LUMP SUM RE[illegible] OFFICER BE[illegible] ENTITLEMEN[illegible] TO BE INCLUDED IN GROSS INCOME

BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)

ARTHUR G. AND EUGENIA LOVERING)

Appearances:

For Appellants: Arthur G. Lovering, in pro. per.

For Respondent: Wilbur F. Lavelle
Associate Tax Counsel

O P I N I O N

This appeal is made pursuant to section 19059 of the Revenue and Taxation Code from the action of the Franchise Tax Board in denying the claim of Arthur G. and Eugenia Lovering for refund of personal income tax in the amount of $165.76 for the yea-s 1962.

Arthur G. Lovering (hereafter referred to as "appellant") was an officer in 'the United States Air Force, En June 1962, 'after having completed almost eighteen years of continuous military service, appellant was released from active duty due to a reduction in force.

Because of the involuntariness of his release in' 1962, appellant received a lump-sum readjustment payment at that time in the amount of $12,300, pursuant to section 265(a) of the Armed Forces Reserve Act. (66 Stat, 481, as amended, 76 Stat. 120, 50 U.S.C.A.§ 1016,) The day after his release as an officer, appellant enlisted in the same branch of the service, intending to complete 20 years of active service and thereby to become eligible for retirement benefits.

Under the terms of the above mentioned federal statute, if a recipient of a read justment payment subsequently became eligible for retirement, his receipt of any retirement pay was "subject to the immediate deduction from that pay of an amount equal to 75 percent of the amount of the readjustment payment, without interest.". (50 U.S.C.A. § 1016, subsec. (c).) Appellant placed $9,225 (75 percent of the $12,300) in the bank, intending to keep it intact for repayment to the federal government upon his retirement, He nevertheless reported the entire $12,300 as income in 1962 for both federal and California income tax purposes.

In August 1964 appellant completed his 20 years of active dutyand retired from the Air Force. At that time he withdrew $9,225 from his bank account and repaid that amount to the federal government,

Appellant then filed amended federal and state income tax returns for the year 1962. In those returns he excluded from his gross income the amount which he paid to the federal government in 1964. Both the Internal Revenue Service and respondent rejected those returns, advising appellant that the $3,225 should be deducted on his returns for 1964, the year of repayment. Such a deduction in 1964 would have exceeded appellant's income for that year by approximately $4,000, The federal government granted him a -refund under section 1341 of the Internal Revenue Code of 1954, which allows a taxpayer to claim a deduction in the year of repayment or, alternatively,. to reduce his tax for the year of repayment by the amount of the tax attributable to the inclusion of the item in income in a prior year, and to receive a refund of any excess,

Respondent has denied appellant's claim for refund for 1962 on the ground that appellant received the $12,300 lump-sum readjustment payment in 1962 under a claim of right and it therefore constituted income to him in that year, even though he subsequently returned a portion of it. Respondent contends that since section 1341 of the 1954 Internal Revenue Code has no counterpart in California law, the only course open to appellant is to claim the repayment as a deduction in 1964, the year of repayment,

In support of his contention that he is entitled to a refund of California personal income tax, appellant states that he was given no option to refuse the readjustment payment made to him in 1962. He states further that he had no intention of ever using that money since he immediately enlisted in the Air Force and knew he would have to repay that amount upon retirement if he was to receive full military retirement pay. He points to the fact that the Internal Revenue Service granted a refund as demonstrating that he is entitled to it.

It is well established that if a taxpayer receives funds under a claim of right, without restriction as to their disposition, such funds are includible in income in the year of receipt, even though it may subsequently turn out that the taxpayer is obliged to repay all or a portion of the amount received. (North American Oil Consolidated v. Burnet, 286 U.S. 417 [76 L. Ed. 1197]; Healy v. Commissioner, 345 U.S. 278 [97 L. Ed. 1007].) This rule has its basis in the annual accounting concept. (United States v. Lewis, 340 U.S. 590 [95 L. Ed. 560], reh. denied, 341 U.S. 923 [95 L. Ed. 1356].) The taxpayer who must make restoration in a subsequent year is entitled to a deduction in the year of repayment. (See North American Oil Consolidated v. Burnet, supra, and Healy v. Commissioner, supra.)

Funds are received under a claim of right when they are treated by a taxpayer as if they belong to him. (Healy v. Commissioner, supra.) In 1962 when appellant received the $12,300 lump-sum readjustment payment he reported it as income and placed $9,225 of it in a bank. From that time on, until he repaid the $9,225 to the federal government in 1964, that amount and the interest which it earned was under his sole dominion and control. Had he chosen to do so he could have spent the entire sum for any purpose at any time during that period. Neither the federal government nor anyone else laid any claim to that sum until appellant chose to return it in 1964 rather than have the amount deducted from his retirement pay.

Considering all of the facts it is clear that any restriction on the use of these funds was self-imposed and arose from a subjective decision on the part of appellant as to how that sum should be used. The fact that a taxpayer indicates an intention not to exercise his power of absolute

dominion over a fund, e.g., by an appropriate entry in his accounting records or by placing it in a separate bank account, does not change its status as income. (Commissioner v. Alamitos Land Co., 112 F.2d 648, cert. denied, 311 U.S. 679 [85 L. Ed. 437]; Rev. Rul. 55-137, 1955-1 Cum. Bull. 215.)

It is our opinion that appellant did receive the entire lump-sum readjustment payment in 1962 under a claim of right and it was therefore properly included in his gross income for that year. As respondent correctly points out, there is no section in the California statutes which corresponds to section 1341 of the Internal Revenue Code of 1954, under which the federal authorities granted a refund to appellant. Under the circumstances we must sustain respondent in its denial of appellant's claim for refund for 1962.

O R D E R

Pursuant to the views expressed in the opinion of the board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section 19060 of the Revenue and Taxation Code, that the action of the Franchise Tax Board in denying the claim of Arthur G. and Eugenia Lovering for refund of personal income tax in the amount of $165.76 for the year 1962, be and the same is hereby sustained.

Done at Sacramento, California, this 21st day of April, 1966, by the State Board of Equalization.

_____, Chairman

_____, Member

_____, Member

_____, Member

_____, Member

ATTEST: _____, Secretary