

VINCENT L. & TONYA R. LANEY §
P.O. Box 512
Henagar, AL 35978, §

STATE OF ALABAMA
DEPARTMENT OF REVENUE
ADMINISTRATIVE LAW DIVISION

Taxpayers,

§

DOCKET NO. INC. 02-156

v.

§

STATE OF ALABAMA
DEPARTMENT OF REVENUE

§

FINAL ORDER

The Revenue Department assessed Vincent L. and Tonya R. Laney (together "Taxpayers") for 1999 Alabama income tax. The Taxpayers appealed to the Administrative Law Division pursuant to Code of Ala. 1975, §40-2A-7(b)(5)a. A hearing was conducted on July 11, 2002 at the Department's Birmingham Taxpayer Service Center. Sam McCord represented the Taxpayers. Assistant Counsel Jeff Patterson represented the Department.

ISSUE

The issue in this case is whether Vincent L. Laney is entitled to innocent spouse status for 1999 pursuant to Code of Ala. 1975, §40-18-27(e). That statute provides in pertinent part that an innocent spouse shall be relieved of liability for Alabama income tax to the same extent allowed for federal purposes.

FACTS

Tonya R. Laney (individually "Taxpayer") started working as a bookkeeper/secretary for RND Mechanical in November 1998. Her duties included doing the business' payroll and paying its bills. The Taxpayer was dismissed from her job in November 1999. She later pled guilty in Dekalb County Circuit Court to having embezzled over \$90,000 from the business during 1999.

The Taxpayers filed a joint 1999 Alabama income tax return. They failed, however, to report the embezzled income on the return. The Department audited the return and assessed the Taxpayers jointly on the amount embezzled by the Taxpayer during the year.¹

The Taxpayers filed a petition for review with the Department. They claimed in the petition that the additional income should be offset by the amount of court ordered restitution, and also that the Taxpayer's husband was entitled to innocent spouse status.

The Department scheduled a conference on the petition for review. Unfortunately, the Taxpayers' attorney was unable to attend. Consequently, a Department hearing officer denied the petition, holding that the repayment of taxable gross income can only be deducted by a cash basis taxpayer in the year of payment, citing *Collins v. Commissioner*, 3 F.3d 625 (2nd Cir. 1993), and also that the husband was not entitled to innocent spouse status because he failed to present evidence that he did not know or have reason to know of the embezzled funds. The Department subsequently entered the final assessment in issue. The Taxpayers appealed.

ANALYSIS

As indicated, an Alabama taxpayer may be allowed innocent spouse status to the same extent allowed under federal law. Section 40-18-27(e). Under current federal law, a person qualifies as an innocent spouse (1) if they file a joint return which has an understatement of income due to erroneous items of the spouse, (2) when they signed the joint return they did not know or have reason to know that there was an understatement of tax, and (3) taking into

¹The Department assessed the Taxpayers based on the total amount of restitution ordered by the DeKalb County Circuit Court, \$90,420.44.

account all facts and circumstances, it would be unfair to hold the innocent spouse liable for tax on the unreported income. 26 U.S.C. §6015.²

Whether the husband is entitled to innocent spouse status in this case turns on whether he knew or had reason to know that his wife had embezzled money during 1999. The “reason to know” standard was discussed in *Kistner v.*

Commissioner, 18 F.3d 1521 (11th Cir. 1994), as follows:

A spouse has “reason to know” if a reasonably prudent taxpayer under the circumstances of the spouse at the time of signing the return could be expected to know that the tax liability stated was erroneous or that further investigation was warranted. *Stevens v. Commissioner of Internal Revenue* [89-1 USTC §9330], 872 F.2d 1499, 1505 (11th Cir. 1989). The test establishes a ‘duty of inquiry’ on the part of the alleged innocent spouse. *Stevens* [89-1 USTC §9330], 872 F.2d at 1505. The courts have recognized several factors that are relevant in determining the ‘reason to know,’ including (1) the alleged innocent spouse’s level of education; (2) the spouse’s involvement in the family’s business and financial affairs; (3) the presence of expenditures that appear lavish or unusual when compared to the family’s past levels of income, standard of income, and spending patterns; and (4) the culpable spouse’s evasiveness and deceit concerning the couple’s finances. *Stevens* [89-1 USTC §9330], 872 F.2d at 1505.

Kistner, 18 F.3d at 1525.

The Taxpayers married in 1988. From 1988 until 1995, the Taxpayer did not work, and her husband provided the sole financial support for the family. The

²Before 1998, the federal innocent spouse provision was at 26 U.S.C. §6013(e). That section was repealed and the current innocent spouse provision at §6015(b) was enacted in 1998 as part of the IRS Restructuring and Reform Act of 1998 (P.L. 105-206). That legislation generally made it easier for individuals to qualify for innocent spouse relief. It also allows a spouse to elect for separation of liability treatment, §6015(c), and also equitable relief, §6015(f). However, Alabama law, at §40-18-27(e), only allows for innocent spouse relief. For a good explanation of the current federal statute, see, Harper, *Federal Tax Relief for Innocent Spouses: New Opportunities Under the IRS Restructuring and Reform Act of 1998*, 61 Ala.Law. 204 (May 2000).

Taxpayer began working in 1995. However, as before 1995, her husband continued to support the family because, according to both the Taxpayer and her husband, the Taxpayer “blew” her entire income on clothes, shoes, jewelry, etc.

The Taxpayer testified that she has always been obsessed with expensive clothes, jewelry, and other personal items. She has also suffered from kleptomania since she was a teenager. She already had an extensive wardrobe when she and her husband married in 1988. When she bought or stole new clothes, she would give away her old clothes so that her closet would not look cluttered.

The Taxpayer and her husband have a joint checking account and a single credit card. The husband also has a separate checking account. He puts part of his pay into his account. The remainder is deposited into the couple’s joint account. The Taxpayer pays the house mortgage, the utilities, and the insurance premiums from that account.

The Taxpayer also maintained a separate bank account and numerous credit cards in 1999 that her husband did not know about. To hide the accounts from her husband, she had the bank statements and the credit card bills sent to her mother’s house. She generally retrieved the statements and bills from her mother’s mailbox daily before her mother returned home from work.

The Taxpayer was arrested for stealing clothes in 1996, but the case was dismissed.

The Taxpayer began embezzling from RND Mechanical soon after she started working there in late 1998. She generally stole the money by issuing herself duplicate pay checks. She also wrote checks for cash and to pay her personal credit card bills.

RND Mechanical fired the Taxpayer in November 1999. It is not clear whether the owners of the business knew about the Taxpayer's embezzlement at that time. However, the Dekalb County Sheriff's Department questioned both the Taxpayer and her husband in December 1999 concerning the embezzled money. The Taxpayer denied her guilt and told her husband she was innocent. The husband reviewed the couple's joint bank account statements and credit card bills, but found no unexplained deposits or expenditures.

The Taxpayer was arrested for embezzlement in March 2000. Her mother and grandmother helped her make bond, and she kept the arrest secret from her husband. She also began receiving psychiatric treatment for kleptomania and depression after her arrest, which she also kept from her husband.

The Taxpayer finally pled guilty to embezzlement in the Spring of 2001. The Taxpayer's husband testified that only after his wife pled guilty did he know that she had actually embezzled money. The Dekalb County Circuit Court put her on probation and ordered her to pay restitution. The Court also ordered the Dekalb County Sheriff to seize and sell her jewelry to help pay the restitution. As indicated, the Department discovered the ill-gotten income, and assessed the Taxpayers jointly for the additional tax due.

The Taxpayer's husband testified that he was not aware that his wife was buying an unusual amount of expensive clothing and jewelry in 1999. He testified that she always had new clothes, and that he did not pay much attention to what she wore or how expensive it might be. The Taxpayer confirmed that her husband never paid attention to her clothes, and would not know the difference between a \$10 pair of shoes and a \$400 pair of shoes.

The evidence establishes that the Taxpayer's husband did not know or have reason to suspect that his wife had embezzled over \$90,000 in 1999. As discussed, the Taxpayer has always had an extensive wardrobe. She carefully

culled her older clothes when she bought or stole new items to make sure her closet was never too crowded. The husband obviously knew that his wife sometimes wore new clothes or jewelry, but his testimony is believable that he did not suspect anything abnormal during 1999.

The Taxpayer's surreptitious behavior also confirms that she tried to hide the embezzlement from her husband. The fact that she had the bank statements from her secret bank account and her numerous credit card bills mailed to her mother's house shows that she tried to hide her actions from her husband. She also kept her arrest in March 2000 a secret from her husband as long as she could, and did not tell him that she was being treated by a psychiatrist for kleptomania and depression.

Viewing the circumstances as a whole, it would also be inequitable to hold the husband liable for tax on the embezzled income. He provided the sole support for his wife and children during the subject year, and there is no evidence that he or his children benefited from the embezzled income. See generally, *Quint v. Commissioner*, T.C. Memo 1985-226, 49 TCM 1465 (1985); *Jones v. Commissioner*, T.C. Memo 1977-51, 36 TCM 227 (1977); *Huelsman v. Commissioner*, 416 F.2d 477 (1969).

The final assessment is affirmed against Tonya R. Laney. Vincent L. Laney is relieved of liability as an innocent spouse. Judgment is entered accordingly.

This Final Order may be appealed to circuit court within 30 days pursuant to Code of Ala. 1975, §40-2A-9(g).

Entered August 29, 2002.