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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 **NOEL C. MCDERMOTT AND**) Case No. 506915
13 **LYNNET C. MCDERMOTT¹**)

	<u>Year</u>	<u>Claim For Refund</u>
	2007	\$6,759.50 ²

17 Representing the Parties:

19 For Appellants: Jeff Johnston, TAAP³
20 For Franchise Tax Board: Nancy E. Parker, Tax Counsel III

22 **QUESTIONS:** (1) Whether appellants have shown the late filing penalty should be abated based on
23 reasonable cause reliance on their certified public accountant (CPA); and

25 ¹ Appellants reside in Santa Cruz County, California.

26 ² This amount represents the late filing penalty. Appellants also contested the estimated tax penalty, which respondent
27 affirmed in its denial of appellants' claim for refund.

28 ³ Appellants filed their appeal letter on their own behalf. Appellants' reply brief was submitted by Rich Naish, of the Tax Appeals Assistance Program (TAAP). Appellants' current representative per the record is Jeff Johnston, from TAAP. Rob Hofmann of TAAP also assisted appellants during the briefing process.

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1 (2) Whether appellants have shown that the estimated tax penalty should be abated.⁴

2 HEARING SUMMARY

3 Background

4 Appellants made estimated payments toward the 2007 year of \$7,000 each on June 15,
5 2007; September 14, 2007; and January 15, 2008, for a total of \$21,000. (App. Reply Br., exhibit A;
6 Resp. Add'l Info, p. 1, ln. 1 and p. 2, lns. 3 & 4.)⁵ Appellants filed their 2007 tax return, prepared by
7 their CPA, on or around November 6, 2008. On the return, appellants calculated \$48,038 in tax and
8 after deducting the \$21,000 in estimated payments reported a tax due of \$27,038, plus \$3,478 in interest,
9 late return penalties, or late payment penalties.⁶ Appellants also reported an underpayment of estimated
10 tax penalty of \$498. (Resp. Op. Br., exhibit A.) Appellants attached payment of \$31,014 with their
11 return to satisfy the self-reported tax, interest, and penalty. (Resp. Add'l Info, p. 1, ln. 5.)

12 On November 24, 2008, after receiving the return and payment beyond the deadlines,
13 respondent issued a return information notice (RIN) proposing a \$6,759.50 late filing penalty and a
14 \$511.08 estimated tax penalty. (Resp. Op. Br., exhibit B, p. 5.) Appellants paid the amount shown on
15 the RIN on December 5, 2008. (*Id.* at p. 1.) On February 9, 2009, appellants filed a letter requesting a
16 refund of the \$6,759.50 late filing penalty. The letter also stated that appellants were not requesting
17 abatement of interest or the estimated tax penalty. (Resp. Op. Br., exhibit B, p. 7.) On May 5, 2009,
18 appellants sent a follow-up letter which is enclosed with their appeal letter, stating that they had not
19 received a response to their February 9, 2009 letter in which they requested abatement of the late filing
20

21 ⁴ As further discussed below, in Staff Comments, appellants should be prepared to clarify whether they are contesting the
22 estimated tax penalty. In their appeal letter, appellants refer to “the late filing and underpayment penalty” and later state, in
23 part, that they believed the estimated payments had satisfied their tax liability and believe the “penalties” should be returned
24 to them. In its opening brief, respondent states (in footnote 2) that appellants are not contesting the estimated tax penalty,
25 citing appellant’s appeal letter.

26 ⁵ Respondent’s additional information, received by the Board on October 29, 2010, was submitted in response to appellants’
27 request and provides FTB’s records of appellants’ payment history, including payment vouchers, for the 2006 and 2007 tax
28 years. According to IRC section 6654, appellants should have also submitted a payment on April 15, 2007. Based on the
29 additional exhibit provided by the FTB on October 29, 2010, appellants submitted a \$7,000 payment on April 15, 2007,
30 however this payment appears to have been submitted for the 2006 year (with a 2006 automatic extension form), rather than
31 the 2007 year.

32 ⁶ Line 63 on appellants’ return provides space to self-report interest, late return penalties, and late payment penalties. It is
33 unclear from the information provided which of these three, or combination thereof, this \$3,478 represents. (Resp. Op. Br.,
34 exhibit A, p. 2, ln. 63.) The parties should be prepared to clarify the breakdown of what this amount represents.

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1 penalty. In this May 5, 2009 letter, appellants also stated FTB had erroneously returned one of their four
2 estimated tax payments and stated that, in addition to requesting abatement of the late filing penalty,
3 they “would also like the interest and penalty assessed to the supposed missing payment (which wasn’t
4 missing) also returned”⁷

5 On June 3, 2009, respondent issued a NOA stating that it had reviewed appellants’ letter
6 dated February 9, 2009, and it was denying appellant’s claim for refund. The NOA stated (on page 1)
7 that appellants’ claim for a refund of penalty and interest is denied, and it further stated (on page 4) that
8 appellants’ request for abatement of the underpayment of estimated tax penalty is denied.⁸ (Resp. Op.
9 Br., exhibit B, pp. 1-4.) This timely appeal followed.

10 Contentions

11 Appellants concede their return was filed after the deadline and concede the interest.
12 Appellants state that they are appealing the denial of their claim for refund of “the 2007 late filing and
13 underpayment penalty” and argue that reasonable cause exists to support abatement. Appellants contend
14 they reasonably relied on their CPA’s advice regarding the calculation of their estimated payments and
15 tax liability. Appellants contend the CPA’s advice caused them to significantly underpay their tax
16 liability, which otherwise would have been paid in full by the April 15, 2008 deadline, and thus caused
17 the late filing penalty.⁹ Appellants argue that the following facts demonstrate grounds for abatement:

- 18 • in early September of 2008, appellants inadvertently left their tax documents at their
19 East Coast cottage where they were staying for the summer;
- 20 • appellants returned to their cottage on October 13, 2008, according to a prescheduled
21 visit, retrieved the documents, and returned to California on October 17, 2008;

24 ⁷ On appeal, appellants have not raised the argument of an alleged erroneous refund by FTB, and there is no evidence in the
25 appeal record of an erroneous refund of one of appellants’ estimated tax payments.

26 ⁸ Although the NOA only refers to appellants’ February 9, 2009 letter (which only requested a refund of the late filing
27 penalty and expressly did not request a refund of the estimated tax penalty or interest), it appears to staff that respondent
28 treated the May 5, 2009 letter as a supplement to appellants’ February 9, 2009 letter, and therefore addressed the claim for
refund of the estimated tax penalty and interest, which was made in the May 5, 2009 letter.

⁹ As discussed below, a late filing penalty amount is based on the amount of unpaid tax as of the due date of the return.

- 1 • when appellants returned with their tax documents in October, the office of the CPA
- 2 who does their taxes was closed for a week due to the tragic death of a partner's son;
- 3 • appellants relied on their CPA to provide a payment schedule for their estimated tax
- 4 payments, and the CPA's advice caused appellants to "grossly underpay" their 2007
- 5 taxes;
- 6 • appellants believed there was no tax liability due;
- 7 • appellants have a history of being steady and reliable taxpayers with consistently
- 8 timely filed returns; and
- 9 • The Internal Revenue Service (IRS) agreed to abate the penalty.

10 Appellants concede it was their choice to not retrieve the tax documents from the East Coast until after
11 the October 15th extended filing deadline, but contend that they did not know they had an outstanding
12 tax liability at that time. (App. Reply Br., p. 5.) Appellants allege that getting the paperwork to the
13 CPA prior to October 15, 2008, would not have averted the error caused by the CPA anyway, and that
14 they acted in a manner that a reasonable person in similar circumstances would have. (*Ibid.*)

15 Respondent contends appellants' decision to not provide their CPA with all the tax
16 documents prior to the extended deadline for filing a timely return shows there is no reasonable cause
17 for the abatement of the late filing penalty. Respondent asserts taxpayers have a non-delegable
18 obligation to adhere to due dates for filing tax returns and cannot abate late filing penalties based on
19 professional advice as to the amount of tax due. (Resp. Reply Br., p. 2.) Respondent addresses
20 appellants' contention that the miscalculation of estimated payments by their CPA led to the amount of
21 the penalty, asserting that had they filed a timely return there would be no late filing penalty, and
22 therefore the CPA's failure to properly calculate estimated payments is not reasonable cause for filing
23 late. (*Ibid.*) Furthermore, respondent contends that appellants have not shown they provided their CPA
24 will all necessary documents to prepare their estimated tax payment schedule or that the payment
25 schedule provided constitutes substantive advice upon which reasonable cause can be based. (*Id.* at
26 pp. 3-4.) While respondent notes appellants have a good filing history, it asserts that, unlike the IRS, it
27 has no statutory authority to abate the penalty based on a good filing history. (Resp. Op. Br., p. 4.)

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1 Applicable Law

2 Burden of Proof

3 On appeal, there is a presumption of correctness of the penalties assessed by respondent.
4 (*Appeal of Robert Scott*, 83-SBE-094, Apr. 5, 1983.) Taxpayers have the burden of proving error in
5 respondent's determination that a penalty applies. (*Leuhsler v. Commissioner* (6th Cir. 1992) 963 F.2d
6 907; *Neely v. Commissioner* (1985) 85 T.C. 934, 947.) To overcome the presumption of correctness of a
7 penalty, including showing reasonable cause, taxpayers must provide credible and competent evidence
8 to support their claim; otherwise, the penalty should not be abated. (*Appeal of Winston R. Schwyhart*,
9 75-SBE-035, Apr. 22, 1975.)

10 Late Filing Penalty

11 California imposes a penalty for failure to file a return by its due date, unless the failure
12 to file was due to reasonable cause and not due to willful neglect. (Rev. & Tax. Code, § 19131.)
13 Taxpayers have until April 15th of the year following the tax year to file returns without triggering the
14 penalty. (*Id.* at § 18566.) If taxpayers file by October 15th, they receive an automatic extension and the
15 penalty is not triggered. (Cal. Code Regs., tit. 18, § 18567.) The late filing penalty is computed at a rate
16 of 5 percent of the tax due for every month that the return is late, up to a maximum of 25 percent. (Rev.
17 & Tax. Code, § 19131, subd. (a).) The minimum amount of the late filing penalty for individuals is the
18 lesser of \$100 or 100 percent of the tax required to be shown on the return. (*Id.* at subd. (b).) The tax
19 amount upon which the penalty is based is the amount of tax required to be shown on the return, reduced
20 by any amount of tax paid on or before the prescribed due date for payment of the tax and any credit
21 against tax which may be claimed upon the return. (*Id.* at subd. (c); *Appeal of Mary Kay Cosmetics*,
22 *Inc.*, 81-SBE-042, May 19, 1981.)

23 Reasonable Cause

24 To establish reasonable cause, a taxpayer "must show that the failure to file timely
25 returns occurred despite the exercise of ordinary business care and prudence, or that cause existed as
26 would prompt an ordinary intelligent and prudent businessman to have so acted under similar
27 circumstances." (*Appeal of Howard G. and Mary Tons*, 79-SBE-027, Jan. 9, 1979.) Ignorance of a
28 filing requirement or a misunderstanding of the law generally does not excuse a late filing. (*Appeal of*

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1 *Diebold, Incorporated*, 83-SBE-002, Jan. 3, 1983.) Reliance on erroneous advice from a tax
2 professional is not reasonable cause where an unambiguous deadline is at issue. (*United States v. Boyle*
3 (1985) 469 U.S. 241; 249-250.) However, reliance on advice regarding a matter of substantive tax law,
4 such as whether it is necessary to file a return, may be reasonable cause. (*Id.* at p. 250.)

5 Each taxpayer has a personal, non-delegable obligation to file the tax return by the due
6 date. (*Appeal of Thomas K. and Gail G. Boehme*, 85-SBE-134, Nov. 6, 1985.) Illness or other personal
7 difficulties may be considered reasonable cause, but not when the difficulties simply cause the sacrifice
8 of the timeliness of one matter (e.g., filing tax returns) so that the taxpayer can pursue other matters.
9 (*Appeal of W. L. Bryant*, 83-SBE-180, Aug. 17, 1983; *Appeal of Michael J. and Diane M. Halaburka*,
10 85-SBE-025, Apr. 9, 1985; *Appeal of William T. and Joy P. Orr*, 68-SBE-010, Feb. 5, 1968.) The fact
11 that tax information is lost or difficult to obtain is insufficient to meet the taxpayer's burden of
12 establishing reasonable cause. (*Appeal of Stephen C. Bieneman*, 82-SBE-148, July 26, 1982.)

13 Estimated Tax Penalty

14 R&TC section 19136 incorporates by reference, with certain modifications, Internal
15 Revenue Code (IRC) section 6654. Pursuant to IRC section 6654(c), taxpayers are required to make
16 estimated tax payments in four equal installments on or before April 15, June 15, and September 15, of
17 each taxable year, and on January 15 of the following taxable year. (See Int.Rev. Code, § 6654 and
18 Rev. & Tax. Code, § 19136.) The required payments must total the lesser of 90 percent of the tax shown
19 on the return for the taxable year or 110 percent of the tax shown on the return for the preceding tax year
20 (for taxpayers with a federal adjusted gross income exceeding \$150,000 and for tax years after 2001).
21 (Int.Rev. Code, § 6654(d)(1).) If taxpayers fail to make the required payments, an estimated tax penalty
22 is imposed. The estimated tax penalty is mandatory pursuant to R&TC section 19136.

23 There is no general reasonable cause exception for the estimated tax penalty; however,
24 reasonable cause can be important under a limited circumstance. IRC section 6654(e)(3)(B) provides
25 for waiver of the penalty if the government determines that during the taxable year for which estimated
26 payments were required to be made or in the previous taxable year: (i) the taxpayer retired after having
27 attained age 62, or became disabled; and (ii) underpayment was due to "reasonable cause." IRC section
28 6654(e)(3)(A) provides a second scenario for waiver of the underpayment of estimated tax penalty, if the

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1 government determines that, as a result of casualty, disaster, or other unusual circumstances, imposition
2 of the penalty would be against equity and good conscience.

3 STAFF COMMENTS

4 Late Filing Penalty

5 Appellants state they returned from their East Coast cottage in early September and left
6 tax documents there. Appellants indicate they were going to return to the East Coast on October 13,
7 2008, and rather than make an extra trip or change their travel dates, they waited for this trip to retrieve
8 the necessary documents. While taxpayers may show reasonable cause if they are physically unable to
9 retrieve documents necessary for filing due to illness, convenience of travel, by itself, does not constitute
10 reasonable cause. (See *Appeal of Michael J. and Diane M. Halaburka, supra.*) Although the documents
11 were left on the East Coast, the fact that documents are difficult to obtain does not constitute reasonable
12 cause. (*Appeal of Stephen C. Bieneman, supra.*) Appellants did not return with the documents until
13 October 17, 2008, after the extended filing deadline. Although appellants indicate their CPA was
14 unavailable when they returned with the documents, they had already passed the extended filing
15 deadline by this time and therefore it does not appear that the CPA's unavailability at this time could
16 have caused the late filing.¹⁰

17 Staff notes that, even if reasonable cause existed for underpaying estimated tax, the late
18 filing penalty is distinct from the estimated tax penalty.¹¹ In order for the late filing penalty to be
19 abated, the R&TC requires that the taxpayer demonstrate reasonable cause for the failure to file the tax
20 return by the due date. Therefore, appellants need to provide evidence and case law establishing they
21 met the requirements of reasonable cause for the late filing of their return. In this connection, appellants
22

23 ¹⁰ As explained above, taxpayers who file after the April 15th deadline but prior to October 15th, six months later, are
24 allowed an automatic extension. If taxpayers do not file by the extended deadline, the extension is not allowed. (Cal. Code
25 Regs., tit. 18, § 18567.) The maximum amount of the late filing penalty is 25 percent of the tax, which is calculated at 5
26 percent per month the return is late. (Rev. & Tax. Code, § 19131, subd. (a).) Therefore, when appellants failed to file their
return within the extended deadline, the penalty was imposed and already reached its maximum amount since it was beyond
five months from the effective April 15, 2008 filing deadline.

27 ¹¹ As discussed below, the estimated tax penalty does not provide a general reasonable cause abatement provision. R&TC
28 section 19131 provides that reasonable cause is a basis for abating the late filing penalty when reasonable cause exists for the
failure to file timely, not for the failure to pay timely. (Rev. & Tax. Code, § 19131, subd. (a).) R&TC section 19131 further
provides that "[t]his section does not apply to any failure to pay any estimated tax . . .," explicitly distinguishing its
provisions from those of R&TC section 19136 which imposes the underpayment of estimated tax penalty. (Id. at subd. (e).)

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1 should be prepared to support with case law their contention that the circumstances, including their
2 belief no further tax was due and the IRS's removal of the late filing penalty, demonstrate that they had
3 reasonable cause for filing their tax return after the deadline. Staff notes that the February 5, 2009 IRS
4 letter removed the federal late filing penalty based on a good filing history and states that the penalty
5 was not removed based on a finding of reasonable cause. (Resp. Op. Br., exhibit D.) Both parties
6 should be prepared to discuss whether appellants can establish reasonable cause for late filing when they
7 apparently did not provide all their necessary tax documents to the return preparer until after the
8 extended filing deadline.

9 Estimated Tax Penalty

10 Appellants should be prepared to clarify their assertions regarding the estimated tax
11 penalty, state on what grounds they contest the penalty (if they do), and provide supporting law and
12 documentation for any such contentions. There is no general reasonable cause exception for the
13 estimated tax penalty. Therefore, appellants must fit into one of the two limited provisions under
14 IRC section 6654(e)(3) for a waiver of the penalty to be permitted. (These two provisions are
15 summarized in Applicable Law, above, and require that the taxpayer either retired or became disabled
16 during the tax year or the preceding tax year and had reasonable cause for underpaying estimated tax, or
17 that due to casualty, disaster or other unusual circumstance the imposition of the penalty would be
18 against equity and good conscience.) In this connection, staff notes that the February 5, 2009 IRS letter
19 acknowledges appellants' reasonable cause arguments, but explains that the estimated tax penalty can
20 only be waived if one of these waiver provisions applies. It appears to staff that the IRS did not find
21 either of the waiver provisions applicable and that the existing record on appeal does not establish that
22 either provision is applicable. Both parties should be prepared to discuss whether appellants meet the
23 requirements of either of the waiver exceptions.

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