

OFFICE OF TAX APPEALS
STATE OF CALIFORNIA

In the Matter of the Appeal of:
ANTHONY KADELL

) OTA Case No. 18032379
)
) Date Issued: May 9, 2019
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)
)

OPINION

Representing the Parties:

For Appellant: Steven G. Culp, CPA
For Respondent: Eric R. Brown, Tax Counsel III
For Office of Tax Appeals: Andrea Long, Tax Counsel

A. VASSIGH, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19324, Anthony Kadell (appellant) appeals an action by the Franchise Tax Board (FTB or respondent) denying appellant’s claim for refund of \$1,830.91 for the 2016 tax year.

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

ISSUE

Whether appellant has shown that the estimated tax penalty should be waived.

FACTUAL FINDINGS

1. On October 13, 2016, appellant sold apartment buildings for \$3,859,000.¹ A real estate withholding of \$128,650 was made at the close of escrow. According to appellant, he retired from property management soon after the sale of the apartment building when he was 62 years old.

¹ The county assessor record lists the sales price as \$2,572,000, but the assessor’s statement appears to refer only to 1111 Doheny. The sale reflects (and appellant’s own statement confirms) that 1111-1115 Doheny were sold. On his tax return, appellant reported a gross sales price of \$3,859,000.

2. On April 1, 2017, appellant timely filed a 2016 California Resident Income Tax Return (Form 540). Appellant reported a California adjusted gross income (AGI) of \$2,899,408, a taxable income of \$2,895,279, and a total tax of \$361,208. After applying estimated tax payments of \$3,822 and a real estate withholding of \$128,650, appellant reported a tax due of \$228,736. On line 113 of his return, appellant reported zero underpayment of estimated tax, but indicated that he attached FTB Form 5805, Underpayment of Estimated Tax by Individuals and Fiduciaries, to his return. Appellant remitted a payment of \$228,736 on April 11, 2017.
3. On the FTB Form 5805 attached to his return, appellant calculated his estimated tax penalty of \$1,900.² He did not remit the penalty, but instead asked respondent to waive the penalty. In an attached narrative, appellant stated that he “was not aware that the safe harbor would not apply.” He explained that he had an unusual occurrence of a large capital gain that stemmed from the sale of an apartment building, his prior tax year liability was \$3,822, and he made an estimated tax payment of \$3,822, plus a real estate withholding of \$128,650. Appellant requested a waiver of the penalty due to reasonable cause. Additionally, he asserted that he qualified for a first-time penalty abatement.
4. On June 20, 2017, respondent sent appellant a Notice of State Income Tax Due, indicating an imposition of an estimated tax penalty of \$1,815.33, plus interest. Payment was due by July 5, 2017. Because appellant did not remit payment, respondent sent an Income Tax Due Notice on August 7, 2017, advising him that full payment and interest was due by August 22, 2017.
5. On August 7, 2017, appellant submitted a claim for refund. By a letter dated August 29, 2017, FTB advised appellant that it would treat the request as a prepayment request for waiver and advised appellant that the underpayment of estimated tax penalty could only be abated for reasonable cause under limited circumstances. On September 6, 2017, appellant remitted payment of \$1,830.91.³
6. In a letter dated October 23, 2017, respondent denied the claim.
7. This timely appeal followed.

² Respondent asserts in its brief that the correct amount of the estimated tax penalty is \$1,815.33.

³ The additional \$15.58 paid by appellant is the interest paid on the late payment of the estimated tax penalty.

DISCUSSION

Except as otherwise provided, R&TC section 19136 conforms to Internal Revenue Code (IRC) section 6654 and imposes a penalty for the underpayment of estimated tax where the taxpayer's installment payments are less than the amounts due at the end of the installment periods. This penalty is similar to an interest charge, which applies from the installment due date to the earlier of April 15 of the following tax year or the date on which the tax is paid in full. (IRC, § 6654(b)(2), R&TC, § 19136, subd. (d).) For California purposes, installment payments are due on April 15 (30 percent of required annual payment), June 15 (40 percent of required annual payment), and January 15 of the following tax year (30 percent of required annual payment). (IRC, § 6654(c)(2), as modified by R&TC, § 19136.1.)

Generally, the required annual payment is the lesser of: (1) 90 percent of the tax shown on the return for the tax year (or, if no return is filed, 90 percent of the tax for such year), or (2) 100 percent of the tax shown on the individual's return for the preceding tax year. (IRC, § 6654(d)(1)(B).) The courts characterize as a "safe harbor" the provisions that shield individuals from estimated tax penalties if the estimated taxes paid during the current tax year comply with the provisions of IRC section 6654(d)(1)(B). (See *Mendes v. Commissioner* (2003) 121 T.C. 308, 325-326.)

For federal income tax purposes, if the AGI shown on the taxpayer's return for the preceding tax year, which begins in 2002 or thereafter, exceeds \$150,000, the applicable percentage is 110, instead of 100, for purposes of IRC section 6654(d)(1)(B)(ii). (IRC, § 6654(d)(1)(C).) For California income tax purposes, R&TC section 19136.3 modifies IRC section 6654(d)(1)(B) for tax years beginning on or after January 1, 2009, in that it provides that clause (ii) shall not apply if the AGI shown on the return for the tax year is equal to or greater than \$1 million (\$500,000 in the case of a married individual filing a separate return). Accordingly, for California income tax purposes, individuals, such as appellant, who report AGI equal to or greater than \$1 million are required to make an annual payment of estimated tax equal to 90 percent of the tax shown on the return for the tax year. (IRC, § 6654(d)(2)(B); R&TC, § 19136.3, subd. (a).)

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.) There is no provision in the tax laws that allows the estimated tax penalty to be abated solely on a finding

of reasonable cause. (*Grosshandler v. Commissioner* (1980) 75 T.C. 1, 20-21; *Estate of Sanders v. Commissioner*, T.C. Memo. 2018-104; *Appeal of Weaver Equipment Co.*, 80-SBE-048, May 21, 1980.) Instead, IRC section 6654(e)(3) provides a limited exception to waive the penalty in two situations involving extreme hardships: (1) if, by reason of casualty, disaster, or other unusual circumstances, imposing the penalty would be against equity and good conscience and, (2) if the late payment was due to reasonable cause and not willful neglect, but only for individuals who retired after attaining the age of 62 in the taxable year or who became disabled in the taxable year. (IRC, § 6654(e)(3)(A)-(B).)

There is no dispute that appellant underpaid his estimated taxes; thus, respondent properly imposed the estimated tax penalty. On his 2016 return, appellant reported California AGI of \$2,899,408, a total tax of \$361,208, estimated tax payments of \$3,822, and real estate withholding of \$128,650. On the FTB Form 5805, appellant asserts that his 2015 tax liability was \$3,822. Appellant did not qualify for safe harbor under the 90 percent payment provision, based on the tax shown on his 2016 return, because appellant did not pay estimated tax in the amount of \$325,087 (which is 90 percent of the total tax of \$361,208). (IRC, § 6654(d)(1)(i).) There was also no estimated tax safe harbor available to appellant based on the tax shown on his 2015 return, because the AGI shown on his 2016 return was equal to or greater than \$1 million. (R&TC, § 19136.3.)

Appellant argues that he is entitled to waiver of the penalty pursuant to IRC section 6654(e)(3)(B), because he was 62 years old when he retired in October 2016, and the failure to timely pay his estimated tax was due to reasonable cause. Appellant states that on July 1, 2010, he assumed management of his residential rental property and he retired when he sold the rental property on October 13, 2016. Appellant asserts that he made reasonable efforts to pay all taxes on a timely basis. He states that, although he “believed that the safe harbor would apply since the estimates plus withholding were in excess of 100% prior year tax,” the “safe harbor did not apply since the gross income for 2016 exceeded \$1,000,000.” Appellant also asserts that he has a long history of tax compliance.

Based on the birth date listed on appellant’s 2016 return, which appellant signed under penalty of perjury, appellant was 62 years old when he sold his building in October 2016. If we accept appellant’s contention that he retired after having attained age 62 in 2016, thereby complying under one prong of the waiver, he would still need to show that reasonable cause

existed for his underpayment of estimated taxes.

However, appellant not shown that the underpayment was due to reasonable cause. Although there is no guidance as to what constitutes reasonable cause for purposes of IRC section 6654(e)(3)(B), the same standard applies to other penalties, and we look to cases involving those penalties for guidance. To establish reasonable cause, a taxpayer must show that his failure to make a timely tax payment of the proper amount occurred despite exercising ordinary business care and prudence. (See *Appeal of Friedman*, 2018-OTA-077P; *Appeal of Scanlon*, 2018-OTA-075P.) The taxpayer bears the burden of proving that an ordinarily intelligent and prudent businessperson would have acted similarly under the circumstances. (*Appeal of Sleight* (83-SBE-244) 1983 WL 15615.) The failure, caused by an oversight, to timely remit the balance due on a tax liability does not, by itself, constitute reasonable cause. (See *Appeal of Risser* (84-SBE-044) 1984 WL 16123 [relating to timely payment of tax].)

Appellant argues that he made his best effort to pay the estimated tax based on his understanding of the tax law. Appellant states that he had an unusual occurrence of a large capital gain that stemmed from the sale of the apartment building, which resulted in a substantial increase to his California AGI of \$2,899,408. Appellant withheld \$128,650 of tax from the sale and, because his prior year's tax was \$3,822, he incorrectly concluded that he fell within the safe harbor provision of IRC section 6654(d)(1)(ii). As discussed above, R&TC section 19136 provides that IRC section 6654(d)(1)(ii) does not apply if the AGI shown the return for the tax year at issue is equal to or greater than \$1 million.

While we are sympathetic to appellant's situation, ignorance of the law does not excuse noncompliance with statutory requirements. (*Appeal of Diebold, Inc.* (83-SBE-002) 1983 WL 15389.) The exercise of ordinary business care and prudence requires a taxpayer to acquaint himself with the law. (*Id.*) Appellant made estimated tax payments of \$3,822 for the 2016 tax year. The 2016 Instructions for Form 540-ES, Estimated Tax for Individuals, provides, "Taxpayers with 2016 California adjusted gross income equal to or greater than \$1,000,000 (or \$500,000 if married/RDP filing separately), must figure estimated tax based on their tax for 2016." Based on these instructions, appellant could be reasonably expected to know of the requirement for the payment of estimated tax for individuals, such as himself, who had California AGI equal to or greater than \$1 million.

Moreover, appellant has not described what efforts, if any, he took to ensure that he timely paid the correct amount of estimated tax payments. These events, as presented by appellant, do not show that the underpayment of estimated taxes occurred despite the exercise of ordinary business care and prudence.

Finally, regarding appellant's reference to his history of compliance, we note that the Internal Revenue Service (IRS) administers a program called "First Time Abate" under which the IRS may administratively abate penalties for late payment and late filing if a taxpayer has timely filed returns and paid taxes due for the past three years. Neither the California Legislature nor FTB has adopted a comparable penalty abatement program, so the IRS penalty abatement and appellant's history of timely filing and paying California taxes cannot be used as a basis for abatement of the late payment penalty at issue here. Instead, appellant must establish that his failure to timely pay his taxes was due to reasonable cause and not due to willful neglect, which he has not done.


For the reasons discussed above, appellant has not met his burden of proving that the estimated tax penalty should be waived.

HOLDING

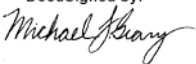
Appellant has not established that the estimated tax penalty should be waived.

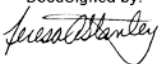
DISPOSITION

Respondent's action is sustained.

DocuSigned by:

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Amanda Vassigh
Administrative Law Judge

We concur:

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Michael F. Geary
Administrative Law Judge

DocuSigned by:

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Teresa A. Stanley
Administrative Law Judge