final redetermination.

In this case the board is still in the process of "making a determination" against R--- for the period April 1, 1986 through June 30, 1989. The proposed offset is therefore proper under section 6483.

C. The Second Audit - July 1, 1989 through June 30, 1992

By one letter dated December 7, 1991, and two letters dated June 10, 1992, R--- filed claims for refund for the period July 1, 1989 through September 30, 1991. The board performed an audit for the period July 1, 1989 through June 30, 1992. The auditor determined that R--- had underreported and underpaid tax for the last two quarters of 1989 but had overreported and overpaid tax for the remaining quarters under audit. After netting the adjustments for each quarter, the auditor determined that the taxpayer had made a net overpayment for all the quarters under audit. It is your position that offsetting can only be done through a notice of determination. Since a notice of determination was not issued and since the time for issuing a notice has expired for the last two quarters in 1989, you believe that the board may not offset the liability for these two quarters against the overpayments made for the remaining quarters.

It is our position that the offsetting was proper. R--- made the overpayments on the later quarters before the expiration of the statute of limitations for issuing a notice of determination for the last two quarters of 1989. Under Owens-Corning Fiberglass Corp. v. SBE (1974) 39 Cal.App.3d 532, the board may retain a payment made within the statute of limitations even though the board subsequently issues an untimely notice of determination for the deficiency in question. This case relied in part upon Lewis v. Reynolds (1932) 284 U.S. 281 which stated:

“While the statutes authorizing refunds do not specifically empower the Commissioner to reaudit a return whenever repayment is claimed, authority therefor is necessarily implied. An overpayment must appear before refund is authorized. Although the statute of limitations may have barred the assessment and collection of any additional sum, it does not obliterate the right of the United States to retain payments already received when they do not exceed the amount which might have been properly assessed and demanded.”

Additionally, the board has been given broad offset powers under Revenue and Taxation Code sections 6483 and 6901 and under Government Code sections 12419.4 and 12419.5.

Sincerely,

Elizabeth Abreu
Tax Counsel

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Enclosure