OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of:	) OTA Case No. 20096613
D.W. DIEM AND	)
D. DIEM	)
	)
	)

OPINION

Representing the Parties:

For Appellants: D.W. Diem and D. Diem

For Respondent: Jean M. Cramer, Tax Counsel IV

A. ROSAS, Administrative Law Judge: Under Revenue and Taxation Code (R&TC) section 19324, appellants D.W. Diem and D. Diem appeal respondent Franchise Tax Board's action in denying appellants' claim for refund totaling $39,338, plus applicable interest, for tax year 2018. Appellants waived the right to an oral hearing, and therefore we decide this matter based on the written record.

ISSUE

Whether appellants are entitled to abatement of the underpayment of estimated tax penalty (estimated tax penalty).

FACTUAL FINDINGS

1. Appellants filed a timely California resident income tax return for tax year 2018. They reported California adjusted gross income (AGI) greater than $1 million.
2. Appellants' estimated tax payments for the tax year at issue totaled $150,000.
3. Respondent determined that appellants were required to make estimated tax payments totaling $1,373,961 as follows:
   - April 15, 2018: on or before this date, appellants should have paid $412,188.21;
   - June 15, 2018: on or before this date, appellants should have paid $549,584.28; and
   - January 15, 2019: on or before this date, appellants should have paid $412,189.21.

4. In November 2019, respondent issued a Notice of Tax Change – Revised Balance, which imposed an estimated tax penalty of $39,338, plus interest and fees. Appellants responded in writing later that month.
5. Over the next several months, the parties engaged in a series of written communications, and respondent issued several notices about the estimated tax penalty of $39,338. Appellants requested abatement of the estimated tax penalty. On July 15, 2020, appellants paid the balance due for tax year 2018.
6. Respondent denied appellants' claim for refund, and this timely appeal followed.

DISCUSSION

Internal Revenue Code (IRC) section 6654 imposes an addition to tax, which is treated and often referred to as a penalty, when an individual fails to timely pay estimated tax. Subject to certain exceptions not relevant to the issue on appeal, R&TC section 19136 incorporates IRC section 6654.[1] The estimated tax penalty is similar to an interest charge in that it is calculated by applying the applicable interest rate to the underpayment of estimated tax. (See IRC, § 6654(a); see also R&TC, §§ 19136(b) and 19521.)[2] Generally, to avoid this penalty, IRC section 6654(d)(1)(B) defines the required annual payment of estimated tax as the lesser of (i) 90 percent of the tax shown on the current year tax return (current year safe harbor rule), or (ii) 100 percent of the tax shown on the prior year tax return (prior year safe harbor rule). However, if the AGI shown on the prior year return exceeds $150,000.00, the taxpayer must pay 110 percent of the tax shown on the prior year tax return. (IRC, § 6654(d)(1)(C).) But for California purposes, the prior year safe harbor provision in IRC section 6654(d)(1)(B)(ii) does not apply if the taxpayer's AGI for the current year is equal to or greater than $1 million. (R&TC, § 19136.3.)[3]

Appellants' estimated tax payments for the tax year at issue, including their withholding payments, totaled $150,000. Respondent determined that appellants were required to make

[1] Where estimated tax payments are due, R&TC section 19136.1(a)(2) generally requires, for California income tax purposes, that the payments be made in installments on or before April 15 and June 15 during the applicable tax year, and January 15 of the immediately succeeding tax year.

[2] With modification, R&TC section 19521 conforms to the federal interest provisions in IRC section 6621.

[3] R&TC section 19136.3 states that IRC section 6654(d)(1)(B) "is modified to additionally provide that clause (ii) shall not apply if the adjusted gross income shown on the return of the individual for the taxable year is equal to or greater than $1 million....."

estimated tax payments totaling $1,373,961, and that appellants underpaid their estimated tax by $1,223,961 (i.e., $1,373,961 - $150,000). Accordingly, respondent imposed an estimated tax penalty of $39,338. Although appellants previously argued that respondent's computation of the penalty did not reflect two of their timely payments in the amount of $50,000 and $80,000, the evidence shows that the respondent's computation did include these payments. Furthermore, while appellants continue to contest the computation of the estimated tax penalty, we are unpersuaded by their arguments. Appellants do not prove by the requisite preponderance of the evidence standard that respondent's computation of the estimated tax penalty was incorrect. (See Cal. Code Regs., tit. 18, § 30219(c).) Thus, our focus is on whether appellants are entitled to abatement of the estimated tax penalty.

Appellants make three main arguments, which we will discuss below: (1) in reliance on their certified public accountant (CPA), they made estimated tax payments in accordance with the prior year safe harbor rule; (2) their reliance on their CPA constitutes reasonable cause; and (3) the "unusual circumstances" in this case warrant waiver of the estimated tax penalty.

First, appellants argue that they relied upon and followed the advice from their CPA in making what he advised were timely payments. Specifically, they indicate that their CPA informed them that under the prior year safe harbor rule, for tax year 2018 appellants were required to pay 110 percent of the prior year's tax in estimated tax payments. (R&TC, § 19136(a); IRC, § 6654(d)(1)(C)(i).) They point out that this is the action they took, paying 110 percent of the prior year's tax in estimated tax payments, in reliance on their CPA's advice. But because appellants' California AGI exceeded $1 million for tax year 2018, the prior year safe harbor rule does not apply. (R&TC, § 19136.3.)

IRC section 6654(d)(1)(B)(ii) provides the prior year safe harbor rule (100 percent), but for California purposes, the prior year safe harbor rule does not apply if the taxpayer's AGI for the current year is equal to or greater than $1 million. (R&TC, § 19136.3.) Although IRC section 6654(d)(1)(C) generally modifies the prior year safe harbor if the AGI shown on the prior year return exceeds $150,000.00 (by changing 100 percent to 110 percent), it is important to note that when the taxpayer's AGI for the current year is equal to or greater than $1 million, there is no prior year safe harbor rule to modify. (R&TC, § 19136.3.)

Thus, in reviewing and analyzing the full statutory text from R&TC section 19136.3, it is clear to us that the safe harbor provision from IRC section 6654(d)(l)(C) does not apply if a

taxpayer's current year AGI is equal to or greater than $1 million. In other words, if a taxpayer's current year AGI is equal to or greater than $1 million, we are left with the current year safe harbor rule, meaning that to avoid the penalty, such a taxpayer must make a required annual payment of estimated tax of 90 percent of the tax shown on the current year tax return.

Second, appellants' reliance argument also includes assertions that reasonable cause exists for abatement of the estimated tax penalty. However, there is no general reasonable cause exception to imposing the estimated tax penalty. (*Appeal of Johnson*, 2018-OTA-119P (*Johnson*); *Appeal of Scanlon*, 2018-OTA-075P; *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.)

Third, it is appellants' position that they demonstrated "unusual circumstances" to warrant waiver of the estimated tax penalty. 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 grounds by which the addition to tax may be waived. Arguing under the first ground only (i.e., IRC, § 6654(e)(3)(A)), appellants indicate that respondent 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."[4] Appellants ask us "to consider this matter under the category of 'other unusual circumstances' as it is narrower than just reasonable cause or a lack of willful neglect." They argue that imposing the estimated tax penalty when they acted in good faith by seeking and following their CPA's advice "is against equity and good conscience and therefore should satisfy the limited waiver provisions of IRC section 6654(e)(3)(A)." We disagree.

The phrase "casualty, disaster, or other unusual circumstances" from IRC section 6654(e)(3)(A) 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*.) As OTA indicated in *Johnson*, *supra*, where specific words

[4] Under the second ground (i.e., IRC section 6654(e)(3)(B)), the addition to tax may be waived if respondent 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. We will not discuss this second provision because appellants provide no evidence or argument that one of them either retired after having attained age 62 or became disabled during the applicable tax year (2018) or the preceding year (2017).

("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. (See also *Sterling Park, L.P. v. City of Palo Alto* (2013) 57 Cal.4th 1193, 1202; *Martin v. Holiday Inns, Inc.* (1988) 199 Cal.App.3d 1434, 1437-1438; Civ. Code, § 3534 ["Particular expressions qualify those which are general"].) 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. (*Johnson*, *supra*.)

While we do not foreclose the possibility that other types of unusual circumstances might fall within this provision, the statutory context suggests that reliance on a CPA, tax preparer, or other agent to properly compute tax is not the type of event that the statutory phrase "casualty, disaster, or other unusual circumstances" was intended to cover. Therefore, we find that imposing the estimated tax penalty on tax that was due does not offend "equity and good conscience."

HOLDING

Appellants did not show that they are entitled to abatement of the estimated tax penalty.

DISPOSITION

We sustain respondent's denial of appellants' claim for refund.

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Alberto T. Rosas
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Alberto T. Rosas
Administrative Law Judge

We concur:

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Keith T. Long
Administrative Law Judge

DocuSigned by:
Amanda Vassigh
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Amanda Vassigh
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Date Issued: 8/3/2021