

**OFFICE OF TAX APPEALS
STATE OF CALIFORNIA**

In the Matter of the Appeal of:

**R. SCHNEIDER AND
P. SCHNEIDER**

) OTA Case No. 21037329
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OPINION

Representing the Parties:

For Appellants:

Michelle Y. Gavigan, CPA

For Respondent:

Nathan H. Hall, Tax Counsel III

For Office of Tax Appeals:

Duy Truong, Graduate Student Assistant

A. LONG, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19324, R. Schneider and P. Schneider (appellants) appeal an action by respondent Franchise Tax Board (FTB) denying appellants’ claim for refund of a late payment of \$9,179 and an estimated tax penalty of \$3,242 for the 2017 tax year.

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

ISSUES

1. Whether appellants have established reasonable cause to abate the late payment penalty.
2. Whether appellants have demonstrated that they are entitled to abate the estimated tax penalty.

FACTUAL FINDINGS

1. On August 31, 2018, appellants filed their California income tax return for the 2017 tax year. Appellants reported estimated payments of \$5,000 and included a Schedule K-1 from SCI Waterstone-Caribbean Fund LLC (SCI Waterstone), which reports total gain of \$1,131,155 and distributions totaling \$632,005. Appellants self-assessed a late payment

penalty of \$9,179 and an estimated tax penalty of \$3,242. Appellants paid the tax and penalties with their return.

2. Appellants filed a refund claim with FTB for a refund of the late payment penalty and the estimated tax penalty, which FTB denied. This timely appeal followed.

DISCUSSION

Issue 1: Whether appellants have established reasonable cause to abate the late payment penalty.

A late payment penalty is imposed when a taxpayer fails to pay the amount shown as due on the return on or before the due date of the return. (R&TC, § 19132.) However, a late payment penalty will be abated if the taxpayers show that the late payment was due to reasonable cause and not due to willful neglect. (R&TC, § 19132(a).) Generally, to establish reasonable cause, the taxpayers must show that the failure to timely pay occurred despite the exercise of ordinary business care and prudence. (*Appeal of Moren*, 2019-OTA-176P.)

The taxpayers' claim that a late payment was due to a lack of documentation or information, or difficulty calculating a tax liability, does not establish reasonable cause for the late payment. (*Appeal of Moren, supra.*) Unsupported assertions are insufficient to satisfy the taxpayers' burden of proof. (*Ibid.*) A determination of whether there is reasonable cause for a late payment is based upon what the taxpayers knew or should have known as the payment due date approached, and what they did or failed to do to obtain the required information. (*Ibid.*) The taxpayers must have exercised ordinary business care and prudence of the type that would have been exercised by an ordinarily intelligent and prudent businessperson under the circumstances. (*Ibid.*)

Here, appellants claim that a substantial amount of their 2017 tax liability stems from a Schedule K-1 from SCI Waterstone that was not sent to them until August of 2018. Appellants assert that WCI Waterstone is an investment firm that filed for bankruptcy in 2009, and the bankruptcy case did not conclude until 2020. Appellants note that they filed a timely tax return in August 2018, soon after they received the Schedule K-1, and fully paid the tax due at that time. Appellants contend that given the complexity of the transaction, appellants could not "surmise there would be an extra nearly half million dollars of income" and there was no reasonable basis to make such a guess.

However, appellants' asserted lack of documentation or difficulty in calculating a tax liability does not, by itself, constitute reasonable cause for a late payment of tax. (*Appeal of*

Moren, supra.) Appellants must show the efforts made to acquire that information from the source that held it. (*Ibid.* [taxpayer established reasonable cause to abate failure to pay penalty by showing numerous unsuccessful attempts made to obtain Schedule K-1 information from a partnership].) Although appellants provide email correspondence with their accountant from 2021 as evidence that they inquired about the K-1, the emails do not indicate whether any inquiries were made when the payment was due (April 15, 2018).

Additionally, appellants' difficulty in determining income with exactitude does not negate the requirement that taxpayers make payments of tax based upon a reasonably accurate estimate of their tax liability. (*Appeal of Rougeau*, 2021-OTA-335P.) There is no dispute that the 2017 tax year was an outlier when compared to appellants' previous tax years. However, appellants received distributions in 2017 totaling \$632,005, which appellants acknowledge, but only made estimated payments totaling \$5,000. Even if appellants could not estimate the capital gains in excess of \$1 million, there is no indication in the record that appellants made any effort to estimate their tax liability with the information they had on April 15, 2018, and make a timely payment accordingly.

Appellants point to their history of timely filing compliance as grounds for abatement of the penalty and addition to tax, and note that the IRS abated the federal failure to pay penalty for the same item. Appellants request for OTA to use discretion in their appeal and to abate the penalty. The IRS administers a program called "First Time Abate" under which the IRS may administratively abate the late payment penalty if taxpayers have timely filed returns and paid taxes due for the past three years. Neither the California Legislature nor the FTB has adopted a comparable penalty abatement program affecting the 2017 tax year. As such, OTA has no authority to grant relief except where the law specifically allows.¹ (See *Appeal of Estate of Gillespie*, 2018-OTA-052P.)

Issue 2: Whether appellants have demonstrated that they are entitled to an abatement of the estimated tax penalty.

Internal Revenue Code (IRC) section 6654 imposes an addition to tax, which is treated and often referred to as a penalty, when taxpayers fail to timely pay estimated tax. Subject to certain exceptions not relevant to the issues on appeal, R&TC section 19136 incorporates IRC

¹ R&TC section 19132.5 allows for the abatement of an individual's first-time timeliness penalties. However, that section only applies to tax years beginning on or after January 1, 2022. (R&TC, § 19132.5(a)(1), (f).)

section 6654. The estimated tax penalty is similar to an interest charge in that it is calculated by applying the applicable interest rate to the underpaid estimated tax. (See R&TC, § 19136(b).) There is no general reasonable cause exception for the estimated tax penalty. (*Appeal of Johnson*, 2018-OTA-119P.) The estimated tax penalty is mandatory unless the taxpayer establishes that a statutory exception applies. (*Ibid.*)

Appellants assert that they “found themselves in an unusual circumstance in which they otherwise would not normally be in.” IRC section 6654(e)(3)(A) provides a limited exception to waive the penalty if, by reason of casualty, disaster, or other unusual circumstances, imposing the penalty would be against equity and good conscience.² 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 inequitable to impose the estimated tax penalty. (*Appeal of Johnson, supra.*) Generally, a large financial gain is not the type of unexpected event qualifying for relief. (*Ibid.*) Rather, the estimated tax penalty has been waived in situations “where a tax law change, disaster, required accounting method change, or a Government action or inaction caused extreme difficulty in estimating the tax.” (*Appeal of Mazdyasni*, 2018-OTA-049P.) A financial transaction, however, no matter how complex, is not an unusual circumstance warranting penalty abatement. (*Ibid.*) Thus, appellants have not established that their failure to make timely estimated tax payments was due to casualty, disaster, or other unusual circumstance and that the penalty would be against equity and good conscience sufficient to warrant a penalty waiver.

² IRC section 6654(e)(3)(B) also provides for the waiver of the penalty if the underpayment was due to reasonable cause and not to willful neglect, but only for individuals who retired after attaining the age of 62 in the tax year or who became disabled in the tax year. Appellants do not contend, and the appeal record does not indicate, that either appellant retired or became disabled during 2017.

HOLDINGS

1. Appellants have not established reasonable cause to abate the late payment penalty.
2. Appellants have not demonstrated that they are entitled to an abate the estimated tax penalty.

DISPOSITION

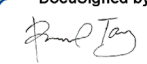
FTB’s actions in denying appellants’ claim for refund is sustained.

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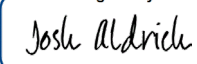
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 Andrea L.H. Long
 Administrative Law Judge

We concur:

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 Richard Tay
 Administrative Law Judge

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 Josh Aldrich
 Administrative Law Judge

Date Issued: 10/31/2022