

BEFORE THE STATE BOARD OF EQUALIZATION
OF- THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
JHIRMACK ENTERPRISES, INC.)

Appearances:

For Appellant: Paul W. Kauffman
 Certified Public Accountant

For Respondent: Kendall E. Kinyon
 Counsel

 O P I N I O N

 This. appeal is made pursuant to section
26075_{1/} subdivision (a) of the Revenue and Taxation
Code from the action of the Franchise Tax Board in
denying the claim of Jhirmack Enterprises, Inc., for

1/ Statutory references are to the Revenue and Taxation
Code unless otherwise indicated.

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refund of an estimated tax penalty **in the amount of \$1,393.74** for the income year ended April 30, 1976.

The sole question for decision is whether a penalty should be imposed for underpayment of estimated tax.

Appellant, a California corporation, commenced doing business in this state in **1968**. It uses the accrual **method** of accounting and files California franchise tax returns on the **basis** of a fiscal year ending **April 30**. On **October 11, 1976**, within an extended period granted by respondent for filing its return for the income year ended April 30, 1976, appellant reported a self-assessed tax liability of **\$114,611.00**. It then also reported estimated tax payments of **\$118,000.00**, and, consequently, overpayment of tax in the amount of **\$3,389.00** for that year.

Respondent determined that appellant made the following estimated tax payments for that year:

<u>Description</u>	<u>Payment Date</u>	<u>Amount</u>	<u>Cumulative Payments</u>
1st Installment	8/26/75	\$ 5,000.00	\$ 5,000.00
2nd Installment	10/15/75	5,000.00	10,000.00
3rd Installment	1/13/76	4,763.00	14,763.00
Additional Payment of 3rd Installment	1/15/76	356.86 (\$351.00. plus interest,	15,119.86 \$5.86)
4th Installment	4/15/76	5,038.00	20,157.86
Payment with Request to Extend Filing Date	7/13/76	98,199.00	118,356.86

Based upon its above determination concerning payments of estimated tax, respondent concluded that appellant was subject to a total penalty of **\$2,964.22** for underpayment of **its' first** and second installments.

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Appellant only contests, **the** penalty imposed; in **the** amount of **\$1,393.74**, for underpayment of the second installment. Respondent concedes only that appellant is entitled to a refund of **\$17.89** because of a mathematical computation error.

The four installments of estimated tax were payable by the middle of the fourth, sixth, ninth, and twelfth months of the income year, respectively; specifically, on August 15, 1975; October 15, 1975; January 15, 1976; and April 15, 1976. (Rev. & Tax. Code, **§ 25563, subd. (d).**) In the event of an underpayment of estimated tax, a penalty is imposed pursuant to section 25951. An underpayment of estimated tax is defined as the excess of **the** amount that would be required to be paid on each installment of estimated tax if the estimated tax amount were equal to **eighty** percent of the amount of tax shown as due on the final return, over the amount actually paid on or before the due date of each installment. (Rev. & Tax. Code, **§ 25952.**) In the instant case, eighty percent of the reported tax liability (**\$114,611.00**) was **\$91,688.80**; one-fourth of the latter amount was **\$22,922.20**. Therefore, the factual record clearly establishes that there was substantial underpayment of estimated tax at each due date.

Section 25954 provides for relief from the penalty as to particular installments if certain minimum requirements are met. The pertinent parts of that section state:

Notwithstanding the provisions of the preceding sections of this article, the addition to the tax with respect to any underpayment of any installment shall not be imposed if the total amount of all payments of estimated tax paid on or before the last date prescribed for the payment of such installment equals or exceeds the amount which would have been required to be paid on or before such date if the estimated tax were whichever of the following is the lesser--

(a) The tax shown on the return of the taxpayer for the preceding income year if a return showing a liability for tax was filed by the taxpayer for the preceding year and such preceding year was a year of 12 months. ...

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The tax liability shown for the preceding income year was **\$20,149.00**. To avoid a penalty for underpayment of the second installment payable by October 15, 1975, pursuant to subdivision (a), appellant was obligated to pay **\$10,074.00** (50 percent of **\$20,149.00**) by October 15, 1975. The cumulative amount of estimated tax directly paid by appellant by that date was **\$10,000.00**.

After respondent's **proposed** assessment of the penalty in December of 1976, **appellant** requested respondent to allow it to credit the prior year's overpayment to the second installment **which had been** payable October 15, 1975. Respondent **denied** this request. Appellant alleges that, when reporting its tax liability for the prior year on January 12, 1976, it had intended to direct respondent to credit the reported overpayment (\$351.00) to the second installment but the computer service utilized erroneously checked the wrong instruction box on the return. If this credit were to be **allowed as a** timely partial payment of such second installment, the payment thereof would exceed **\$10,074.00** and the **second** installment would thereby be excepted from the penalty, even though there would still be **substantial underpayment** of that installment. Appellant urges it is lawfully entitled to change the application of the reported overpayment **from the third installment to the second installment**. It maintains that within the statutory period within which a credit can be made (see Rev. & Tax. Code, **§ 26073**), a taxpayer may lawfully revoke, with respect to an application of an overpayment; the original election and direct a new one. It asserts that it would be grossly inequitable and unfair to preclude a change of election under the facts of this appeal.

Turning to the pertinent statutes, we find that section 26081 provides credits or refunds of overpayments of estimated tax shall be made by respondent in the same manner as overpayments of tax. In that regard, section 26071 provides that if an overpayment is determined for any year for any reason, the amount of the overpayment shall be credited to any taxes then due from the taxpayer and the balance refunded. **It is also a** statutory rule that a debtor may designate the debt **to which** a payment shall be

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applied. This rule is codified in section 1479 of the Civil Code which provides in pertinent part:

Where a debtor, under several obligations to another, does an act, by way of performance, in whole or in part, which is equally applicable to two or more of such obligations, such performance must be applied as follows:

One -- If, at the time of performance, the intention or desire of the debtor that such performance should be applied to the extinction of any particular obligation, be manifested **to the creditor, it must be so applied.** (Emphasis added.)

Thus, in a debtor-creditor relationship, application of a payment is to be made in accordance with the instructions of a debtor where such instructions are given. This rule applies with respect to tax obligations (cf. First Investment Service Co., Cal. St. Bd. of Equal., July 31, 1973). Furthermore, a debtor who has made a direction as to application may not change the direction so as to require application to another obligation after the creditor has made the application originally directed. The debtor simply has no right thereafter to direct a different application of the same funds, (See Hammond Lumber Co. v. Henry, 87 Cal. App. 231 [261 P. 1027] (1927); Flynn v. Seale, 2 Cal. App. 665 [84 P. 263] (1906); 48 Cal. Jur. 3d, Payment § 38, p. 789; see also Starr v. Commissioner, 267 F.2d 148 (7th Cir. 1959); Rev. Rul. 55-448, 1955-2 Cum. Bull. 595, where the same rule was applied in the field of federal income taxation.)

Finally,, section 25953 provides:

The period of the underpayment shall run from the date the installment was required to be made to whichever of the following date is the earlier--

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(a) The 15th day of the third month following the close of the income year.

(b) With respect to any portion of the underpayment, the date on which such portion is paid. For purposes of this subdivision, a payment of estimated tax on any installment date shall be considered a payment of any previous underpayment only to the extent such payment exceeds the amount of the installment determined under subdivision (a) of Section 25952 for such installment date. (Emphasis added.)

In the appeal before us, the reported overpayment for the prior year was credited in accordance with appellant's directions. The crediting of the reported overpayment by respondent resulted in a partial payment of the third installment, (See Rev. & Tax. Code, § 19082.1.) Pursuant to the authorities mentioned above, appellant could not thereafter direct a change in the application of the credit.

Contrary to appellant's contention, we do not find respondent's refusal to permit a change of application to be inequitable. The original **underpayment was substantial. Specifically, by the time the second installment was payable (Oct. 15, 1975) only \$10,000.00** had been directly paid to respondent; pursuant to section 25952, subdivision (a), one-half of **\$91,688.80** (80 percent of the tax liability of **\$114,611.00**), i.e., **\$45,844.45**, was the minimum amount payable by that time to avoid the statutory definition of underpayment.

Moreover, when **the** second installment was due (Oct. 15, 1975) there was no indication of any overpayment available to apply thereto'. It was not until approximately the due date of the third installment (Jan. 15; 1976) **that appellant sought the credit, and, at that time, respondent was directed to apply it to the third installment.** Not until after respondent made the actual application and issued the proposed assessment of the penalty did appellant manifest any intention to change its election. To permit taxpayers to change elections retroactively in this manner, in the absence of any statutory authority therefor, would create chaos in the administration of tax laws. (See Starr v. Commissioner, supra.)

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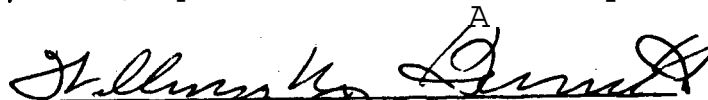
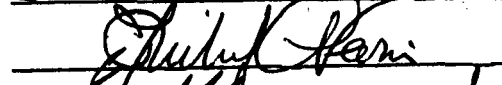


In conclusion, there is simply no statutory authority authorizing the relief sought by appellant. The underpayment penalty is mandatory **and is not** excused because of extenuating circumstances. (See Appeal of Decoa, Inc., Cal. St. Bd. of Equal., April 5, 1976.) Consequently, we must sustain respondent's action.

O R D E R

Pursuant to **the views** expressed in the opinion of the board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section 26077 of the Revenue and Taxation Code, that the action of the Franchise Tax Board in denying the claim of Jhinnack Enterprises, Inc., for refund of estimated tax penalty in the amount of **\$1,393.74** for the income year ended April 30, 1976, be and the same is hereby modified in accordance with the concession of the Franchise Tax Board. In all other respects the action of the Franchise Tax Board is sustained.

Done at Sacramento, California, this 11th day of December, 1979, by the State Board of Equalization.

 Chairman
 , Member
 , Member
 , Member
_____, Member