

OFFICE OF TAX APPEALS
STATE OF CALIFORNIA

In the Matter of the Appeal of:) OTA Case No. 221212144
P. RIVE AND)
N. DVORAK)
_____)

OPINION

Representing the Parties:

For Appellant: John T. Advani, CPA
For Respondent: Camille Dixon, Tax Counsel

A. KLETTER, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19324, P. Rive and N. Dvorak (appellants) appeal an action by respondent Franchise Tax Board (FTB) denying appellants' claim for refund of \$56,818 for the 2020 tax year.

Appellants waived the right to an oral hearing; therefore, the Office of Tax Appeals (OTA) decides this matter based on the written record.

ISSUE

Whether the penalty for underpayment of estimated tax (estimated tax penalty) can be waived or abated.

FACTUAL FINDINGS

1. Appellants timely remitted estimated tax payments totaling \$15,652,341 through the third quarter of the 2020 tax year. On May 1, 2021, appellants remitted an extension payment of \$10,200,000 for the 2020 tax year.
2. Appellants timely filed their joint 2020 California Resident Income Tax Return (return) by the extended due date. Appellants' adjusted gross income (AGI) reported on their return exceeded \$1 million. Appellants' 2020 return showed a \$25,926,081 tax liability. Appellants attached FTB Form 5805, Underpayment of Estimated Tax by Individuals and

- Fiduciaries, and self-assessed a \$1 estimated tax penalty pursuant to the annualized income installment method.
3. FTB subsequently issued appellants a Notice of Tax Return Change – Revised Balance proposing to assess a \$56,818 estimated tax penalty, plus interest.
 4. Appellants later paid the amount due and filed a claim for refund of the estimated tax penalty.
 5. On October 4, 2022, FTB issued a Notice of Action denying appellants’ claim for refund.
 6. This timely appeal followed.

DISCUSSION

Except as otherwise provided, R&TC section 19136 conforms to Internal Revenue Code (IRC) section 6654 and imposes an addition to tax, which is treated as and often referred to as a penalty, where taxpayers fail to timely pay estimated tax.¹ 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 IRC, § 6654(a); R&TC, § 19136(b); *Appeal of Johnson*, 2018-OTA-119P.)

For the 2020 tax year, appellants’ AGI exceeded \$1 million and therefore the required annual payment was 90 percent of the tax shown on the current year return. (R&TC, § 19136.3.) Appellants’ tax liability shown on the 2020 tax return was \$25,926,081.00, and the required annual payment was therefore \$23,333,472.90. Here, appellants underpaid their fourth quarter estimated payment by \$7,681,131.90 ($\$23,333,472.90 - \$15,652,341.00 = \$7,681,131.90$). FTB therefore properly imposed an estimated tax penalty of \$56,818.00 on the underpayment.

Appellants do not contest the imposition or computation of the estimated tax penalty. Instead, appellants present reasonable cause arguments for abatement of the estimated tax penalty. However, 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. (*Appeal of Saltzman*,

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 prior to April 15 and June 15 of the applicable tax year, and January 15 of the subsequent tax year. For federal income tax purposes, an additional installment is also due by September 15 of the applicable tax year.

Due to the COVID-19 pandemic, FTB postponed the 2020 first and second quarter estimated tax payment deadline to July 15, 2020. (See *State Postpones Tax Deadlines until July 15 Due to the COVID-19 Pandemic*, March 18, 2020, available at: <https://www.ftb.ca.gov/about-ftb/newsroom/news-releases/2020-3-state-postpones-tax-deadlines-until-july-15-due-to-the-covid-19-pandemic.html>.) The third and fourth quarter estimated tax payment deadlines were not postponed.

2019-OTA-070P.) As a result, there is no general reasonable cause exception to the imposition of the estimated tax penalty, and the estimated tax penalty imposed under IRC section 6654 is mandatory unless taxpayers establish that a statutory exception applies. (*Ibid.*; *Appeal of Scanlon*, 2018-OTA-075P.) 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.”² The exception for unusual circumstances is considerably narrower than reasonable cause. (*Appeal of Mazdyasni*, 2018-OTA-049P.)

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 estimated tax penalty. (*Appeal of Saltzman, supra.*) Examples of circumstances that warrant waiver of the estimated tax penalty include: the taxpayer’s books and records were destroyed by fire or other casualty; an estimated tax payment was not made due to the death or serious illness of the taxpayer; imposition of the penalty would be inequitable because, for example, the taxpayer substantially overstated their tax liability on their return or because the taxpayer designated that an overpayment of prior year tax be credited against their estimated tax, but the overpayment is offset for either past-due child support or non-tax federal debt under IRC section 6402(c) or (d), and the taxpayer was not notified of the offset until after the estimated tax payment due date. (*Appeal of Mazdyasni, supra.*) The IRS has waived the estimated tax penalty in situations where a tax law change, disaster, required accounting method change, or Government action or inaction, caused extreme difficulty in estimating the tax. (*Ibid.*)

Several cases have considered whether unusual circumstances warranted waiver under IRC section 6654(e)(3)(B) of the estimated tax penalty. In *Farhoumand v. Commissioner*, T.C. Memo. 2012-131, the tax court determined that stock market volatility was not an unusual circumstance justifying waiver of the estimated tax penalty. In *Appeal of Johnson, supra*, OTA held that unexpected real estate capital gains income from the sale of property was not an unusual circumstance justifying waiver of the estimated tax penalty. In *Appeal of Mazdyasni*,

² IRC section 6654(e)(3)(B) provides that FTB may waive the tax where it determines that (i) during the tax year for which the estimated payments were required to be made, 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 willful neglect. Appellants have not alleged that this exception applies; therefore, this Opinion will not discuss the exception further.

supra, and *Appeal of Saltzman, supra*, OTA held that neither difficulty in estimating partnership income, nor the unexpected receipt of partnership payment were unusual circumstances justifying waiver of the estimated tax penalty. Each one of these cases consistently held that the taxpayer's good faith, or that the taxpayer acted reasonably under the circumstances, are not relevant circumstances to waiver under IRC section 6654(e)(3)(B) because that section does not permit abatement of the estimated tax penalty solely based on reasonable cause.

On appeal, appellants request abatement of the estimated tax penalty for reasonable cause. Appellants also describe facts which illustrate that they acted in good faith in understating their fourth quarter payment due date, namely, that appellant P. Rive's 2020 year-end tax summary was provided in December by Merrill Lynch to appellants and their tax preparer inadvertently excluded transactions with significant gain.³ However, as outlined above, the taxpayer's good faith, or that the taxpayer acted reasonably under the circumstances, are not relevant to waiver under IRC section 6654(e)(3)(B). (*Appeal of Mazdyasni, supra; Appeal of Saltzman, supra.*)

Appellants have not established why they would have no reason or ability to know about the transaction or that they did not have sufficient time to calculate and pay with reasonable accuracy the final estimated tax payment. (*Appeal of Mazdyasni, supra.*) Appellants do not dispute their tax liability or that estimated tax payments were due. Difficulty in estimating the tax is not an unusual circumstance for purposes of penalty abatement within the meaning of IRC section 6654(e). (*Ibid.*) Rather than suffering an unexpected hardship, appellants received a substantial gain on their transactions. (See *Appeal of Saltzman, supra.*) Thus, imposing an interest charge on tax due on appellants' gain does not offend "equity and good conscience." (*Ibid.*)

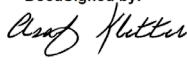
³ Appellants' claim for refund references the sale of a substantial amount of Tesla shares for which the cost basis was missing and hence excluded by Merrill Lynch's internal system from the Form 1099. Appellants included a June 3, 2022 letter from Merrill Lynch supporting the underreporting of estimate gains for the 2020 tax year. OTA notes that the letter (1) references underreported 2021 estimated gains, not 2020, as appellants assert, and (2) references a corrected 2020 IRS consolidated Form 1099 which was not attached.

HOLDING

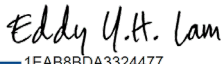
The estimated tax penalty cannot be waived or abated.

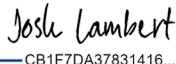
DISPOSITION

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

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Asaf Kletter
Administrative Law Judge

We concur:

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Eddy Y.H. Lam
Administrative Law Judge

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Josh Lambert
Administrative Law Judge

Date Issued: 6/7/2023