OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of:	OTA Case No. 18011316
GERALD F. AND	Date Issued: March 27, 2018
BARBARA G. JOHNSON	

OPINION

Representing the Parties:

For Appellants: Barbara G. Johnson, Pro Per
Gerald F. Johnson, Pro Per

For Respondent: Anne Mazur, Specialist

THOMPSON, Administrative Law Judge: Pursuant to California Revenue and Taxation Code (R&TC) section 19324,[1] Gerald F. Johnson and Barbara G. Johnson (appellants) appeal an action by the Franchise Tax Board (FTB or respondent) denying appellants' claim for refund in the amount of $8,012.12[2] for the 2015 tax year.

Appellants waived their right to an oral hearing and therefore the matter is being decided based on the written record.

ISSUE

Whether appellants are liable for the estimated tax penalty as determined by the FTB.

---

[1] Unless otherwise indicated, all "Section" references are to sections of the California Revenue and Taxation Code as in effect for the tax year at issue.

[2] This is the amount of an addition to tax, often referred to as an estimated tax penalty, paid by appellants. On appeal, the FTB has agreed to reduce the penalty to $6,502 in order to properly take into account the real estate withholding payment discussed in the Factual Findings.

FACTUAL FINDINGS

1. On February 12, 2015, appellants closed escrow on the sale of real estate.
2. Appellants' escrow company transmitted $175,316 in real estate withholding to the FTB.
3. Appellants timely filed a California income tax return for the 2015 tax year. Appellants' tax return reflected the $175,316 of withholding on the real estate transaction. The tax return reflected no other withholding or estimated tax payments. The tax return showed tax due of $444,510.
4. The FTB processed the tax return and imposed an addition to tax of $8,012.12 for underpayment of estimated tax.
5. Appellants paid the $8,012.12 amount and filed a timely refund claim requesting that the FTB abate the penalty on the ground that appellants had reasonable cause for failing to make estimated tax payments.
6. The FTB denied the refund claim, and appellants filed this timely appeal.

DISCUSSION

Subject to certain exceptions not relevant to the issues on appeal, Section 19136 incorporates Internal Revenue Code (IRC) section 6654. IRC section 6654 imposes an addition to tax, which is treated as a penalty, where an individual fails to timely pay estimated tax.[3] The addition to tax is similar to an interest charge in that it is calculated applying the interest rate imposed on underpayments on the amount of the underpayment of estimated tax. (See IRC, § 6654(a) [calculating the addition to tax by reference to the interest rate imposed on underpayments]; Section 19136(b) [referring to Section 19521 which, with modification, conforms to the federal interest provisions in IRC § 6621].)

There is no provision in the IRC or R&TC that allows the addition to tax for the underpayment of estimated tax to be abated based solely on a finding of reasonable cause. As a result, there is no general reasonable cause exception to imposition of the addition to tax for the underpayment of estimated tax. (*Adams v. Commissioner*, T.C. Memo. 2013-7; *Farhoumand v. Commissioner*, T.C. Memo. 2012-131; *Nasir v. Commissioner*, T.C. Memo. 2011-283; see also

[3] Where estimated tax payments are due, Section 19136.1(a)(2) generally requires, for California income tax purposes, that the payments be made in installments on or prior to April 15 and June 15 of the applicable tax year, and January 15 of the subsequent tax year. For federal income taxes, an additional installment is also due by September 15 of the applicable tax year.

Appeal of Weaver Equipment Company, 80-SBE-048, May 21, 1980.) The addition to tax under IRC section 6654 is mandatory unless the taxpayer establishes that a statutory exception applies. (*Nitschke v. Commissioner*, T.C. Memo. 2016-78.)

Although there is no provision allowing for the abatement of the addition to tax based solely on reasonable cause, IRC section 6654(e)(3) provides two avenues upon which the addition to tax may be waived. First, under IRC section 6654(e)(3)(A), the government may waive the addition to tax if it determines that, "by reason of casualty, disaster, or other unusual circumstances the imposition of such addition to tax would be against equity and good conscience." Second, under IRC section 6654(e)(3)(B), the addition to tax may be waived if the IRS (or here, the FTB) determines that (i) during the applicable tax year or the preceding year, the taxpayer either retired after having attained age 62, or became disabled, *and* (ii) the underpayment was due to "reasonable cause" and not due to willful neglect. Thus, the issue of whether a taxpayer had reasonable cause for underpaying estimated tax only arises if, during the applicable tax year or the preceding year, the taxpayer either retired after having attained age 62, or became disabled.

Here, appellants argue that they had reasonable cause for not making estimated tax payments in 2015. Appellants contend that their income during 2015 was far higher than usual due to a "once in a lifetime real estate capital gains event." Appellants note that there was real estate withholding on the transaction which paid much more than 110 percent of their prior year's tax. Appellants argue that, under a safe harbor contained in IRC section 6654(d)(1), when a high-income earner pays 110 percent or more of the prior year's tax, he or she is not liable for the estimated tax penalty. California law, however, expressly abrogated that safe harbor provision for high-earning taxpayers (those with adjusted gross income of $1 million or more) for tax years beginning on or after January 1, 2009. (Section 19136.3.) Therefore, that safe harbor provision does not apply here.

As discussed above, the addition to tax for underpayment of estimated tax cannot be abated based solely on reasonable cause. Reasonable cause is only relevant if, during the applicable tax year or the preceding year, the taxpayer either retired after having attained age 62, or became disabled. (See *Adams v. Commissioner*, *supra*.) Appellants have not alleged, and the record does not show, that they retired or became disabled in 2014 or 2015.[4] As a result, there is no basis to find that appellants qualify for a waiver under IRC section 6654(e)(3)(B).

Under IRC section 6654(e)(3)(A), the issue is whether appellants' circumstances constitute a "casualty, disaster, or other unusual circumstances" that would cause the imposition of the addition to tax to be "against equity and good conscience." In *Farhoumand v. Commissioner*, *supra*, the United States Tax Court considered whether this provision should apply to taxpayers who contended they acted in good faith but had a higher tax liability than expected.

The Farhoumands argued that the bursting of the dot-com bubble in 2000 constituted an unusual circumstance justifying waiver of the penalty. The Farhoumands further argued that they reasonably believed they would not owe income tax because they made an honest mistake of law. However, the Tax Court found that stock market volatility was not an unusual circumstance and that the Farhoumands' argument that they acted in good faith constituted a reasonable cause type argument that was irrelevant because the estimated tax penalty statute provides no reasonable cause defense.

While we are sympathetic to appellants' argument that they acted in good faith and did not realize that estimated tax payments would be required, these types of arguments are reasonable cause arguments, and the statute does not allow for the waiver of additional tax on this basis. Moreover, like the stock market volatility in *Farhoumand*, appellants' sale of property was not a "casualty, disaster or other unusual circumstance" that would cause the imposition of the addition to tax to be "against equity and good conscience."

When we interpret the statutory phrase "casualty, disaster or other unusual circumstances," we consider the canon of *ejusdem generis*, meaning that, where specific words (here, "casualty" and "disaster") are followed by more general words ("other unusual circumstances"), the more general words are generally limited to items that are similar to the specific words. (*Sterling Park, L.P. v. City of Palo Alto* (2013) 57 Cal.4th 1193, 1202; see also *Martin v. Holiday Inns, Inc.* (1988) 199 Cal.App.3d 1434, 1437 – 1438; Civ. Code § 3534 ["Particular expressions qualify those which are general."].) If this were not the case, the

[4] In its brief, the FTB noted the existence of this provision for newly retired or disabled individuals, and stated that there was no evidence that it applied. Appellants' reply brief did not address the issue.

lawmakers' use of the more specific words would be meaningless, as they could have simply used the more general words and omitted the specific words. However, we are cautious to ensure that we do not give the words "other unusual circumstances" such a narrow interpretation that they do not have any meaning beyond the specific words of "casualty" and "disaster." (See *Sterling Park, LP.*, *supra*, at p. 1203.)

With the above in mind, we note that casualties and disasters are unexpected events that cause a hardship or loss such that, depending on the circumstances, it might be inequitable for the addition to tax to apply. While we do not foreclose the possibility that other types of unusual circumstances might fall within this provision, the statutory context suggests that a profitable sale of real property is not the type of event that the provision was intended to cover. Moreover, the decision of the Tax Court in *Farhoumand*, *supra*, suggests a narrow interpretation of the provision. In that case, there were unanticipated losses due to a large stock market decline, but the Tax Court found that stock market volatility was not an unusual circumstance within the meaning of IRC section 6654(e)(3)(A).

It is not unusual for taxpayers to sell real property, and, unlike a casualty, disaster or similar unusual circumstances, appellants' sale of real property was not an unexpected event that caused a loss or hardship. Appellants point to the passage of Proposition 30, but this change in the law occurred in 2012, three years prior to the year at issue, so appellants had adequate time to take it into account. Furthermore, it does not offend equity or good conscience to impose an addition to tax on appellants' failure to pay estimated tax when they recognized a large amount of gain on the sale of real property but failed to make estimated tax payments. In this respect, appellants present a weaker case for application of IRC section 6654(e)(3)(A) than the taxpayers in *Farhoumand*, because, unlike the taxpayers in that case, appellants recognized a large gain rather than suffering unexpected financial losses.

Appellants reference a trial court decision filed by the Sacramento County Superior Court in *Toys "R" Us, Inc. v. Franchise Tax Bd.*, No. 99AS03572, on October 18, 2000. This decision is not a published decision and may not be cited or relied upon. (See Cal. Rules of Court, rule 8.1115 [setting forth types of California court decisions that may be cited and relied upon].) We have no basis to rely upon the decision or believe that it would alter the applicable legal analysis.

HOLDING

In light of the foregoing, we hold that the FTB properly imposed the underpayment of estimated tax penalty against appellants for 2015.

DISPOSITION

Respondent's action denying appellants' claim for refund is modified to partially grant appellants' refund claim in accordance with respondent's concession on appeal that the amount of the addition to tax should be reduced from $8,012.12 to $6,502.00. Respondent's action is otherwise sustained.

DocuSigned by:
Grant Thompson
FC572D5881AE41B...

Grant S. Thompson
Administrative Law Judge

We concur:

DocuSigned by:
0C90542BE88D4E7...

Tommy Leung
Administrative Law Judge

DocuSigned by:
Teresa A Stanley
0CC6C6ACCC6A44D...

Teresa A. Stanley
Administrative Law Judge