BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
AIR HANDLERS, INC.)

Appearances:

For Appellant: James W. Collins
President

For Respondent: James P. Corn
Counsel

O P I N I O N

This appeal is made pursuant to section 25667 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Air Handlers, Inc., against proposed assessments of additional franchise tax in the amounts of $1,954.62 and $365.40 for the income years 1961 and 1963, respectively.

Subsequent to the filing of this appeal, appellant conceded the correctness of the proposed assessment for 1963. It has also conceded the correctness of all but one of the adjustments proposed for the income year 1941. Consequently, the only issue remaining for decision is whether appellant had additional 1961 income in the amount of $28,937.49, representing a

disallowed deduction for "purchases" of merchandise.

Appellant is a California corporation engaged in business as a heating and air conditioning contractor. In 1965 the Internal Revenue Service made a number of audit adjustments to appellant's reported federal income tax liability for the years 1959-1963. To the extent that those adjustments were applicable for California franchise tax purposes, respondent followed them in issuing notices of proposed assessment for the years 1961 and 1963. Subsequently, the original federal adjustments were modified by an appellate conferee. When respondent received. a copy of the Conference Audit Statement, it made corresponding changes when it issued notices of action on appellant's protest to the earlier franchise tax assessments. Appellant agreed to the final federal determination embodied in the Conference Audit Statement, and it paid the. resulting federal income tax deficiencies for the years 1961-1963.

The only matter now in dispute concerns a 1961 deduction of $28,937.49. Appellant spent this sum in 1961 to buy investment land for the personal benefit of Mr. James Collins, its president and sole shareholder. Because of a bookkeeping error, appellant deducted this item as a "purchase" of merchandise.. It discovered the error in 1962, however, and thereupon credited the 1962 "purchases " account with $28,937.49 and debited the same amount to "Loans to Shareholders." The revenue agent who conducted the original federal audit determined that the error should have been corrected in 1961, the year that it was made. Consequently, he increased appellant 's 1961 income by $28,937.49 and decreased its 1962 income by the same amount. Respondent made an identical adjustment to appellant's income for each year, resulting in a deficiency assessment for 1961 and a computation of proposed overpayment for 1962. Respondent is withholding final action on' the proposed overpayment for 1962 pending our determination of this appeal.

Appellant did not contest the revenue agent's method of correcting the erroneous deduction, and the resulting increase in appellant's 1961 income was not modified by the Conference Audit Statement. According

to appellant , it did not dispute this action because it made no difference in the ultimate amount of the federal deficiencies for the years under audit. For franchise tax purposes , however, appellant contends that the $28,937.49 should not be taxable because, under appellant's unique accounting method, the reduction of the "purchases" account by this amount in 1961 would have been offset by a corresponding addition to a contingency reserve account called the "Reserve for Overbilling." Consequently, its income allegedly would have been substantially the same as was actually reported on its 1961 return.

It is well established that a deficiency assessment based on a federal audit report is presumptively correct and must be shown by the taxpayer to be erroneous. (Appeal of Nicholas H. Obritsch, Cal. St. Bd. of Equal., Feb. 17, 1959; Appeal of Henrietta Swimmer, Cal. St. Bd. of Equal ., Dec. 10, 1963; Appeal of Samuel and Ruth Reisman, 1 . St. Bd. of Equal., March 22, 1971.) In this case it is perfectly obvious that the revenue agent correctly added back to appellant's 1961 income an admittedly erroneous deduction. It is equally clear, we believe , that respondent properly did the same thing for state tax purposes, Appellant really does not contest this directly, but instead asserts that its accounting method would have allowed it to claim a proper deduction for an addition to its special reserve, if it had chosen to correct the clerical error in 1961 rather than in 1962. In answer to this contention, we need say no more than that appellant, has not proved either that it would have taken such a deduction or that it would have been proper to do so. We might add, however, that even when, appellant had the opportunity in 1962 to make such an offsetting addition to its "Reserve for Overbilling, " it did not do so.

Since appellant has failed to prove the existence of any error in respondent 's determination, respondent's action in this matter must be upheld.

Appeal of Air Handlers, Inc.

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 theref or,

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 Air Handlers, Inc. against proposed assessments of additional franchise tax in the amounts of $1,954.62 and $365.40 for the income years 1961 and 1963, respectively, be and the same is hereby sustained.

Done it Sacramento, California, this 31st day of July, 1973, by the State Bbard of Equalization.

_____, Chairman

_____, Member

_____, Member

_____, Member

_____, Member

ATTEST: _____, Secretary