[Tax Court Memo Opinion, T.C. Memo. 1955]

Even when a taxpayer files a declaration of estimated tax, they are still subject to penalties for substantial underestimation if the estimated tax paid is significantly less than their actual tax liability.

Summary

Petitioners were initially assessed penalties for both failure to file and substantial underestimation of estimated taxes for 1949 and 1950. The Tax Court, in its initial report, incorrectly found that petitioners failed to file declarations for both years. Upon petitioners' exception, the court issued a supplemental opinion correcting its factual error for 1950, acknowledging that a declaration was indeed filed. However, the court upheld the penalty for substantial underestimation for 1950 because the estimated tax paid was less than 80% of the correct tax liability. The original findings and penalties for 1949 remained unchanged.

Facts

Petitioners failed to file declarations of estimated tax for 1949.

For 1950, petitioners timely filed a declaration of estimated tax and paid $2,500, reporting a net income of $41,339.48.

Petitioners' actual tax liability for 1950 was substantially higher than initially reported, leading to a significant underestimation of tax.

The Commissioner determined penalties for failure to file and substantial underestimation for both 1949 and 1950.

Procedural History

The Tax Court initially issued a report on November 24, 1954, finding petitioners liable for penalties for both failure to file and underestimation for 1949 and 1950.

Petitioners filed exceptions to the court's findings, specifically pointing out that they *had* filed a declaration for 1950.

The Tax Court issued this supplemental opinion to correct its factual finding regarding the 1950 declaration, but upheld the underestimation penalty for 1950.

Issue(s)

1. Whether petitioners are liable for a penalty for failure to file a declaration of estimated tax for 1949?

2. Whether petitioners are liable for a penalty for substantial underestimation of estimated tax for 1950, despite having filed a declaration?

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Holding

1. Yes, because the original finding that the failure to file for 1949 was due to willful neglect remains unchanged.

2. Yes, because their estimated tax of $2,500 was less than 80% of their correct tax for 1950, triggering the penalty for substantial underestimation under Section 294(d)(2) of the Internal Revenue Code of 1939.

Court's Reasoning

For 1949, the court reaffirmed its prior finding that the failure to file was due to willful neglect, thus upholding the penalty under section 294(d)(1)(A).

For 1950, the court corrected its factual error, acknowledging that petitioners did file a declaration. However, the court emphasized that filing a declaration does not automatically absolve taxpayers from underestimation penalties.

The court applied section 294(d)(2), which imposes a penalty for substantial underestimation if the estimated tax is less than 80% of the actual tax. The court noted that "reasonable cause" is not a defense to the section 294(d)(2) penalty, citing *B. R. Smith, 20 T. C. 668*.

The court stated, "However, they are, as determined by the Commissioner, liable for the section 294 (d) (2) penalty for 1950 since their estimated tax of $2,500 was less than 80 per cent of their correct tax for that year."

Practical Implications

This case underscores that merely filing an estimated tax declaration is insufficient to avoid penalties if the estimated tax paid is significantly lower than the actual tax owed. It clarifies the distinction between penalties for failure to file (section 294(d)(1)(A)) and penalties for substantial underestimation (section 294(d)(2)).

Legal practitioners should advise clients that accurate estimation of tax liability is crucial, and filing a nominal estimated tax payment is not a safeguard against underestimation penalties if the estimate is far below the actual tax. This case highlights that the underestimation penalty is triggered by the *amount* of underestimation, regardless of whether a declaration was filed, unless the underestimation falls within statutory exceptions not discussed in this opinion.

This decision reinforces the importance of thorough and accurate tax planning and estimation to avoid penalties, even when taxpayers attempt to comply with filing requirements.

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