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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 **AJAY RANCHHOD**) Case No. 449283

	<u>Years</u>	<u>Claims For Refund</u>
	2005	\$10,170.65 ¹
	2006	

17 Representing the Parties:

18 For Appellant: Ajay Ranchhod
19 For Franchise Tax Board: L. Red Gobuty, Tax Counsel

21 **QUESTIONS:** (1) Whether appellant has shown that he had “reasonable cause” for the late payment
22 of tax.
23 (2) Whether respondent properly imposed a penalty for underpayment of estimated
24 tax.

26 ¹ The Board Proceedings Division, in its reply to appellant’s appeal letter, acknowledged claims for refund for 2005 and 2006
27 in the total amount of \$10,170.65. In its opening brief, respondent states that its records show that the total amount on appeal
28 is actually \$22,386.73, consisting of \$16,283.95 for 2005 and \$6,102.78 for 2006. Respondent further states that the actual
claimed amount for each taxable year is comprised of unspecified amounts of a penalty for the late payment of tax, a penalty
for the underpayment of estimated tax, and applicable interest.

1 (3) Whether appellant has shown that the interest at issue should be abated.

2 HEARING SUMMARY

3 Background

4 Appellant is a real estate developer in Stockton, California, who operated his business
5 (with two other “partners”) in the form of a limited liability company called “American-USA Homes.”
6 During the appeal years, appellant’s business suffered reverses, allegedly because of a fraud perpetrated
7 upon him and the generally poor climate for real estate development and sales in the Stockton area at
8 that time. Appellant² filed a California tax return for 2005 on October 15, 2006, after making an
9 extension payment of \$25,000 for 2005 on April 15, 2006, and another payment for 2005 of \$40,000 on
10 September 15, 2006. On his tax return for 2005, appellant reported California adjusted gross income of
11 \$1,471,048, itemized deductions of \$13,269, and a resulting taxable income of \$1,457,779. Appellant
12 self-assessed on his return a total unpaid tax liability of \$136,089, a late payment penalty of \$10,877, a
13 penalty for underpayment of estimated tax of \$1,794, and interest of \$4,796. Appellant remitted none of
14 these self-assessed amounts with his return.

15 Respondent states that, in processing appellant’s return for 2005, it accepted his self-
16 assessment of tax in the amount of \$136,089 but revised upward the penalty for understatement of tax to
17 \$1,838.88 plus interest of \$35.45. At some unstated time, respondent then discovered that appellant had
18 made the foregoing payments of \$25,000 and \$40,000 and concluded that, after the reduction of his total
19 tax liability by those payments, his balance due was \$111,089. Respondent does not explain in detail
20 how it calculated appellant’s balance due. Respondent states further that it revised downward the late
21 payment penalty to \$9,588.92, plus interest in the amount of \$5,554.45. In addition, respondent states
22 that it revised the interest on the late paid tax to the amount of \$4,567.65. On or about November 9,
23 2006, respondent sent appellant a Return Information Notice which informed him of his balance due.

24 On December 15, 2006, appellant made a payment toward his balance due for 2005 in the
25 amount of \$40,000. On December 28, 2006, respondent issued to appellant an Income Tax Due Notice
26

27 ² Appellant and his wife filed joint California returns for the appeal years. However, only appellant filed an appeal with
28 respect to those years. For ease of reference, “appellant” in this hearing summary will sometimes refer to both appellant and
his wife.

1 which notified him of penalties in the amount of \$11,592.34, accrued interest of \$4,562.87, payments of
2 \$65,000.00, and a balance due of \$87,244.21. Appellant made an additional payment of \$24,000 on
3 January 15, 2007, and another payment of \$24,000 on February 15, 2007. After receiving the latter two
4 payments, respondent calculated that appellant had overpaid his tax liability for 2005 by the amount of
5 \$627.05. Respondent issued a refund to appellant of that amount on or about March 8, 2007.

6 Appellant filed a California tax return for 2006 on October 15, 2007. On that return, he
7 reported California adjusted gross income of \$610,292, itemized deductions of \$219,363, and a resulting
8 taxable income of \$390,929. Appellant self-assessed on his 2006 return a total tax liability of \$32,099, a
9 late payment penalty of \$2,568, a penalty for underpayment of estimated tax of \$1,407, and interest of
10 \$1,379, for a total amount due of \$37,453. Appellant did not remit any amount with his 2006 return.

11 In processing appellant's return, respondent accepted his self-assessment of tax of
12 \$32,099. However, respondent calculated the amount of the penalty for late payment to be \$2,909.41,
13 plus interest of \$28.74. Further, respondent calculated the amount of interest on the late paid tax to be
14 \$1,729.07 and the amount of the penalty for underpayment of estimated tax to be \$1,407.09, plus
15 interest of \$18.00. Respondent mailed an Income Tax Due Notice to appellant on December 19, 2007,
16 in which respondent informed him that his balance due for 2006 was \$10,170.65. Appellant made a
17 payment of \$10,170.65 on January 4, 2008, which, together with a payment of \$28,000 that he had made
18 on December 7, 2007, completely satisfied his tax liability for 2006.

19 In addition to making his final payment for 2006 on January 4, 2008, appellant wrote to
20 respondent on that date at its Taxpayer Advocate Office ("TAO") requesting abatement of the penalties
21 and interest assessed against him for the appeal years. In his letter, appellant acknowledged owing the
22 underlying tax but took the position that the penalties and interest should be abated allegedly because the
23 loss of funds resulting from being defrauded by a loan company and the poor market for the construction
24 and sale of houses in Stockton prevented him from paying the underlying tax in a timely manner. In a
25 subsequent letter to the TAO, appellant stated that another significant factor that contributed to his late
26 payment of tax was liens that the Internal Revenue Service ("IRS") mistakenly placed on his real estate
27 projects. He alleged that he was unable to generate funds from the sale of those projects to satisfy his
28 tax liability because of the liens. After consideration of the information provided by appellant, the TAO

1 apparently treated the letters from appellant as refund claims for the late payment penalty, the penalty
2 for underpayment of estimated tax, and the interest assessed against appellant and denied those claims.
3 This timely appeal followed.

4 Contentions

5 Appellant essentially contends that the late payment penalty, the penalty for
6 underpayment of estimated tax, and the interest at issue should be abated because he had “reasonable
7 cause” for his late payment of tax. In support of his contention, appellant alleges in his opening brief
8 that, around October 2004, he was introduced to a broker who told appellant that he could arrange real
9 estate loans which would allow appellant to enter into real estate projects without the use of appellant’s
10 own funds. Appellant states that such an arrangement was attractive to him because he planned to enter
11 into the market for the development of commercial real estate in response to a declining market for the
12 development of residential property. He states further that, in March 2005, the broker informed him that
13 a real estate partnership had been formed which would be under appellant’s control and that he could
14 expect funding from that partnership in the amount of \$10 million after he paid a “commitment amount”
15 of \$182,000. Appellant alleges that, while the broker was arranging the funding that the broker had
16 promised, appellant had entered into a contract to purchase real property for commercial and residential
17 development for a purchase price of \$3.2 million and a date for close of escrow in December 2005. At
18 the execution of the contract, appellant was required to place into escrow a deposit of \$25,000 and then
19 make certain “escrow extension” payments of \$10,000 each until escrow finally closed. The contract
20 had a “liquidated damages” provision in the event of default by appellant, but only part of that provision
21 has been placed in the record. (App. Reply Br., Exhibit A, pp. 2-3.) Appellant entered into another
22 contract to purchase other real property for approximately the same price in May 2005. The second
23 contract provided for a close of escrow on August 8, 2005, an initial deposit of \$25,000, and payments
24 of \$15,000 each time the close of escrow was extended.

25 Stating that he relied upon the representation of the broker that the anticipated funding of
26 \$10 million was to become available soon, appellant released what he characterizes as “advances” in the
27 total amount of \$115,000 to the escrow accounts established for the two properties that he was
28 purchasing. He alleges that he had at that point “every intention of fulfilling our tax obligations before

1 year-end 2005” in light of the extraordinary profitability of his business during 2005. Appellant then
2 states that, in August 2005, the broker disappeared and that, as a result, appellant became concerned
3 about the “commitment amount” of \$182,000 and other funds that he had apparently placed in the
4 control of the broker. Appellant further states that, after a search for the broker and the funds proved
5 unsuccessful, he also became concerned about funding the close of escrow with respect to the two real
6 properties. He alleges that the money that he had earmarked for his payment of tax had to be used to
7 close escrow because the sellers of the respective properties were threatening him with unspecified
8 “liability” if he did not close escrow. Appellant then seems to allege that, in addition to the money that
9 he had earmarked for payment of tax, he closed the escrows with an unspecified amount of money that
10 he borrowed from a bank shortly before the close of the escrows. Finally, appellant alleges that the total
11 amount of his own money that he used to close the escrow was almost \$2.5 million.

12 Appellant alleges further that “[w]e were not unduly concerned about our ability to pay
13 the Taxes by March 2006” because real estate agents had assured him that seven of their completed
14 homes would each sell for a profit of about \$390,000. Appellant states that although those sales would
15 have provided a surplus of \$750,000, which allegedly would have been sufficient to satisfy his tax
16 liability, the first sale of those homes occurred only in June 2006. Appellant adds that, during that
17 period, the broker was captured and apparently convicted. He then summarizes that he was unable to
18 generate the necessary funds to satisfy his tax liability because the market for housing completely
19 collapsed in 2006. As an example, he points out that he was compelled to sell on a “short-sale” certain
20 homes that he was constructing and, as a result of those sales, generated taxable income to him but no
21 actual funds. As a further example, appellant states that he attempted to sell in 2006 commercial
22 property that he had been developing but was able to sell the property only in December 2007 at a “fire
23 sale” price that generated cash in the disappointing amount of \$250,000.

24 Finally, appellant alleges that he gradually satisfied his tax liability by refinancing all of
25 his rental properties and then using the equity in those properties to make payments to respondent. He
26 states that he experienced a great deal of difficulty in refinancing those properties because of the lien
27 that the IRS had placed on them. Appellant has provided, in his final brief, a copy of a letter from the
28 IRS acknowledging that the lien was erroneously imposed. (App. Reply Br., Exhibit O.) He has also

1 provided there letters to him from lending institutions purporting to show the continuing difficulty that
2 he has experienced in obtaining loans and other forms of credit as a result of the lien. Appellant states
3 that he has not provided copies of the refinancing documents because of the large number of pages that
4 copying would entail.

5 Respondent first contends that the late payment penalty should not be abated because
6 appellant has not shown “reasonable cause” for late payment under Revenue and Taxation Code
7 (“R&TC”) section 19132. Noting the similarities between R&TC section 19132 and Internal Revenue
8 Code (“IRC”) section 6651, respondent quotes in its opening brief the following language from
9 regulations promulgated under section IRC 6651:

10 A failure to pay will be considered to be reasonable cause
11 To the extent that the taxpayer has made a satisfactory showing
12 That he exercised ordinary business care and prudence in providing
13 For payment of his tax liability and was nevertheless either unable
14 To pay the tax or would suffer an undue hardship (as described in
15 In § 1.6161-1(b) of this chapter) if he paid on the due date.
16 In determining whether the taxpayer was unable to pay the tax in
17 Spite of the exercise of ordinary business care and prudence in
18 Providing for payment of his tax liability, consideration will be
19 Given to all the facts and circumstances of the taxpayer’s financial
20 Situation, including the amount and nature of the taxpayer’s
21 Expenditures in light of the income (or other amounts) he could,
22 At the time of such expenditures, reasonably expect to receive prior
23 To the date prescribed for the payment of the tax.

19 (Treasury Regulation section (“Regulation”) 301.6651-1(c)(1).)

20 And further:

21 The term “undue hardship” means more than an inconvenience to the
22 Taxpayer. It must appear that substantial financial loss, for example,
23 Loss due to the sale of property at a sacrifice price, will result to the
24 Taxpayer from making payment on the due date of the amount with
25 Respect to which the extension is desired. If a market exists, the sale of
26 Property at the current market price is not ordinarily considered as
27 Resulting in an undue hardship.

25 (Regulation 1.6161-1(b).)

26 In that brief, respondent states that appellant had not provided any evidence that he tried
27 to conserve any assets to pay his taxes in spite of the substantial amount of income that he reported for
28 the appeal years. In addition, respondent alleges that there was no evidence in the record that appellant

1 had attempted to sell any properties or to obtain a loan secured by those property in order to satisfy his
2 tax liability. Finally, respondent states that it is willing to consider any actual evidence presented by
3 appellant that financial difficulties prevented him from satisfying his tax liability in a timely manner.
4 After considering the information provided by appellant in his opening brief, respondent cites in its reply
5 brief additional language from Regulation 301.6651-1(c)(1) that “[a] taxpayer will be considered to have
6 exercised ordinary business care and prudence if he made reasonable efforts to conserve sufficient assets
7 in marketable form to satisfy his tax liability, and nevertheless was unable to pay all or a portion of the
8 tax when it became due.”³ Relying upon that language from the regulation, respondent argues that
9 appellant did not exercise ordinary business care and prudence when he decided to pay his taxes with
10 future proceeds from the sale of residential property rather than with the money that he had previously
11 earmarked for the payment of those taxes but ultimately used to close the two escrows.

12 Respondent also contends that the penalty for underpayment of estimated tax should not
13 be abated because appellant did not satisfy during the appeal years the requirement of IRC section 6654
14 that he make adequate quarterly payments and there is no “reasonable cause” exception to that statute
15 that would apply to him. Respondent notes that IRC section 6654(e)(3)(B) effectively provides for a
16 “reasonable cause” exception for newly retired or disabled individuals whose underpayments of
17 estimated tax were due to reasonable cause and not to willful neglect but points out that appellant was
18 neither newly retired nor disabled during the appeal years. Respondent also notes that IRC section
19 6654(e)(3)(A) provides for waiver of the penalty “to the extent that the Secretary [of the Treasury]
20 determines that by reason of casualty, disaster, or other unusual circumstances the imposition of such
21 addition to tax would be against equity and good conscience.” Respondent takes the position that IRC
22 section 6654(e)(3)(A) does not apply to appellant. Appellant does dispute that he did not make adequate
23

24 ³ Staff notes that the immediately preceding sentence in Regulation 301.6651-1(c)(1) states as follows:

25 Further, a taxpayer who invests in speculative or illiquid assets has not
26 Exercised ordinary business care and prudence in providing for the payment
27 Of his tax liability unless, at the time of the investment, the remainder of the
28 Taxpayer’s assets and estimated income will be sufficient to pay his tax or
It can be reasonably foreseen that the speculative or illiquid investment made
By the taxpayer can be utilized (by sale or as a security for the loan) to realize
Sufficient funds to satisfy the tax liability.

1 quarterly payments under IRC section 6654 during the appeal years.

2 Finally, respondent contends that the interest at issue should not be abated because there
3 is no “reasonable cause” exception to the assessment of interest. In addition, respondent argues that
4 appellant does not qualify for the abatement of interest under R&TC section 19104, subdivision (a),
5 because he has not shown that the assessment of interest was attributable to an unreasonable error or
6 delay by officer or employee of respondent in performing a ministerial or managerial act.

7 Law

8 R&TC section 19132, subdivision (a)(1)(A), provides that a penalty shall be imposed in
9 the case of the failure by a taxpayer to pay the amount shown as tax on his return on or before the date
10 prescribed for payment of that tax determined with regard to any extension of time for payment, unless it
11 is shown that the failure is due to reasonable cause and not due to willful neglect. The taxpayer bears
12 the burden of showing that both of those conditions exist. (*Appeal of M. B. and G. M. Scott*, 82-SBE-
13 249, Oct. 14, 1982.) In order to show “reasonable cause,” the taxpayer must show that his failure to pay
14 timely the proper amount of tax occurred despite the exercise of ordinary business care and prudence.
15 (*Appeal of M. B. and G. M. Scott, supra.*)

16 R&TC section 19136, subdivision (a), incorporates by reference the provisions of IRC
17 section 6654, except as otherwise provided. IRC section 6654(a) essentially imposes a penalty in the
18 case of underpayment of estimated tax by an individual. IRC section 6654(b)(1) states that the amount
19 of the underpayment shall be the excess of the required installment over the amount of the installment
20 paid on or before the due date of the installment. IRC section 6654(c) provides for four separate
21 installments for each taxable year. IRC section 6654(d)(1)(A) states generally that the amount of any
22 required installment shall be 25 percent of the required annual payment. IRC section (d)(1)(B) provides
23 that the term “required annual payment” means the lesser of (i) 90 percent of the tax shown on the return
24 for the taxable year (or, if no return is filed, 90 percent of the tax for that year) or (ii) 100 percent of the
25 tax shown on the return of the individual for the preceding taxable year. IRC section 6654(e)(3)
26 provides for the waiver of the penalty for the underpayment of estimated tax in specified circumstances.

27 R&TC section 19101 provides generally for the assessment of interest on tax that is
28 unpaid on its due date. R&TC section 19104, subdivision (a)(1), provides for the abatement of interest

1 with regard to a deficiency or proposed deficiency of tax to the extent that the interest is attributable in
2 whole or in part to any unreasonable error or delay by an officer or employee of respondent (acting in
3 his or her official capacity) in performing a ministerial or managerial act.

4 STAFF COMMENTS

5 Appellant should provide balance sheets and income statements for both himself and
6 American-USA Homes for both appeal years, as well as representative copies of documents
7 demonstrating the difficulty that he allegedly experienced in refinancing his rental properties during the
8 appeal years.⁴ Both parties should be prepared to discuss at the hearing, with appropriate citation to
9 authority, whether appellant's decision to fund the close of escrow with respect to the two real properties
10 that he purchased in 2005 with money that he had earmarked to satisfy his tax liability, and then to
11 satisfy that liability with anticipated payments from the future sale of residential property, represented
12 the exercise of ordinary business care and prudence. In addition, appellant should be prepared to
13 describe in detail the possible consequences that he perceived of not closing the escrows at the agreed
14 times.

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26 ⁴ Those documents should be mailed 14 days before the hearing to: **Mira Tonis**
27 **Board Proceedings Division**
State Board of Equalization
28 **P. O. Box 942879 MIC:80**
Sacramento, CA 94279-0080