

STATE OF CALIFORNIA  
BOARD OF EQUALIZATION

465.1543

BUSINESS TAXES APPEALS REVIEW SECTION

In the Matter of the Petition )  
for Redetermination Under the ) DECISION AND RECOMMENDATION  
Sales and Use Tax Law of: )  
)  
THE P--- - R--- CO. ) No. SR -- XX - XXXXXX-010  
)  
Petitioner )

The Appeals conference in the above-referenced matter was held by Staff Counsel Lucian Khan on April 6, 19XX in San Diego, California.

Appearing for Petitioner: D--- R---  
Vice President

Appearing for the  
Sales and Use Tax Department: Phillip Klepin  
District Principal Auditor  
  
Patricia Hoggard  
Senior Tax Auditor

Protested Item

Disallowed credits for overpayments of tax on the first two quarters of 1988, measured by \$XX,XXX, for the audit period covering October 1, 1987 through December 31, 1989.

Contention

Overpayments for the first two quarters of 1988 should either be allowed as credit against other periods assessed in the audit, or refunded.

Summary

Petitioner is an advertising and public relations firm with an in-house art department. In an audit covering the above period, the auditor determined that for the first two quarters of 1988, petitioner reported and paid tax in excess of the amount due. The auditor was not able to trace the overpayments to originating transactions, but later determined the overpayments were made to compensate for prior underpayments of tax which occurred sometime in 1986 or earlier. This conclusion was based on notes contained in petitioner's tax return files which are dated in 1986 and 1987. The notes indicate tax was previously underpaid and that it was petitioner's intent to

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make up the increments quarterly.

Petitioner asked the auditor to apply the overpayments for these two quarters against underpayments for other periods in the audit; however, upon final review by the district office, this request was denied. The determination was issued on December 26, 1990, and on January 8, 1991, petitioner filed its petition for redetermination in which this is the sole issue raised.

Petitioner argues that sales on the first two quarters of 1988 were overreported based on the suggestion of a new staff accountant who believed that since there was a balance in the sales tax payable accrual account, sales must have been underreported in the past. There is no detail as to what sales were underreported or what period it relates to. It is all based on a balance in the sales tax payable account in the general ledger, as of December 31, 1987. Petitioner does not agree that the notes found in its files leads to the conclusion that there was a prior underpayment of tax, but rather that there may have been an underpayment in previous years. If there was a prior underpayment of sales tax, it would have occurred sometime prior to 1986. This is because the balance in the sales tax payable account as of December 31, 1987, which was used to increase sales reported in 1988, was the same amount in the account on December 31, 1985. In support of this argument, petitioner has submitted additional notes made by its staff regarding the balance in the sales tax accrual account, notes regarding the underreporting of sales tax, and a copy of the general ledger page for the sales tax payable account as of December 31, 1985. Finally, petitioner argues that even if taxes prior to the audit period were underreported, any assessment of additional taxes would have been barred by the statute of limitations.

The Sales and Use Tax Department (SUTD) argues that in a typical audit, the auditor is able to trace credits in the accrual account to tax reported on sales tax returns. In the present case, this could not be done by making a review of the copy of the general ledger page for the sales tax payable account as of December 31, 1985. There are noted differences between debits and credits in the accrual account for each quarter of 1985; therefore, it is conceivable that the underpayments relate to the second, third, and fourth quarters of 1985. The statute of limitations did not expire on these periods until July 31, 1988, October 31, 1988, and January 31, 1989, respectively. Thus, the additional tax reported for the first and second quarters of 1988 was reported within the statute covering the underpayments of tax due after March 31, 1985. In the decision of Owens-Corning Fiberglas Corp. v. State Board of Equalization (1974) 39 Cal.App.3d 532, 114 Cal.Rptr. 515, the court held that amounts paid prior to the expiration of the statute of limitations upheld the state's right to the tax.

#### Analysis and Conclusions

In resolving the issue of whether petitioner is entitled to have the two quarterly overpayments either refunded or applied to underpayments for other periods in the audit, the following questions must be considered: (1) Has there been a proven overpayment? (2) Was there a prior underpayment? (3) If there were prior overpayments and underpayments, must the Board grant petitioner a credit or refund?

Here, there is no dispute that for the first and second quarters of 1988, petitioner paid in excess of the taxes actually due. As to whether there is sufficient evidence of underpayments prior to the audit period, I conclude that there was. The sales tax payable account as of December 31, 1985 and December 31, 1987 showed a balance in excess of that reported to the Board. The handwritten notes obtained from petitioner's files indicate a prior underpayment of tax (although the exact period is not specified), and the intent to make up increments quarterly. Overpayments were then made for the first two quarters of 1988. The fact that petitioner cannot pinpoint the exact periods in which the underpayments may have been made, is not sufficient evidence to conclude that prior underpayments never occurred. The fact there was a balance in the sales tax payable account without further explanation is indicative of a prior underpayment.

To determine whether the Board may retain petitioner's overpayments as compensation for earlier underpayments, or whether petitioner would be entitled to either a credit or refund, we must review the time limits imposed upon the Board for issuing a deficiency determination under Revenue and Taxation Code Section 6487, and under Section 6902 for petitioner to file a claim for refund, and any noted exceptions to the rules set forth.

Section 6487 provides for a three-year statute of limitations period for taxpayers filing on other than an annual basis, when there is no evidence of fraud or intent to evade the tax. Section 6902 provides that for persons required to file returns on other than an annual basis, no refund shall be approved by the Board after three years from the last day of the month following the close of the quarterly period for which the overpayment was made.

Applying the above rules, the January 8, 1991 petition was in reality a claim for refund, because the sole issue raised related to the "credit" which petitioner believes should be applied to its account. This "claim" was timely, because even the first quarter of 1988 would not have outlawed until May 1, 1991. On the other hand, the determination which SUTD issued on December 26, 1990 was only timely with respect to periods commencing with the fourth quarter of 1987, and after. The audit covered the period of October 1, 1987 through December 31, 1989, thus the prior underpayments were outlawed at the time the determination was issued.

As to whether or not petitioner is entitled to either a refund or credit for the 1988 overpayments where the Board did not issue a timely deficiency determination for periods in which the prior underpayments were made, this issue is specifically addressed in the Owens-Corning Fiberglas case (supra) which has been cited by SUTD. In that case, the taxpayer who was undergoing an audit sent the Board a check in the amount of \$65,000 in order to stop the running of interest for a deficiency determination which had not yet been billed. When the determination was later issued, it was not within the three-year statutory period; thus, the sole issue was whether the Board could retain funds voluntarily deposited even though it failed to issue a timely determination. The court held that the taxpayer was not entitled to a refund of that portion of the payment held by the Board for delinquent taxes admittedly owed. The court found particularly applicable the statement in Lewis v. Reynolds (1932) 284 U.S. 281, 283, 76 L.Ed. 293, 294, 52 S.Ct. 145, where that court held, "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." The court also noted that the Board applied the payment by the taxpayer long before the statute of limitations would have prevented recovery by the Board. In citing the case of Mudd v. McColgan (1947) 30 Cal.App.2d 463, 467, the court noted the statute of limitations and its enforcement provisions does not create a condition precedent to taxpayer liability, thereby extinguishing the state's right to the tax; rather, it imposes limits on the time in which various remedies may be used to collect the tax owed. Therefore, to the extent the state utilizes these remedies after they are barred by the statute of limitations, the state may not retain the tax paid. (Marchica v. State Board of Equalization (1951) 107 Cal.App.2d 501, 509.) But in the absence of particular statutory provisions to the contrary, the state will be permitted to offset sums against outstanding tax liabilities notwithstanding the expiration of the applicable statute of limitations. (Northrop Aircraft v. Cal. Emp. Etc. Com. (1948) 32 Cal.2d 872, 880.)

Based on the above authorities, we conclude that although the Board did not issue a determination covering the earlier periods in which apparent underpayments were made, since there is sufficient evidence of the underpayments, and the overpayments for the first two quarters of 1988 were voluntarily made, the Board is entitled to retain the overpayments without offsetting those amounts against underpayments for other periods within the audit. If, in a Request for Reconsideration, petitioner can prove there was no prior underpayment of taxes, it would then be entitled to either have the offset requested, or a refund. At this point, the evidence is sufficient that a prior underpayment of tax occurred notwithstanding the fact that the exact period or periods cannot be identified.

Recommendation

Deny the petition.

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Lucian Khan, Staff Counsel

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Date