such signature. A Power of Attorney must have original signatures in order to be valid for this purpose.

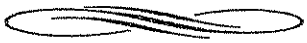
- Waivers must indicate the title of the signer (must be a current officer of the corporation).

Procrastinators

If you (and your clients) have previously signed a waiver to extend the statute of limitation period and the new expiration period is approaching, the FTB auditor is likely to ask you to sign another waiver. And another one. And another one.

If it becomes apparent to you (possibly after the third waiver request) that your auditor is a procrastinator, "just say no" the next time the auditor wants you to sign a waiver. If the auditor has been unable to complete the case within six or seven years, he or she probably won't be able to complete it enough to affirm any impending assessments. You may always contact the auditor's supervisor to express your concerns. FTB management recognizes that multiple waivers are not in the best interest of California taxpayers.

— ***Gina Rodriquez***



Statute of Limitations

Amending a closed year

For all years open under the statute of limitation as of October 10, 1999, taxpayers must file a claim for refund within four years of the date a timely return is filed (including extensions) or within one year of the date of overpayment, whichever period expires later (R&TC Sec. 19306). Similarly, the FTB generally may issue a proposed assessment within the later of four years from the due date of the return (without regard to extensions) or four years from the date the return was filed (R&TC Secs. 19057 and 19066). This period is extended to six years if gross income on the taxpayer's return is understated by more than 25 percent (R&TC Sec. 19058). Different rules apply when there is a federal adjustment.

What happens, however, if the FTB, while auditing 1998, realizes that a taxpayer's charitable contributions carryover from 1994 wasn't a valid charitable contribution in 1994? Can the FTB assess the taxpayer for the excessive deduction in 1994, a closed year? No, the FTB cannot propose assessments against a closed year (1994 closed April 15, 1999).

A related question is more interesting. Can the FTB "amend" the 1994 return in order eliminate the contribution carryover? This is exactly what the IRS did in Rev. Rul. 77-225. The IRS held that, based on prior case law, the expiration of the statute of limitations for the year in which the deduction was taken does not bar a disallowance of the carryover in years that are still open. Following this ruling, the FTB could therefore eliminate an improper charitable contribution carryover and disallow the deduction for that carry-forward in any open year.

Relying on the same logic, the IRS has disallowed net operating loss (NOL) carryovers from closed years (Rev. Rul. 56-285). The FTB has also litigated this issue. In ***Appeal of Eastern Trading and Construction Co.*** (January 1, 1993, 93A-0825-PH), the corporate taxpayer admitted that it had made a clerical error in calculating its NOL carryover in a closed year. The Board decision framed the issue very simply: The FTB has the authority to recompute the correct NOL, even though the statute of limitation period on the originating year has already closed. Citing federal and California case law, the decision states that while the statute of limitations prevents the recomputation of taxes in the closed year, it does not prevent the recomputation for purposes of determining the proper carryover to any open year.

It works both ways

A remaining question: Can taxpayers use this rule in order to effectively open a closed year for purposes of creating or increasing a carryover? Yes, the IRS stated in a private letter ruling that taxpayers may also correct (or create) proper carryovers (PLR 9504032, Oct.

31, 1994). That ruling reiterated that the relevant year for statute of limitations purposes is the year in which the deduction is taken, not the originating year. So, in this instance, what is good for the goose is good for the gander. Both the IRS and FTB and taxpayers may adjust closed years for use in an open year.

There are numerous areas in which this rule may be applicable. Many of them involve federal and California conformity. Thus, taxpayers may use this rule to increase carryovers, such as for:

- Charitable contributions;
- Capital losses;
- Passive activities; and
- Investment interest expense.

Some areas where the amounts may be substantially different for California include:

- Net operating loss for California; and
- Credits carried over to the current year such as:
  - Employer child care;
  - Agricultural products;
  - Various solar;
  - Energy conservation;
  - LARZ hiring/sales;
  - Low-emission vehicle;
  - Orphan drug;
  - Political contributions;
  - Ridesharing and
  - Young infant.

— ***Richard Malamud***

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Example of Recalculating a Closed Year to Obtain a Refund

In preparing the 1999 tax return, a taxpayer says, "I don't know what to do with the $25,000 dividend reinvestment (cost basis of my stock). It is still reflected on my Quicken statements, but I sold the stock five years ago. Assuming that the $25,000 was not included in his basis when the stock was sold, the taxpayer can increase the basis of the stock in the closed year to take into account the additional $25,000 basis.

You discover that in 1994 your client originally reported a $10,000 gain, but had not included the $25,000 of reinvested dividends as part of the basis of the stock sold. In this situation the closed year may be changed to reflect a net $15,000 capital loss. So, the taxpayer should have reported a $3,000 capital loss in 1994. Since the statute of limitations for the 1994 return has expired, no refund is allowed for that year, but a $12,000 carryover is allowed for 1995.

If the taxpayer filed the 1995 return on April 15, 1996, he may file a claim for refund by April 17, 2000 (April 15 is a Saturday), and may file claims for each subsequent year. Assuming the taxpayer had no additional capital gains or losses in the intermediate years and that all of the years are still open, an amended return for a $3,000 capital loss per year can be filed for all of the open years (up to the total $12,000 carryover).

Tax Tip

There are no indications in the cases or revenue rulings about how a taxpayer should file these corrections. The best method is probably just to file any open years or amended returns as if the proper amount had been reported and simply attach a statement indicating that the carryover is increased to reflect the proper amount from a closed year.

Sales Tax Review and Update

Patrick Leone, *CPA*

Printer and Graphic Artists Update

Graphic artists are subject to many new changes in sales and use taxes, as we described in the November 1999 issue of the **California Taxletter**. There is more to learn, however.

First of all, electronic or digital art (the process of using computer software and hardware to compile