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7 **BOARD OF EQUALIZATION**
8 **STATE OF CALIFORNIA**

10 In the Matter of the Appeal of:) **HEARING SUMMARY**
11) **PERSONAL INCOME TAX APPEAL**
12 **THOMAS L. CANTOR AND**) Case No. 597487
13 **CHERYL A. CANTOR¹**)

14
15 Year
16 2009

Claim
For Refund
\$51,503

17 Representing the Parties:

18 For Appellants: Melody S. Thornton, CPA
19 For Franchise Tax Board: Christopher T. Tuttle, Graduate Legal Assistant
20

21 **QUESTION:** Whether appellants have demonstrated that they are entitled to a refund of the
22 underpayment of estimated tax penalty.

23 HEARING SUMMARY

24 Background

25 *Qui tam Lawsuit*

26 In the late 1990s, appellant-husband (a biochemist) became aware of complaints from
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28 ¹ Appellants reside in San Diego County, California.

1 doctors about the use of medical test kits named Advantage Intact Parathyroid Hormone Assay (medical
2 test kit), which were manufactured by Nicholas Institute Diagnostics (NID), a subsidiary of Quest
3 Diagnostics. (Appeal Letter (AL), p. 1.) The medical test kits were used by doctors to determine
4 treatment for dialysis patients who suffered from End State Renal Disease. (*Id.*)

5 Using his own time, appellant-husband determined that the medical test kits were not
6 accurate and were giving false readings. (*Id.*) Because doctors were using the medical test kits to
7 determine treatment for dialysis patients, the false readings were allegedly leading to unnecessary
8 surgeries. (*Id.*)

9 In 2004, appellant-husband, with the assistance of the law firm of Phillips & Cohen,
10 filed a qui tam lawsuit alleging that NID was defrauding the government by causing healthcare
11 providers to bill Medicare and other federal healthcare programs for medical tests and unnecessary
12 surgeries, as well as for unnecessary and harmful vitamin D drugs to treat inaccurately diagnosed
13 diseases. (*Id.*) In response, a governmental investigation was conducted. As a result of governmental
14 investigation, Quest Diagnostics shut down NID in 2006. (*Id.*)

15 In 2009, appellant-husband was granted three whistleblower awards. The qui tam
16 settlement from the federal government netted \$27,938,613 and the two state settlements totaled
17 \$3,230,945. (*Id.* p. 2.)

18 *Appellants' return*

19 Appellants filed a timely 2009 California income tax return with the Franchise Tax
20 Board (FTB or respondent) on April 15, 2010, reporting, among other things, a federal adjusted gross
21 income (AGI) of \$32,088,924, a California AGI of \$32,079,222, a California taxable income of
22 \$31,647,973, withholdings of \$44,203, and estimated tax payments of \$3,272,400. (FTB opening brief
23 (FTB OB), Ex. A.)

24 After reviewing appellants' 2009 return, the FTB determined that appellants failed to
25 make full and timely 2009 California estimated income tax payments. (FTB OB, p. 2.) The FTB's
26 records show that appellants made the following payments (and/or have the following credits) for the
27 2009 tax year:

28 ///

Item	Effective Date	Payment/Credit
Estimated payment	April 15, 2009	\$8,003.00
Estimated payment	June 8, 2009	\$30,000.00
Estimated payment	Sept. 15, 2009	\$12,700.00
Estimated payment	Dec. 23, 2009	\$3,210,700.00
Estimated payment	April 13, 2010	\$8,455.00
Withholdings	April 15, 2010	\$44,203.00
Interest allowance amt.	September 21, 2010	\$16.13
Bill payment	Nov. 10, 2010	\$10,977.00

On October 4, 2010, the FTB sent appellants a Return Information Notice, setting forth an underpayment of estimated tax penalty of \$58,527.81, plus interest.² (*Id.*)

In response, appellants' certified public accountant (CPA) sent the FTB a letter dated October 28, 2010, asserting that she gave appellants incorrect advice in relation to their 2009 estimated income tax payments and requesting that the underpayment of estimated tax penalty be abated for reasonable cause:

The law regarding estimated tax payments for individuals with AGI over \$1,000,000 was enacted in September 2008 and effective for years beginning on or after January 1, 2009. I am a CPA and have prepared tax returns for more than 20 years. During the years 2006-2009 (sic) I served on the State Tax Committee of the California Society of CPAs because it is important to me to be knowledgeable about the tax laws. I knew of the 2008 law change and I forgot about it.

The client sent me an email asking me how to calculate much (sic) the taxes would be so that the correct estimate amount would be paid. I have included copies of the taxpayer's (sic) question and my reply in which I correctly stated that the taxpayers should follow the safe harbor method.

This was not an intentional disregard of the law and I respectfully request that the penalty be abated for reasonable cause. (FTB OB, p.2 & Ex. D.)

Subsequently, appellants remitted full payment on November 10, 2010. (FTB OB, p. 2.) Afterwards,

² The FTB states that it initially overstated the underpayment of estimated tax penalty to be \$58,527.81. However, the FTB asserts in footnote 1 of its opening brief that upon further consideration of appellants' claim for refund, it subsequently adopted appellants' determination that the underpayment of estimated tax penalty totaled \$51,503. Furthermore, the FTB states that it refunded the difference.

1 appellants submitted a timely claim for refund on June 7, 2011. When the FTB denied appellants' claim
2 for refund on October 6, 2011, appellants filed this timely appeal. (*Id.*)

3 Contentions

4 Appellants

5 Appellants concede that they did not make the required estimated tax payments for the
6 2009 tax year in a timely manner. (AL, pp. 1-2 & FTB OB, Ex. D.) Appellants argue, however, that
7 the FTB should refund the underpayment of estimated tax penalty on the basis of reasonable cause.
8 (AL, p. 2.) Specifically, appellants assert that (i) their receipt of the settlement proceeds was a one-time
9 occurrence and they otherwise have a good payment history, and (ii) their late payment of estimated tax
10 was not done intentionally, as they sought the advice of their accountant and were given incorrect
11 information. (AL, p. 2 & FTB OB, Ex. D.)

12 The FTB

13 The FTB asserts that it properly imposed the underpayment of estimated tax penalty and
14 appellants have not shown they are entitled to relief from that penalty. (FTB OB, pp. 2-4.)

15 First, the FTB argues that appellants did not make the required estimated tax payments in
16 a timely manner. (*Id.*) As for the timing of the estimated tax payments, the FTB notes that under
17 Internal Revenue Code (IRC) section 6654—which is generally incorporated by Revenue and Taxation
18 Code (R&TC) section 19136, with specific modifications—the required estimated tax payments are
19 generally due on April 15, June 15, and September 15 of the taxable year, and January 15 of the
20 succeeding taxable year. (Int. Rev. Code, § 6654; Rev. & Tax Code, § 19136.) (FTB OB, p. 2.) Next,
21 as for the dollar amount of each estimated tax payment, IRC section 6654(d)(1) provides that (A) the
22 amount of any installment shall be 25 percent of the “required annual payment,” and (B) the “required
23 annual payment” is defined as the lesser of (i) 90 percent of the tax shown on the return for the taxable
24 year, or (ii) 100 percent of the tax shown on the return of the individual for the preceding taxable year.
25 The FTB asserts, however, that R&TC section 19136.3 modifies IRC section 6654(d)(1) for tax years
26 beginning on January 1, 2009, in that it removes the option of paying 100 percent of the tax for the
27 preceding taxable year when the AGI of the individual for the taxable year is equal to or greater than
28 \$1 million. (*Id.* p. 3.) As to the facts at hand, the FTB contends that because appellants' AGI for the

1 2009 tax year was \$32,079,222, they exceeded the \$1 million threshold and, thus, they did not have the
2 option of paying 100 percent of the tax for the preceding taxable year. (*Id.*) The FTB contends that
3 based on the payment/credit history set forth above, appellants did not make their required estimated tax
4 payments in a timely manner. (*Id.*)

5 Second, the FTB asserts that the underpayment of estimated tax penalty cannot be
6 relieved upon a mere showing of reasonable cause, citing *Appeal of Geroge A. and Jean D. McEwen*,
7 85-SBE-091, decided on Aug. 20, 1985. (*Id.* p. 2.) The FTB contends, however, that there are two
8 statutory bases for waiver of the underpayment of estimated tax penalty set forth in IRC section
9 6654(e)(3), to which California conforms:

- 10 1. IRC 6654(e)(3)(A) provides for waiver of the penalty if the government determines that by
11 reason of casualty, disaster, or other unusual circumstances the imposition of the penalty
12 would be against equity and good conscience.
- 13 2. IRC section 6654(e)(3)(B) provides for waiver of the penalty if the government determines
14 that (i) underpayment was due to “reasonable cause,” and (ii) either the taxpayer retired after
15 having attained age 62, or the taxpayer became disabled in the taxable year for which
16 estimated payments were required to be made or in the previous taxable year.

17 The FTB asserts, however, that appellants have not demonstrated that they meet any of the two statutory
18 exceptions. (*Id.* p. 3.)

19 Applicable Law

20 R&TC section 19136 incorporates by reference, with certain modifications, IRC section
21 6654. Pursuant to IRC section 6654(c), a taxpayer is required to make estimated tax payments on or
22 before April 15, June 15, and September 15, of each taxable year, and by January 15 of the following
23 taxable year. (See Int.Rev. Code, § 6654 and Rev. & Tax. Code, § 19136.) If the taxpayer fails to make
24 the required payments, an underpayment of estimated tax penalty is imposed. The underpayment of
25 estimated tax penalty is mandatory pursuant to R&TC section 19136.

26 *Calculation*

27 The underestimated tax penalty is calculated by applying the “underpayment rate” to the
28 “amount of the underpayment” for the “period of underpayment.” (Int.Rev. Code, § 6654, subd. (a).)

1 For purposes of the R&TC, the “underpayment rate” is provided in R&TC section
2 19521. (Rev. & Tax Code, § 19136, subd. (b).)

3 The “amount of underpayment” is the excess of the “required installment” over the
4 amount (if any) of the installment paid on or before the due date for the installment. (Int.Rev. Code,
5 § 6654, subd. (b)(1).) IRC section 6654(d)(1) generally provides that (A) the amount of any “required
6 installment” shall be 25 percent of the “required annual payment,” and (B) the “required annual
7 payment” is defined as the lesser of (i) 90 percent of the tax shown on the return for the taxable year, or
8 (ii) 100 percent of the tax shown on the return of the individual for the preceding taxable year.

9 R&TC section 19136.1, subdivision (a)(1), modifies IRC section 6654 for tax years
10 beginning on or after January 1, 2009 (and before January 1, 2010),³ by providing that the amount of
11 required installments shall be 30 percent of the required annual payment for the first and second required
12 installments, and 20 percent of the required annual payment for the third and fourth required
13 installments.

14 R&TC section 19136.3 modifies IRC section 6654(d)(1) for tax years beginning on or
15 after January 1, 2009, in that it removes the option of paying 100 percent of the tax for the preceding
16 taxable year when the AGI of the individual for the taxable year is equal to or greater than \$1 million.

17 The “period of underpayment” runs from the due date of the installment to the lesser of
18 the due date of the return or the date of payment. (Int.Rev. Code § 6654, subd. (b)(2).)

19 *Relief from penalty*

20 Neither R&TC section 19136 nor IRC section 6654 allow for relief from the
21 underpayment of estimated tax penalty upon a mere showing of reasonable cause. Relief from the
22 penalty is not available upon a mere showing of “reasonable cause” or a “lack of willful neglect.”
23 (*Appeal of Weaver Equipment Company*, 80-SBE 048, May 21, 1980.)⁴

24 There are only two bases for waiver of the underpayment of estimated tax penalty, and
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26 _____
27 ³ R&TC section 19136.1, subdivision (a)(2), modifies IRC section 6654 for tax years beginning on or after January 1, 2010,
28 by providing that the amount of required installments shall be 30 percent of the required annual payment for the first required
installment, 40 percent of the required annual payment for the second required installment, “zero” for the third required
installment, and 30 percent of the required annual payment for the fourth required installment.

⁴ Board of Equalization cases are generally available for viewing on the Board’s website (www.boe.ca.gov).

1 these bases are set forth in IRC section 6654(e)(3), to which California conforms:

- 2 1. IRC 6654(e)(3)(A) provides for waiver of the penalty if the government determines that by
3 reason of casualty, disaster, or other unusual circumstances the imposition of the penalty
4 would be against equity and good conscience. (Emphasis supplied.)
- 5 2. IRC section 6654(e)(3)(B) provides for waiver of the penalty if the government determines
6 that (i) underpayment was due to “reasonable cause,” and (ii) either the taxpayer retired after
7 having attained age 62, or the taxpayer became disabled in the taxable year for which
8 estimated payments were required to be made or in the previous taxable year.⁵

9 In relation to IRC section 6654(e)(3)(A), the Internal Revenue Manual⁶ provides:

10 The waiver provisions of IRC section 6654(e)(3)(A) are not equivalent to reasonable
11 cause. For example, reliance on the advice of a competent tax advisor may constitute
12 reasonable cause that would warrant relief from other penalties, but it does not provide a
basis for a waiver of the estimated tax penalty under IRC section 6654(e)(3)(A). (Internal
Revenue Manual, Section 20.1.3.2.2.1.2 (March 31, 2010).)

13 The Internal Revenue Manual provides the following examples of situations where a waiver may be
14 granted if it is determined that imposition of the penalty would be against equity and good conscience:

- 15 A. The taxpayer’s records are destroyed by fire or flood or other natural disaster. . . .
16 See IRM 20.1.3.1.5.2.1.
- 17 B. The taxpayer becomes seriously ill or is seriously injured and is unable to manage
18 his affairs.
- 19 C. The taxpayer designates that an overpayment of tax shown on a prior return is to
20 be credited against estimated tax, but the overpayment is offset for either past-due
child support or non-tax federal debt under IRC section 6402(c), and the taxpayer
is not notified of the offset before the due date of the estimated tax installment.
(Internal Revenue Manual, Section 20.1.3.2.2.1.2 (March 31, 2010).)

21 In *Farhoumand v. Commissioner*, T.C. Memo 2012-131, the tax court held that stock
22 market volatility (i.e., bursting of the dot-com bubble) did not qualify as an “unusual circumstance”
23 under IRC section 6654(e)(3)(A) for purposes of waiving the underpayment of estimated tax penalty.
24 Furthermore, although the taxpayers argued that their actions constituted an “honest mistake”, the court

25 _____
26 ⁵ On appeal, appellants do not allege they retired after having attained the age of 62, or that they became disabled in the
27 taxable year for which the estimated tax payments were required; thus, IRC section 6654(e)(3)(B) is apparently not at issue in
this appeal. Thus, the focus of this appeal seems to be on IRC section 6654(e)(3)(A).

28 ⁶ Although the Internal Revenue Manual merely represents the Internal Revenue Service’s policy, rather than binding law,
staff believes it may provide helpful guidance.

1 held that the imposition of the underpayment of estimated tax penalty did not violate “equity and good
2 conscious” as that phrase is used in IRC section 6654(e)(3)(A).

3 STAFF COMMENTS

4 Appellants assert that their reliance on incorrect professional advice (in addition to their
5 good compliance history) provides reasonable cause for abatement of the underpayment of estimated
6 tax penalty. Staff is sympathetic to the factual circumstances, but the law does not permit abatement of
7 the underpayment of estimated tax penalty based on a finding of reasonable cause (unless the taxpayer
8 retired after age 62 or became disabled during the applicable period, which appellants have not alleged
9 in this appeal). (See Int.Rev. Code § 6654, subd. (e)(3)(B).)

10 As noted above, IRC 6654(e)(3)(A) provides a more limited exception to imposition of
11 the penalty where the government determines that “by reason of casualty, disaster, or other unusual
12 circumstances the imposition of such addition to tax would be against equity and good conscience.”
13 Staff is not aware, however, of any authority holding that reliance on incorrect legal advice and prior
14 good compliance may constitute a “casualty, disaster, or other unusual circumstance” that would cause
15 the imposition of the penalty to be “against equity and good conscience.” As noted above, the Internal
16 Revenue Manual states that “reliance on the advice of a competent tax advisor . . . does not provide a
17 basis for a waiver of the estimated tax penalty under IRC section 6654(e)(3)(A).” At the oral hearing,
18 appellants will want to provide argument and authority for the position that good compliance history
19 and reliance on incorrect professional advice may constitute a “casualty, disaster, or other unusual
20 circumstance” that would cause the imposition of the penalty to be “against equity and good
21 conscience.”

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