

Amending a closed year to change an open year

It is possible to file an amended return for a year that is closed by the statute of limitations, but generally not to assess tax or request a refund for that year.

By Gina Rodriguez, EA and Richard Malamud, J.D. LL.M. CPA.

While auditing a 2008 return, the FTB discovers that a taxpayer's charitable contributions carryover from 2004 wasn't valid. Can the FTB assess the taxpayer for the excessive deduction in 2004, a closed year? The answer is "no" because the normal statute of limitations (SOL) has expired for proposing an assessment for 2004 (2004 closed April 15, 2009). However, they may recompute the carryover to future years.

Recomputations

While the FTB cannot assess tax for a closed year, they can "amend" a closed year in order to eliminate the carryover — as in the audit above — in an open year. The SOL limitations prevents reassessment of taxes owed for years barred; it does not prevent recomputation for purposes of calculating taxes owed for open years.¹

In Revenue Ruling 77-225, the IRS held that, based on prior case law,

the expiration of the SOL 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 may, therefore, eliminate an improper carryover and disallow the deduction for that carryforward in any open year.

Relying on the same logic, the IRS has disallowed net operating loss (NOL) carryovers from closed years.² The FTB successfully argued this same position before the Board of Equalization, whereby a corporate taxpayer admitted that it had made a clerical error in calculating its NOL carryover in a closed year.³ The Board stated that the FTB has the authority to recompute the correct NOL, even though the SOL period on the originating year has already closed.

It works both ways

Taxpayers can also amend a closed year to create or increase a carryover in an open year.⁴

There are numerous areas in which this rule may apply. Many of them involve federal and California conformity, and are often seen when a new client walks in the door. Look for clients who may need to increase carryovers for:

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

Filing

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. ☹

NOTE: There is an exception for refunds based on the Other State Tax Credit.⁵

About the author

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¹ *Phoenix Coal Co. v. Comm.* (1956) 231 F.2d 420 (2d Cir.)

² Rev. Rul. 56-285

³ *Appeal of Eastern Trading and Contracting Co.* (January 15, 1993) Cal. St. Bd. of Equal. Case No. 93A-0825-PH

⁴ PLR 9504032 dated October 31, 1994

⁵ R&TC §19311.15

EXAMPLE 9-4: In preparing your client's 2009 tax return, he 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, you can increase the basis of the stock in the closed year to take into account the additional \$25,000 basis. You discover that, in 2004, 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.

You may adjust the closed year to reflect a net \$15,000 capital loss. So, the taxpayer should have reported a \$3,000 capital loss in 2004.

Since the SOL for the 2004 return has expired, no refund is allowed for that year, but a \$12,000 capital loss carryover is allowed for 2005. If the taxpayer filed the 2005 return on October 16, 2006, you may file a claim for refund with the FTB by October 15, 2010, and file claims for each subsequent year.

Assuming that your client had no additional capital gains or losses in the intermediate years and that all of the years are still open, you may file an amended return for a \$3,000 capital loss per year for all of the open years (up to the total \$12,000 carryover).



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California same-sex marriages still in limbo

Same-sex couples will have to wait and see what happens with a case pending before the court of appeals.

By Renée Rodda, J.D.
Editor

Although a U.S. District Court judge declared the Proposition 8 ban on same-sex marriages unconstitutional, the Ninth Circuit Court of Appeals has ordered that the ban remain in place at least until the appeal is heard the week of December 6, 2010.¹

The district court's decision states that the voter-approved rule violates the constitutional rights of gays and lesbians.² However, these are just the first steps in what will be a long battle as the case is appealed, possibly all the way to the United States Supreme Court.

Income tax issues

For income tax purposes, California treated all same-sex married couples who were married prior to the ban the same as registered domestic partners (RDPs).³

It appears that the same rules will apply to any same-sex couples who marry if the ban is lifted. This means that community property rules will apply, and they will file as married for California purposes, even though they must file as single for federal purposes.

For same-sex couples who were married prior to the ban, the California Legislature passed a resolution (AJR 29) on August 9, 2010, asking the IRS to issue a revenue ruling that says that same-sex married couples should be treated the same as RDPs for federal purposes, too. The request is in response to CCA 201021050, which states that RDPs in California must now combine their income and each report half of it on his or her federal tax return, but does not address same-sex married couples.

For more information on CCA 201021050, see "New federal rules for California registered domestic partners" in the July 2010 issue of *Spidell's California Taxletter*.[Ⓞ]

¹ *Order on Motion to Stay in Perry et al. v. Schwarzenegger et al.* (August 16, 2010) U.S. Court of Appeals, Ninth Circuit, Case No. 10-16696

² *Perry et al. v. Schwarzenegger et al.* (August 4, 2010) U.S. District Court, Northern District of California, Case No. 09-2292 VRW

³ FTB Notice 2008-5

Understanding ethics continuing education requirements

Some ethics requirements have changed recently, so make sure you are up to date on what is required.

By Kathryn Zdan, CRTP and Lisa Mackey
Taxletter Staff

Some licenses have new ethics requirements, or requirements that can be tricky to understand. See the chart on page 100 for a complete list of renewal information for CPAs, EAs, CTECs, CFPs, and attorneys.

CPAs

For license renewals after January 1, 2010, CPAs must complete:

- Four hours of ethics education every renewal period; and
 - Two hours of Board-approved regulatory review every six years.
- Ethics courses must cover:
- A review of nationally-recognized codes of conduct, emphasizing how the codes of conduct relate to professional responsibilities;

- Case-based instruction focusing on real-life situational learning;
- Ethical dilemmas facing accounting professionals; or
- Business ethics, ethical sensitivity, and consumer expectations.

This course will not be pre-approved by the Board of Accountancy (BOA), but each course must be a minimum of one 50-minute hour. Also, if the course is a self-study course, it must require a 90% or better score for credit to be given.

NOTE: CPAs may take an eight-hour professional conduct and ethics course approved under the old rules, and satisfy both the new four-hour ethics requirement and the two-hour regulatory review requirement. Courses that were approved by the Board to meet the eight-hour requirement will continue to be valid through the December 31, 2010.¹

See **Ethics**, page 98