BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
SURREY HOUSE, INC.)

Appearances:

For Appellant: Sheldon S. Scharlin
Certified Public Accountant

For Respondent: Robert L. Koehler
Counsel

O P I N I O N

This appeal is made pursuant to section 25666 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Surrey House, Inc., against proposed assessments of additional franchise tax in the amounts of $13,981.41 and $13,693.05 for the taxable years 1971 and 1972, respectively.

The issues for determination are: (1) whether appellant has overcome the presumption that the federal determination relied upon by respondent in making its adjustments was correct; and (2) whether section 24722 of the Revenue and Taxation Code, which provides a protecting limit on taxes when a change in accounting method is adopted, is applicable.

Appellant, which was incorporated in California on January 25, 1971, obtains manuscripts from writers and arranges for printing and distribution by contract. As the result of a federal audit, the Internal Revenue Service determined that appellant should have been on the accrual method of accounting instead of the cash basis. The resulting federal adjustments placed appellant on the accrual basis of accounting retroactive to its date of incorporation, January 25, 1971. Appellant consented to these changes. Respondent issued proposed assessments on the basis of the federal adjustments which resulted in net income of $201,163.00 for 1971, and in losses for 1972 and 1973. It is from this action that appellant appeals.

It is appellant's position that the federal adjustments were incorrect because they did not properly accrue expenses to 1971. Appellant also maintains that it consented to the federal adjustments only because a net operating loss was available. Finally, appellant argues that section 24722 of the Revenue and Taxation Code applies to reduce the tax.

Respondent contends that appellant has failed to overcome the presumption that the federal adjustments are correct. Respondent also argues that section 24722 is part of a remedial statutory scheme which provides for certain adjustments when a taxpayer has one time period in which it used one method of accounting followed by a second time period when it used a different accounting method. In this appeal, respondent maintains, the "change" in accounting method related back to appellant's date of incorporation; therefore, since appellant used only one accounting method throughout its entire existence, section 24722 is inapplicable.

Section 25432 of the Revenue and Taxation Code provides, in part, that a taxpayer shall either concede the accuracy of a federal determination or state wherein it is erroneous. It is well settled that a determination by the Franchise Tax Board based upon a federal audit is presumed to be correct, and the burden is on the taxpayer to overcome that presumption. (Todd v. McColgan, 89 Cal.

App. 2d 509 [201 P.2d 414] (1949); Appeal of Jackson Appliance, Inc., Cal. St. Rd. of Equal., Nov. 6, 1970.) Although respondent's determination, based on a federal audit report, is presumptively correct and appellant has the burden to overcome that presumption, appellant also has the opportunity to show that the determination was incorrect. (Rev. & Tax. Code, § 25432.)

Initially, appellant's argument that it agreed to the federal adjustments only because of the availability of a net operating loss must be rejected. It is well settled that the presumptive correctness attached to respondent's action based upon a federal audit is not overcome merely by a taxpayer's allegation that it consented to the federal determination only because a net operating loss was present. (See, e.g., Appeal of Western Orbis Company, Cal. St. Bd. of Equal., Aug. 1, 1974; Appeal of Jackson Appliance, Inc., supra.) However, in attempting to overcome the presumption of correctness, appellant has submitted numerous copies of invoices, check stubs and bank statements which, it contends, establish the accrual of additional expenses in 1971 which were not allowed as deductions. Based upon this material, respondent has agreed to allow $16,163.32 as printing expenses accrued during 1971 and to adjust its determination accordingly. Based upon the documentary evidence submitted by appellant summarized in the table below, it is our determination that an additional deduction for printing expense in the amount of $9,670.40 was properly accrued in 1971 and should be allowed.

Invoice			Check		
No.	Date	Amount	No.	Date	Amount
3990	12/16/71	$4,253.32			
3999	12/16/71	4,202.98			
4000	12/16/71	1,214.10	259	2/11/72	$9,670.40
	Total	$9,670.40			$9,670.40

Appellant's bank statement indicates that check No. 259 in the amount of $9,670.40 was paid on February 22, 1972.

Finally, we consider appellant's contention that section 24722 of the Revenue and Taxation Code provides relief in this situation. The purpose of the remedial provisions contained in sections 24721 through 24724 is to prevent amounts from being duplicated or omitted when a change in the taxpayer's accounting method is instituted. (See Cal. Admin. Code, tit. 18, reg. 24721-24724(a).) In order to cause a duplication or

omission, the change in accounting methods envisioned by these sections must encompass two different but contiguous time periods where two different accounting methods are used. In appellant's case, since the change in accounting method related back to its incorporation, appellant has used but one accounting method during its entire existence. Therefore, there could be no risk of duplication or omission of amounts due to the use of two different accounting methods. Accordingly,. the remedial provisions are inapplicable.

For the reasons set out above, respondent's determination must be modified in accordance with its concession and in accordance with the views expressed in this opinion.

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 25667 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of Surrey House, Inc., against proposed assessments of additional franchise tax in the amounts of **$13,981.41** and **$13,693.05** for the taxable years 1971 and 1972, respectively, be and the same is hereby modified in accordance with respondent's concession and in accordance with the views expressed in this opinion. In all other respects, the action of the Franchise Tax Board is sustained.

Done at Sacramento, California, this **21st** day of May , 19'80, by the State Board of Equalization.

_____, Chairman

_____, Member

_____, Member

_____, Member

_____, Member