BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
FRANK R. AND C. A. **MOOTHART**)

For Appellants: Frank **R.** Moothart, in pro. per.

For Respondent: Bruce W. Walker
Chief Counsel

Kathleen M. Morris
Counsel

O P I N I O N

This appeal is made pursuant to section 18594 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protests of Frank **R.** and C. A. **Moothart** against proposed assessments of additional personal income tax in the amounts of **$2,627.05** and **$2,900.00**, plus interest, for the years 1970 and 1972, respectively.

Appellants have now acquiesced in and have paid the amount assessed as additional tax for each year. The propriety of the interest imposed on those deficiency assessments is the only issue remaining for decision in this appeal. The amounts of interest in question are $807.82 and $543.75 for the years 1970 and 1972, respectively.

Appellants filed timely California personal income tax returns for 1970 and 1972 and paid the taxes reported thereon to be due. At some later date respondent received federal audit reports on appellants for both of those years. On January 15, 1975, respondent issued notices of proposed assessments based upon the federal audit adjustments. The amounts of additional tax assessed were $2,627.05 for 1970 and $2,900.00 for 1972. Appellants protested these deficiency assessments on March 6, 1975, stating that they were still contesting the matter at the federal level and that they would inform respondent when a final federal determination was made. Accordingly, respondent deferred its action pending the outcome of the federal proceedings.

On April 4, 1975, appellants filed their 1974 California personal income tax return with respondent. On the face of the return they indicated that their tax withheld during 1974 and their 1974 estimated tax payments exceeded their tax liability for that year by $6,575.22. This amount was entered on line 33 of the return, labeled "Refund to You." Attached to the return was a letter to respondent dated April 4, 1975, which read as follows:

> We are submitting our Form 540 for 1974 which shows refund due in the amount of $6,575.22. Please apply $2,627.05 of this refund to our 1970 tax due and $2,900.00 to our 1972 tax adjustment. The balance should be applied to the 1975 tax.
>
> We have maintained an adequate balance throughout the years to cover the potential adjustments for 1970 and 1972. Therefore, interest would be offsetting and there should be no penalties.
>
> Sincerely,
>
> F. R. Moothart

In reviewing appellants' return, respondent did not discover this letter. Acting upon the refund request on the face of the return, respondent mailed appellants a check in the amount of $6,575.22 on May 13, 1975.

Thereafter, respondent wrote appellants requesting information regarding the status of the federal action. Respondent allegedly received no response from appellants and on May 28, 1976, it affirmed the proposed assessments of additional tax for 1970 and 1972. In the meantime, on March 12, 1976, appellants had returned the $6,575.22 to respondent, asking that it be applied to their 1975 tax liability, Respondent has computed and assessed interest on the deficiencies from the due dates of the 1970 and 1972 returns (April 15, 1971, and April 15, 1973, respectively) to March 12, 1976, the date the refund was returned to respondent. The amount of interest so computed was deducted from the tax refund otherwise due appellants for the taxable year 1976,

Appellants are of the opinion that they should not be required to pay any interest on the deficiency assessments issued against them for 1970 and 1972. Their position seems to have two bases: (1) they contend that in their letter of April 4, 1975, they requested respondent to credit the refund due them for 1974 against those deficiencies, and respondent ignored that request and instead issued a refund check to them; and (2) even without considering the erroneous refund, through overpayments of tax and their estimated tax payments they at all times maintained sufficient funds in their account with respondent to cover any amounts determined to be due from them. Under those circumstances they contend there would be "offsetting interest."

Respondent concedes that its refund of the $6,575.22 was contrary to the request contained in appellants' letter of April 4, 1975. Respondent contends that the imposition of interest on the deficiencies to the date that refund was returned was nevertheless mandatory under section 18688 of the Revenue and Taxation Code. We must agree with respondent.

Section 18688 provides, in part:

> Interest upon the amount assessed as a deficiency shall be assessed, collected and paid in the same manner as the tax ... from the date prescribed for the payment of the tax until the date the tax is paid. (Emphasis added.)

In earlier decisions we have held that the imposition of interest on a deficiency assessment is mandatory under this section. (See, e.g., Appeal of James B. and Katherine M. Beckham, Cal. St; Bd. of Equal., June 28, 1977; Appeal of Allan W. Shapiro, Cal. St. Bd. of Equal., Aug. 1, 1974; Appeal of Ruth Wertheim Smith, Cal. St. Bd. of Equal., Aug. 3, 1965.) In cases where respondent has issued a deficiency assessment in order to recoup an erroneous refund, we have determined that interest on the deficiency continues to accrue until that erroneous refund is returned to respondent by the taxpayer, since the taxpayer has the use of the money during the period he retains it. (Appeal of Bruce H. and Norah E. Planck, Cal. St. Bd. of Equal., Aug. 16, 1977; Appeal of Dorothy M. Page, Cal. St. Bd. of Equal., May 10, 1977; Appeal of Audrey C. Jaegle, Cal. St. Bd. of Equal., June 22, 1976.) Interest on a deficiency is not in the nature of a penalty but is compensation for the use of the money. (Ross v. United States, 148 F. Supp. 330 (D. Mass. 1957).)

In the instant case we note that even if respondent had seen the letter attached to appellants' 1974 tax return and had acted upon the request contained therein, interest on the deficiencies for 1970 and 1972 still would have been due under section 18688 of the Revenue and Taxation Code from the due dates of the returns for those years to the date appellants' instructions were carried out and the deficiencies could be deemed "Paid". Under the facts of this appeal, there was no deemed "payment" of the deficiencies by the credit of overpayments because of respondent's failure to discover appellants' letter. Instead, respondent mailed them a refund check in the amount of $6,575.22, and interest continued to run on the unpaid deficiencies. Appellants retained that refund for almost a year, returning it to respondent on March 12, 1976. Following our earlier decisions set out above, we must conclude that respondent properly assessed interest on the deficiencies for.1970 and 1972 to March 12, 1976, the date of payment.

Our decision on this issue is not altered by appellants' contention that they at all times had sufficient excess funds in their account with respondent to create an "offsetting interest" situation. It appears that in each taxable year those funds consisted of tax withheld by employers, payments of estimated tax made by appellants during the taxable year, and authorized credits of overpayments of tax for one taxable year against estimated tax for the succeeding taxable year. Withholding tax is treated as a credit against the taxpayer's income tax liability for the taxable year with respect to which

it is withheld. (Rev. & Tax. Code, § 18551.1, subd. (a).) Similarly, estimated income tax payments are considered payments on account of the personal income tax imposed for the taxable year (Rev. & Tax. Code, § 18557). In appellants' case, both these types of prepayments were deemed paid on April 15 following the close of the taxable year. (See Rev. & Tax. Code, § 18551.1, subd. (b).) That being so, they accumulated no interest during the taxable year. Although a taxpayer may elect to have overpayments of tax for one taxable year credited against estimated income tax for the succeeding taxable year (see Rev. & Tax. Code, § 19064), if such an election is made, no interest is allowed on the overpayment so credited. (Cal. Admin. Code, tit. 18, reg. 19064(a).) These provisions precluded the accrual of interest on any of the funds which appellant had on deposit with respondent. Under the circumstances, there was no "offsetting interest," as appellants contend.

For the above reasons, respondent's action in this matter must be sustained.

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,

Appeal of Frank R. and C. A. Moothart

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section 18595 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protests of Frank R. and C. A. Moothart against proposed assessments of additional personal income tax in the amounts of $2,627.05 and $2,900.00 for the years 1970 and 1972, respectively, plus interest in the total amount of $1,351.57, be and the same is hereby sustained, with the understanding that all amounts which have been paid will be credited to appellants' account.

Done at Sacramento, California, this 8th day of February, 1978, by the State Board of Equalization.

_____, Chairman

_____, Member

_____, Member

_____, Member

_____, Member