

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)	
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Ralph F. Lewis)	No. 94A-0340
)	

Representing the Parties:

For Appellant:	Ralph F. Lewis
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For Respondent:	Bruce R. Langston,
Counsel	

Counsel for Board of Equalization:	Sophia H. Chung, Staff Counsel
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O P I N I O N

This appeal is made pursuant to section 19045 (formerly section 18593)^{1/} of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Ralph F. Lewis against a proposed assessment of additional personal income tax in the amount of \$2,037.30 for the year 1982.

The primary issue presented is whether respondent's notice of proposed assessment for the 1982 taxable year is barred by the applicable statute of limitations.

The Internal Revenue Service (IRS) audited Liberty 53, a limited partnership, in which appellant was a limited partner. On January 6, 1988, the IRS wrote a letter to appellant and advised him that settlement negotiations regarding Liberty 53 had been concluded. The letter enclosed a settlement agreement for partnership adjustments (Form 870-P) for the 1982, 1983 and 1984 taxable years. On January 8, 1988, appellant signed the Form 870-P and returned it to the IRS. Subsequently, on July 14, 1988, the Commissioner of the IRS, through an authorized officer, signed the Form 870-P.

The Form 870-P reflected the total adjustments to the partnership returns for the years in question. However, appellant's individual federal returns for those years were not adjusted until February 1989, when the IRS wrote a letter to appellant and enclosed Form 1902-C, a schedule explaining the computational adjustments made to his individual income tax returns based on the changes to the partnership items.^{1/} The adjustments resulted in a deficiency for 1982 and overpayments for 1983 and 1984. On March 20, 1989, the IRS issued a deficiency assessment notice for 1982.

Respondent received information from the IRS regarding a deficiency for the 1982 taxable year. On March 1, 1993, based on information it received from the IRS, respondent issued a notice of proposed assessment (NPA) for 1982. Respondent took no action with regard to the tax liability of appellant for 1983 and 1984. Appellant filed a timely protest to the NPA. The protest was denied and respondent issued a notice of action on January 24, 1994, from which this timely appeal followed.^{2/}

Generally, respondent must issue an NPA within four years from the date on which a return is filed. (Rev. & Tax. Code, § 18586, subd. (a), amended and renumbered as § 19057, subd. (a), operative January 1, 1994.) However, when the IRS has made changes to a taxpayer's gross income or deductions, and such changes affect the tax owed to the state, the taxpayer is required to report those changes to the Franchise Tax Board within 90 days of the final federal determination. (Rev. & Tax. Code, § 18451, amended and renumbered as § 18622, operative January 1, 1994.) If the taxpayer fails to report the federal changes within 90 days, the Franchise Tax Board has four years after the change, correction or amended return is reported to or filed with the federal government in which to issue its NPA.^{3/} (Rev. & Tax. Code, § 18586.2, renumbered as § 19060, operative January 1, 1994.)

^{1/} A partnership item is defined as an item which is more appropriately determined at the partnership level rather than at the partner level. (I.R.C. § 6231 (a)(3).) Examples of partnership items include the partnership aggregate and each partner's share of items of income, gain, loss, deduction or credit of the partnership. (Treas. Reg. § 301.6231(a)(3)-1.)

^{2/} Respondent has since conceded that the amount of the proposed assessment should be reduced from \$2037.30 to \$1788.00.

^{3/} Effective January 1, 1993, section 18586.2 provides that if a taxpayer fails to report a change as required by section 18451, the Franchise Tax Board may issue a notice of proposed assessment resulting from the adjustment at any time after the change, correction or amended return is reported to or filed with the federal government.

Appellant did not report the federal adjustments to respondent within 90 days as required by former section 18451. Therefore, under former section 18586.2, respondent had four years from the date the changes were reported to or filed with the federal government in which to issue its NPA for 1982. The four-year statute provided for in former section 18586.2 begins to run on the date that the federal determination becomes final. (See Appeal of Frederick and Carol Engelbrecht, Cal. St. Bd. of Equal., Feb. 4, 1986.)

Respondent has promulgated a regulation defining a final determination as "an irrevocable determination or adjustment of a taxpayer's federal tax liability from which there exists no further right of appeal either administrative or judicial." (Cal. Code Regs., tit. 18, § 18586.3, subd. (e).) Internal Revenue Code section 6224, subdivision (c), provides that a mutually executed Form 870-P is binding on all parties with respect to the determination of partnership items for the applicable partnership taxable year, unless a party to the agreement can show fraud, malfeasance, or misrepresentation of fact.^{4/} (See Alexander v. United States, 44 F.3d 328 (5th Cir. 1995).) Additionally, after a Form 870-P is mutually executed by the taxpayer and the IRS, there is no further right of appeal to redetermine a partner's liability resulting from the settlement of partnership items. (See Korff v. Commissioner, ¶ 93,033 T.C.M. (RIA) (1993).) Hence, we conclude that the 870-P constitutes an "irrevocable determination" as to partnership items on the date signed by the IRS Commissioner, if, as in this case, the taxpayer had previously signed the 870-P agreement.

Furthermore, California Code of Regulations, title 18, section 18586.3, subdivision (e), states that an example of a final federal determination is a closing agreement made under Section

7121 of the Internal Revenue Code.^{5/} Under federal law, Form 870-P settlement agreements operate

^{4/} Internal Revenue Code section 6224 provides:

(c) Settlement agreement.

In the absence of a showing of fraud, malfeasance, or misrepresentation of fact--

(1) **Binds all parties.** A settlement agreement between the Secretary and 1 or more partners in a partnership with respect to the determination of partnership items for any partnership taxable year shall (except as otherwise provided in such agreement) be binding on all parties to such agreement with respect to the determination of partnership items for such partnership taxable year. . . .

The record in this case indicates that neither the IRS or appellant had at any time challenged the settlement on the basis of fraud, malfeasance or misrepresentation of fact.

^{5/} Internal Revenue Code section 7121 provides:

Sec. 7121. Closing agreements.

(a) **Authorization.** -- The Secretary is authorized to enter into an agreement in writing with any person relating to the liability of such person . . . in respect of any internal revenue tax for any taxable period.

(b) **Finality.** -- If such agreement is approved by the Secretary . . . such agreement shall be final and conclusive, and, except upon a showing of fraud or

in the same manner as closing agreements.^{6/} In Alexander v. United States, supra, 44 F.3d at 332, the court stated that:

The Service formulated the 870-P pursuant to its authority under section 6224(c) to enter into binding settlement agreements "with respect to the determination of partnership items." I.R.C. § 6224(c)(1). As both sides recognized, these settlement agreements are closely analogous to the long-established closing agreements authorized under section 7121 of the Code. I.R.C. § 7121. Like closing agreements, a section 6224(c) settlement agreement is in the nature of a contract, binding on all parties absent proof of "fraud, malfeasance, or misrepresentation of fact."

Thus, as respondent recognizes a closing agreement under Internal Revenue Code section 7121 to be a final determination, it has impliedly recognized Form 870-P under Internal Revenue Code section 6224(c) as a final determination. Accordingly, we hold that a mutually executed Form 870-P under Internal Revenue Code section 6224(c), like a closing agreement under Internal Revenue Code section 7121(b), is an irrevocable determination, and therefore, constitutes a final federal determination.

We note that when appellant entered into Form 870-P with the IRS with respect to his distributive share of the partnership items, his liability on his individual income tax return had not yet been calculated. However, after a settlement has been reached, the substantive partnership level issues have been resolved, and all that remains is the mechanical procedure of applying such settlement to the partner by means of a computational adjustment.^{7/} (Bob Hamric Chevrolet, Inc. v. United States, 849

malfeasance, or misrepresentation of a material fact -

- (1) the case shall not be reopened as to the matters agreed upon or the agreement modified by any officer, employee, or agent of the United States, and
- (2) in any suit, action, or proceeding, such agreement, or any determination, assessment, collection, payment, abatement, refund, or credit made in accordance therewith, shall not be annulled, modified, set aside, or disregarded.

^{6/} In H Graphics/Access, Ltd. Partnership v. Commissioner, ¶92,345 T.C.M. (RIA) (1992), the tax court held that:

The standard that section 6224(c) prescribes for setting aside a settlement agreement is the same standard prescribed by section 7121(b) for setting aside a closing agreement. Section 7121(a) authorizes [the Commissioner] to enter into agreements in writing with any person relating to the liability of that person in respect to any internal revenue tax for any taxable period. Closing agreements are binding on the parties as to the matters agreed upon and may not be annulled, modified, set aside, or disregarded in any suit or proceeding unless there is a showing of fraud, malfeasance, or misrepresentation of material fact. . . . We will follow the same principles in applying section 6224(c).

^{7/} In addition to computational adjustments, a change of a partnership item may also result in a change in a nonpartnership item which requires a factual determination at the partner level. Such change is not merely

F.Supp. 500 (W.D. Tex. 1994).)

We conclude that the final federal determination with respect to the computational adjustments to appellant's federal return, arising out of changes to partnership items, occurred when the Form 870-P became final on July 14, 1988. Therefore, respondent's NPA issued on March 1, 1993, was untimely under the four-year statute of limitations provided by former section 18586.2.

computational but requires findings of fact peculiar to the particular partner and is generally not covered by a Form 870-P. (See N.C.F. Energy Partners v. Commissioner, 89 T.C. 741 (1987) (addition to tax for negligence under Internal Revenue Code section 6653(a) requires a factual determination as to a partner's negligence).) In the present appeal, we are only deciding the finality of the federal determination with respect to the partnership item adjustments under a Form 870-P settlement agreement and the resulting computational adjustments.

ORDER

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 19047 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of Ralph F. Lewis against a proposed assessment of additional personal income tax in the amount of \$2,037.30 for the year 1982 be and the same is hereby reversed.

Done at Sacramento, California, this 31st day of August, 1995, by the State Board of Equalization, with Board Members Mr. Klehs, Mr. Dronenburg, Mr. Andal, Mr. Sherman and Mr. Halverson present.

Johan Klehs, Chairman

Ernest J. Dronenburg, Jr., Member

Dean F. Andal, Member

Brad J. Sherman, Member

Rex Halverson*, Member

*For Kathleen Connell, per Government Code section 7.9.

Unless otherwise specified, all section references in the text are to sections of the Revenue and Taxation Code as in effect for the year in issue.