

**OFFICE OF TAX APPEALS  
STATE OF CALIFORNIA**

In the Matter of the Appeal of: ) OTA Case No. 18011086  
RICHARD B. AND )  
BETH A. SALTZMAN ) Date Issued: March 5, 2019  
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 )

OPINION

## Representing the Parties:

For Appellants: Kevin M. Owens, CPA

For Franchise Tax Board (FTB): Eric A. Yadao, Tax Counsel III

G. THOMPSON, Administrative Law Judge: Pursuant to California Revenue and Taxation Code (R&TC) section 19324,<sup>1</sup> Richard B. Saltzman and Beth A. Saltzman (appellants) appeal an action by FTB denying appellants' claim for refund in the amount of \$35,384 for the 2015 tax year.<sup>2</sup>

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 determined by FTB.

## FACTUAL FINDINGS

1. During April of 2015, Mr. Saltzman, a California nonresident, received securities constituting a guaranteed payment for services of approximately \$70 million from an entity treated as a partnership for tax purposes (Partnership).

<sup>1</sup> 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.

<sup>2</sup> This is the amount of the addition to tax, often referred to as an estimated tax penalty, imposed by FTB for the failure to make timely estimated tax payments.

2. On or about June 11, 2015, the Partnership made an estimated tax payment of \$9,502,213, on appellants' behalf, to the State of New York.
3. During 2015, appellants paid estimated tax to California, however they did not make payments to California during 2015 with respect to the payment received from the Partnership.<sup>3</sup>
4. On January 5, 2016, appellants paid estimated tax of \$10,000 for the 2015 tax year.
5. On April 15, 2016, FTB credited appellants with an extension payment of \$2,050,000 for the 2015 tax year.
6. On October 15, 2016, appellants filed a California Nonresident or Part-Year Resident Income Tax Return for 2015. After taking into account estimated tax payments, an extension payment, and withholding, appellants reported an overpayment of tax.
7. Appellants' tax return reported that no penalty applied for the underpayment of estimated tax.<sup>4</sup> However, appellants enclosed with their tax return a Form 5805 Underpayment of Estimated Tax by Individuals and Fiduciaries in which they requested waiver of the estimated tax penalty.
8. On the Form 5805, appellants argued that the failure to timely pay estimated tax with respect to the \$70 million payment "was due to unusual circumstances and reasonable cause and not willful neglect." Appellants further argued that the penalty should be waived under Section 19136.<sup>5</sup> In support, appellants stated that, at the time the payment was received, "financial statement audits were not yet completed for the underlying partnerships in which Mr. Saltzman [was] an investor . . ."<sup>6</sup> Appellants explained that

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<sup>3</sup> Based on records provided by FTB, it appears that, on April 15, 2015, appellants were credited with transferring a \$4,498 overpayment from the 2014 tax year to the 2015 tax year. On October 13, 2015, appellants paid estimated taxes of \$18,000.

<sup>4</sup> Both appellants' California return and their federal return used the annualized income installment method to calculate when estimated tax payments were due. Internal Revenue Code (IRC) section 6654(d)(2) allows taxpayers to use the annualized installment method to calculate tax. (As relevant to the issues in this appeal, California conforms to IRC section 6654 pursuant to Section 19136.) Under the annualized installment method, the estimated tax payment that is due for each estimated tax due date is based in part on the taxable income for the months in the taxable year preceding the due date. The annualized installment method makes calculations more complex but results in a lower estimated tax penalty for appellants.

<sup>5</sup> IRC section 6654(e)(3)(A) provides that the estimated tax penalty may be waived if the taxing agency 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."

<sup>6</sup> It appears appellants were referring to the underlying partnerships in which the Partnership was invested.

estimated tax payments were made to New York and stated that they retained competent tax advisors to ensure compliance with their tax obligations. Appellants further stated that, when the audited financial statements were completed in March of 2016, appellants were informed that the \$70 million payment was subject to California apportionment (such that a portion of the income was taxable by California), and Mr. Saltzman made a good faith effort to submit required estimated tax payments within a reasonable time.<sup>7</sup>

9. On December 5, 2016, FTB issued a notice imposing an estimated tax penalty of \$35,384 and showing a balance due of \$15,181.35.
10. On December 29, 2016, appellants responded to FTB by essentially reiterating the arguments made in the Form 5805 submitted with their tax return.<sup>8</sup>
11. On January 18, 2017, and March 1, 2017, FTB issued additional notices reflecting imposition of the estimated tax penalty.
12. On April 28, 2017, FTB issued a notice denying appellants' request for waiver of the estimated tax penalty and showing a balance due of \$15,413.
13. Appellants subsequently made payments satisfying the balance FTB indicated was due for 2015.
14. On May 31, 2017, appellants filed a claim for refund of the \$35,384 estimated tax penalty imposed for the 2015 tax year.
15. On July 11, 2017, FTB denied appellants' claim for refund.
16. Appellants then filed this timely appeal.

### DISCUSSION

IRC section 6654 imposes an addition to tax, which is treated and often referred to as a penalty, where an individual fails to timely pay estimated tax.<sup>9</sup> Subject to certain exceptions not relevant to the issues on appeal, Section 19136 incorporates IRC section 6654. The estimated

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<sup>7</sup> It appears that appellants may be referring to the \$2,050,000 extension payment for 2015 that FTB credited on April 15, 2016.

<sup>8</sup> Appellants also argued that FTB had incorrectly calculated their withholding amount. FTB later allowed the full withholding amount of \$19,667 reported by appellants for the 2015 tax year. Therefore, the amount of withholding is not at issue on appeal.

<sup>9</sup> 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.

tax penalty is similar to an interest charge in that it is calculated applying the applicable interest rate to the underpayment of estimated tax. (See IRC, § 6654(a) [calculating the estimated tax penalty 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 section 6621].)

There is no provision in the IRC or R&TC that allows the estimated tax penalty 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 estimated tax penalty. (*Appeal of Johnson*, 2018-OTA-119P,<sup>10</sup> Mar. 27, 2018 (*Johnson*); *Adams v. Commissioner*, T.C. Memo. 2013-7.) The estimated tax penalty is mandatory unless the taxpayer establishes that a statutory exception applies. (*Johnson, supra*; *Nitschke v. Commissioner*, T.C. Memo. 2016-78.) Although there is no provision allowing for abatement of the estimated tax penalty based solely on reasonable cause, IRC section 6654(e)(3)(A) provides that the taxing agency may waive the estimated tax penalty if it determines that, “by reason of casualty, disaster, or other unusual circumstances the imposition of [the estimated tax penalty] would be against equity and good conscience.”<sup>11</sup>

During appeal, appellants reiterated their arguments that unusual circumstances existed and that they acted reasonably in light of the unusual circumstances. Appellants noted that the Partnership made an estimated tax payment on their behalf to their state of residence, New York, and stated that, until the Partnership’s financial statements were finalized in March of 2016, they had no reason to believe the payment would be subject to tax by California. Appellants also stated that they had a good tax compliance history with the State of California. Appellants cited several cases involving the abatement of penalties based on reasonable cause.

Appellants further argued that, if any estimated tax penalty is imposed, the amount of the penalty should be reduced from \$35,384 to \$13,285. Appellants stated that, on reviewing this matter further, they might have used apportionment information from the Partnership’s 2014 tax year to estimate the amount of income attributable to California for the 2015 tax year.

Appellants stated that this information was not available until the fourth quarter of 2015. On this

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<sup>10</sup> The Office of Tax Appeals publishes opinions on its website at: <<http://www.ota.ca.gov/opinions>>.

<sup>11</sup> IRC section 6654(e)(3)(B) provides another potential avenue for waiver of the penalty where the taxing agency 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. However, there is no evidence or argument that this provision is applicable.

basis, appellants argued that the fourth quarter was the earliest they could have estimated their California income and that the estimated tax payment for that income would not have been due until the next quarterly due date, January 15, 2016. Appellants contended that, if any penalty is imposed, it should only apply to the period following January 15, 2016, and on this ground calculated a reduced penalty amount of \$13,285.

We will first consider appellants' primary argument, which is that waiver of the estimated tax penalty is warranted under IRC section 6654(e)(3)(A). Under this provision, the issue is whether appellants' circumstances constitute a "casualty, disaster, or other unusual circumstances" that would cause the imposition of the estimated tax penalty to be "against equity and good conscience."

In *Farhoumand v. Commissioner*, T.C. Memo. 2012-131 (*Farhoumand*), the 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 argument that was irrelevant because the estimated tax penalty statute provides no reasonable cause defense.

Here, like the Tax Court in *Farhoumand*, we are not persuaded that the taxpayers' circumstances constituted a "casualty, disaster, or other unusual circumstances" that would cause the imposition of the estimated tax penalty to be "against equity and good conscience." The phrase "casualty, disaster, or other unusual circumstances" generally refers to unexpected events that cause a hardship or loss such that, due to the circumstances, it would be "against equity and good conscience" to impose the penalty. (*Johnson, supra.*) Here, rather than suffering an unexpected hardship, Mr. Saltzman received a substantial payment from a partnership. While the estimated tax penalty is often referred to as a penalty, it effectively imposes an interest charge to compensate the government for the time value of tax that is due but is not paid until a later date. We find that imposing an interest charge on tax that was due on the payment received by Mr. Saltzman does not offend "equity and goodconscience."

As noted above, appellants argue that they acted reasonably as information to calculate the amount of the estimated tax payment to California was not available on a timely basis and they timely paid estimated tax to their state of residence.<sup>12</sup> These arguments are reasonable cause arguments, and the applicable statutes do not permit abatement of the addition to tax for underpayment of estimated tax solely on the basis of reasonable cause.

While appellants cite several cases in support of their arguments, the cited cases concern statutes in which reasonable cause provides a basis for abating the penalty at issue. None of the cited cases involve a waiver of the estimated tax penalty under IRC section 6654(e)(3)(A), which imposes a higher standard than mere reasonable cause. We are aware of no case law that would support waiver of the estimated tax penalty in circumstances that are similar to the circumstances here.

We next address appellants' argument that, at a minimum, the amount of the penalty should be calculated based on the amount of tax that could be reasonably estimated during the months preceding each due date for estimated tax. At first glance, this argument seems reasonable. Treasury Regulation section 1.6654-5 states that taxpayers should calculate estimated tax payments based on the amount of gross income which the taxpayer can "reasonably expect" based on "the facts and circumstances existing at the time prescribed for determining the estimated tax . . ." However, the regulation does not state that the amount of the estimated tax penalty will be reduced if the taxpayer makes a reasonable estimate. Moreover, the regulation could not state this, because such a provision would be contrary to the applicable statute. As applicable here, IRC section 6654(d)(2)(B)(i) provides that the amount of the penalty is determined by reference to "*the tax* for the taxable year computed by placing on an annualized basis *the taxable income*, alternative minimum taxable income, and adjusted self-employment income for months in the taxable year" preceding the applicable due date. (Emphasis added.) Thus, the applicable statute determines the penalty by reference to the actual taxable income for the months preceding the due date, rather than by reference to such taxable income as can be reasonably estimated. This is consistent with the fact that the statute effectively imposes an interest charge on the delay in paying the correct amount of tax, rather than imposing a punitive

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<sup>12</sup> FTB has not contested appellants' representation of the relevant facts, and, for the sake of argument, we will assume that appellants' representation of the facts is accurate.

penalty. In any event, California conforms to the federal statute, and we have no basis to change the method that the statute provides for calculating the estimated tax penalty.

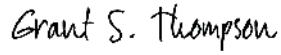
### HOLDING

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

### DISPOSITION

FTB's action denying appellants' claim for refund is sustained.

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Grant S. Thompson  
Administrative Law Judge

We concur:

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Alberto T. Rosas  
Administrative Law Judge

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Douglas Bramhall  
Administrative Law Judge