

OFFICE OF TAX APPEALS
STATE OF CALIFORNIA

In the Matter of the Appeal of:)
S. WARD) OTA Case No. 231014491
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OPINION

Representing the Parties:

For Appellant: S. Ward
For Respondent: Camille Dixon, Attorney

A. KLETTER, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19324, S. Ward (appellant) appeals an action by respondent Franchise Tax Board (FTB) denying appellant’s claim for refund of \$125,413 plus applicable interest for the 2021 tax year.

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

ISSUES

1. Whether appellant has shown reasonable cause to abate the late payment penalty.
2. Whether appellant is entitled to interest abatement.

FACTUAL FINDINGS

1. In May 2021, appellant exercised nonqualified stock options (NSO) in a privately-held company (the Company). In September 2021, appellant sold stock in the Company.
2. Appellant timely filed a 2021 California Resident Income Tax Return (return), which reported total tax of \$1,637,602, income tax withholding of \$630,298,¹ and tax due of

¹ The total amount of withholding, \$630,298, is undisputed and reflects a small fraction of appellant’s 2021 tax liability. FTB reclassified \$610,996 of withholding as real estate and other withholding. The income for which the \$610,996 was withheld is unclear.

\$1,007,304. Appellant self-assessed interest and penalties on the return. Appellant made no payment with the return.

3. FTB accepted the return as filed. On December 8, 2022, FTB issued appellant a Notice of Tax Return Change – Revised Balance, which imposed a late payment penalty and interest and showed a balance due.
4. On July 14, 2023, appellant fully satisfied the balance due. Appellant filed a claim for refund of the late payment penalty and interest.
5. On August 28, 2023, FTB denied appellant’s claim for refund.
6. This timely appeal followed. Appellant provides an email thread with their ex-husband (E), allegedly the CEO of the Company, which contains the following exchange in January 2021:

[Appellant]: With [the Company], will there only be certain periods where folks can sell, or is it similar to the public market where it is continuous? Will it allow same-day exercise/sell transactions, or will I still have to hold for 6 months?

[E]: It is not like public markets where it is continuous. There will be quarterly liquidity events where you can sell certain amounts. You can only sell during those times. Right now you can only sell “mature shares” which is stock you held for six months. In the future we might be able to do same-day exercise/sell but it is unlikely to happen until 2022 at the earliest.

DISCUSSION

Issue 1: Whether appellant has shown reasonable cause to abate the late payment penalty.

R&TC section 19132(a) imposes a late payment penalty when a taxpayer fails to pay the amount shown as due on the return by the date prescribed for the payment of tax. Generally, the date prescribed for the payment of tax is the due date of the return (without regard to extensions of time for filing). (R&TC, § 19001.) Here, FTB properly imposed the late payment penalty because the payment due date was April 15, 2022, and appellant did not satisfy the 2021 tax liability until July 14, 2023, over a year later. Appellant does not dispute the imposition or calculation of the penalty.

The late payment penalty may be abated if the taxpayer shows that the failure to make a timely payment of tax was due to reasonable cause and not due to willful neglect. (R&TC, § 19132(a)(1).) To establish reasonable cause for the late payment of tax, a taxpayer must show

that the failure to make a timely payment of the proper amount of tax occurred despite the exercise of ordinary business care and prudence. (*Appeal of Moren*, 2019-OTA-176P.) The taxpayer bears the burden of proving that an ordinarily intelligent and prudent businessperson would have acted similarly under the circumstances. (*Ibid.*) As to appellant's burden, the applicable standard of proof is by a preponderance of the evidence. (Cal. Code Regs., tit. 18, § 30219(b).) Unsupported assertions are insufficient to satisfy a taxpayer's burden of proof. (*Appeal of Moren*, *supra.*)

Appellant alleges that the sale of stock in the Company generated most of the tax liability for the 2021 tax year, which appellant untimely paid. Appellant also asserts that the remaining unpaid tax liability arose from appellant's NSO exercise in May 2021. Appellant asserts reasonable cause for the late payment of tax. Concerning appellant's NSO exercise, appellant claims that the Company significantly under-withheld California income tax on the transaction. Concerning the sale of stock, appellant further claims that appellant used the gains to buy a home, and that despite appellant's intention to sell additional shares of stock in the Company to pay the tax liability, appellant was unable to sell any shares. Appellant further asserts that they did everything in their power to find liquidity, but the amount of the stock sale and under-withholding was more than they could afford. Finally, appellant further alleges a good history of tax compliance. Each basis for reasonable cause is addressed in turn below.

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 Rougeau*, 2021-OTA-335P.) A taxpayer's difficulty in determining income with exactitude does not negate the requirement that a taxpayer make payments of tax based upon a reasonably accurate estimate of their tax liability. (*Ibid.*) A taxpayer must establish that they could not have acquired the information necessary to make an estimate of their tax liability. (*Ibid.*) Concerning the NSO exercise, appellant exercised the NSO as early as May 2021, eleven months before their tax return was due. Appellant provides no facts or evidence to show that appellant could not acquire the necessary information to reasonably estimate (or timely correct) the tax withholding on the income. Accordingly, appellant has not met their burden of proof. (*Appeal of Moren*, *supra.*)

Concerning the September 2021 sale of stock in the Company, appellant explains that they used the proceeds as a down payment to buy a house. Appellant claims that E, the alleged CEO of Company, falsely informed appellant that the Company will provide opportunities for shareholders to sell shares every quarter, and that appellant relied on that statement. Appellant further claims that they planned to sell additional shares in the Company in the next quarter's liquidity event and use the proceeds to pay the tax obligation from the September sale; however, future quarterly events did not happen, and appellant asserts that they unsuccessfully tried to sell additional shares in the Company through other means. Appellant further asserts that as a result, appellant was required to sell their home in May 2023, to pay the tax obligations. As noted above, appellant asserts that the September 2021 sale of stock generated most of the 2021 tax liability. Accordingly, as early as the date of sale, appellant acquired the necessary information to make a reasonably accurate estimate of their 2021 tax liability and make a timely payment accordingly. (See *Appeal of Rougeau, supra.*)

Appellant claims that they relied on future liquidity events purportedly promised by the Company to pay the tax obligation from the stock sale, which did not ultimately happen. However, appellant explains that the Company was not publicly traded. Moreover, E's statements in the January 2021 email exchange indicate that the stock was subject to significant liquidity restrictions, because selling was not continuous, only certain amounts could be sold, and only stock with a holding period of six months or more could be sold.² Additionally, the exchange indicates that the stock was subject to significant price fluctuation. Regardless of appellant's expectations, appellant was unable to sell stock before the payment due date. It requires no special training or effort to ascertain a deadline and make sure that it is met, and a taxpayer has a personal obligation to meet statutory deadlines. (See *United States v. Boyle* (1985) 469 U.S. 241, 251-252.) An ordinarily intelligent and prudent businessperson acting similarly under the circumstances, upon realizing that the liquidity events would not allow for a timely payment, would arrange for another option to timely pay the tax due and ensure the

² While appellant asserts that some or all of E's statements were false or miscommunications, appellant does not assert, let alone provide evidence, to show that an ordinarily intelligent and prudent businessperson acting similarly under the circumstances would continue to rely on the liquidity events to timely pay the tax due. (See *Appeal of Rougeau, supra.*) Moreover, on appeal, appellant explains that the Company blocked third party offers to buy their stock in the secondary market, and the board of directors denied appellant's request for the Company to buy back their shares or allow a transaction. Despite becoming aware that the stock could not be sold, appellant did not arrange for another option to pay the tax due and ensure that the deadline was met.

deadline was met. (See *Appeal of Rougeau, supra.*) Therefore, appellant's reliance on the anticipated liquidity events is not reasonable cause for failing to make a timely payment of tax for the 2021 tax year.

Appellant also alleges financial difficulties, including a lack of liquidity to pay their tax liabilities. A failure to pay will be considered due to reasonable cause to the extent the taxpayer has made a satisfactory showing that they exercised ordinary business care and prudence in providing for payment of their tax liability and was nevertheless either unable to pay the tax or would suffer an undue hardship if they paid on the due date. (Treas. Reg. § 301.6651-1(c)(1).) All the facts and circumstances will be considered, including the amount and nature of the taxpayer's expenditures in light of the income (or other amounts) they could, at the time of such expenditures, reasonably expect to receive prior to the date prescribed for the payment of the tax. (*Ibid.*; *Appeal of Rougeau, supra.*) An undue hardship is not merely a general statement of hardship; it is more than an inconvenience to the taxpayer and it must appear that substantial financial loss, for example, due to the sale of the property at a sacrifice price, will result to the taxpayer for making payment on the due date. (Treas. Reg. § 1.16161-1(b).) If a market exists, the sale of property at the current market price is not ordinarily considered as resulting in an undue hardship. (*Ibid.*)

Here, appellant has not met their burden to prove reasonable cause to abate the late payment penalty. Appellant asserts that they did everything in their power to find liquidity, but appellant was in control of the timing and amount of the NSO exercise and stock sale, and has not shown what effort, if any, they made to conserve a sufficient portion of the income for California taxes. (See *Appeal of Rougeau, supra.*) The record shows that appellant's withholding was a fraction of the total tax liability. As such, appellant failed to ensure sufficient funds were conserved to pay the tax that would be owed. As described above, appellant has also not established that it was reasonable to rely on liquidity events on uncertain dates and for uncertain amounts to make a timely payment.

Appellant expended the income from the stock sale to buy a home,³ and pursuant to Treasury Regulation section 301.6651-1(c)(1), appellant has not demonstrated what income (other than the liquidity events addressed above), they reasonably could have expected at the

³ Appellant has not explained the amount or use of the income from their NSO exercise, so only the stock sale is addressed above.

time of the expenditure to pay the tax liability. Moreover, real estate is an illiquid asset; a taxpayer who invests funds in illiquid assets has not exercised ordinary business care and prudence in providing for the payment of the tax liability unless, at the time of the investment, the remainder of the taxpayer's assets and estimated income will be sufficient to pay the tax, or it can reasonably be foreseen that the illiquid investment can be utilized (by sale or as security for a loan) to realize sufficient funds to satisfy the tax liability. (*Appeal of Rougeau, supra*, citing Treas. Reg. § 301.6651(c)(1).) Appellant has not shown what assets remained in their possession, or that their estimated income was at the time appellant used the stock sale proceeds as a downpayment on the house, let alone whether those amounts were sufficient to pay the tax, nor has appellant demonstrated that they attempted to leverage the home to realize sufficient funds to satisfy the tax liability prior to April 15, 2022. (See *Appeal of Rougeau, supra*.)

Appellant has not asserted or provided evidence that they would have suffered undue hardship if a timely tax payment was made. Appellant has also not asserted that they would have been required to sell their home at a sacrifice price to pay the tax due. As a market existed for appellant's home, the sale of property at the current market price is not ordinarily considered an undue hardship. (Treas. Reg. § 1.16161-1(b).) Lacking evidence upon which to base a finding of undue hardship, no basis for relief has been shown.

Finally, appellant claims this is the first time they were unable to timely pay their tax obligation because of the circumstances and asserts a long history of timely tax payment. However, while the IRS has a penalty abatement program called First Time Abate, neither the California legislature nor FTB adopted a comparable penalty abatement program for the 2021 tax year.⁴ Therefore, no relief is available on this basis.

Issue 2: Whether appellant is entitled to interest abatement.

Interest must be assessed from the date a tax payment is due through the date that it is paid. (R&TC, § 19101(a).) Imposing interest is mandatory; it is not a penalty, but it is compensation for appellant's use of money after it should have been paid to the state. (*Appeal of Moy, 2019-OTA-057P.*) Generally, to obtain relief from interest, a taxpayer must qualify under

⁴ R&TC section 19132.5, effective for tax years beginning on or after January 1, 2022, allows an individual taxpayer to request a one-time abatement of a timeliness penalty. This provision is inapplicable to the 2021 tax year at issue here. (R&TC, § 19132.5(f).)


R&TC section 19104 or 21012.⁵ (*Ibid.*) Appellant does not allege, and the evidence does not show, that either statutory provision for interest abatement applies to the facts of this case. R&TC section 19104 does not apply here because appellant does not allege, and the evidence does not show, that the interest is attributable in whole or in part, to any unreasonable error or delay by an FTB employee. R&TC section 21012 does not apply because FTB did not provide appellant with any requested written advice. Therefore, FTB properly imposed interest and there is no basis to abate it.

HOLDINGS

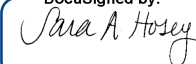
1. Appellant has not shown reasonable cause to abate the late payment penalty.
2. Appellant is not entitled to interest abatement.

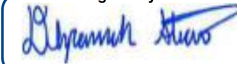
DISPOSITION

FTB’s action denying appellant’s claim for refund is sustained.

DocuSigned by:

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Asaf Kletter
Administrative Law Judge

We concur:

DocuSigned by:

6D3FE4A0CA514E7
Sara A. Hosey
Administrative Law Judge

DocuSigned by:

43F5DCA21D8D46B... For
Lauren Katagihara
Administrative Law Judge

Date Issued: 7/29/2024

⁵ Under R&TC section 19112, FTB may waive *unpaid* interest for any period for which FTB determines that an individual or fiduciary is unable to pay interest due to extreme financial hardship. However, appellant has paid the interest in this appeal. Moreover, OTA does not have authority to review FTB’s denial of a request to waive interest under R&TC section 19112. (*Appeal of Moy, supra.*)