

ROBERT W. & JO ANN M. HUMBER §  
475 Crossville Loop Road §  
Vernon, AL 35592, §

STATE OF ALABAMA  
DEPARTMENT OF REVENUE  
ADMINISTRATIVE LAW DIVISION

Taxpayers, §

DOCKET NO. INC. 03-230

v. §

STATE OF ALABAMA §  
DEPARTMENT OF REVENUE.

### FINAL ORDER

The Revenue Department assessed Robert W. and Jo Ann M. Humber (together “Taxpayers”) for 1998 and 1999 income tax. Jo Ann Maddox (Humber) (individually “Taxpayer”) appealed to the Administrative Law Division pursuant to Code of Ala. 1975, §40-2A-7(b)(5)a. A hearing was initially conducted on August 12, 2003. Craig Geno represented the Taxpayer. Assistant Counsel Mark Griffin represented the Department. A second hearing was conducted on January 17, 2007. Craig Geno and Mark Griffin again represented the Taxpayer and the Department, respectively.

The issue in this case is whether the Taxpayer is entitled to innocent spouse relief in the subject years 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 purposes to the same extent allowed for federal purposes.

The Taxpayers were married in the 1980’s. They both worked at Citizens Bank in Vernon, Alabama during the 1990’s. The Taxpayer was an executive assistant at the Bank. Her husband was an officer.

The Taxpayers filed joint Alabama returns for 1998 and 1999 on which they reported the income they earned at the Bank. The Taxpayer’s husband, who also prepared the Bank’s returns, prepared the returns. The Taxpayer signed the returns without reviewing

them. She testified at the January 17 hearing that she had never dealt with the couple's taxes, and that she trusted her husband to do the right thing.

The Taxpayer's husband was arrested by the FBI in June 1999 for embezzling from the Bank. He subsequently pled guilty and was sentenced to federal prison in 2000.

To recoup its losses, the Bank sold the Taxpayers' residence and also most of the furniture in the house. The Taxpayer was forced to move into her father's house, where she currently resides. She was also forced to resign her job at the Bank. She is now divorced and works as a clerk for \$9 an hour.

After being arrested, the Taxpayer's husband filed amended, married filing separate Alabama returns for 1998 and 1999 on which he reported the embezzled income. The Department refused to allow or accept the amended returns. It subsequently assessed the Taxpayers, jointly, for the tax due on the previously unreported income.

The Taxpayer claims she is entitled to innocent spouse relief because she was unaware of and did not personally benefit from the embezzled income. She also applied for innocent spouse status with the IRS. The IRS tentatively granted the Taxpayer relief, and has not assessed or taken other action against the Taxpayer. It is not known, however, if the IRS granted innocent spouse relief, which Alabama allows, or separation of liability or equitable relief, see 26 U.S.C. §§6015(c) and 6015(f), respectively, which Alabama does not recognize. In any case, because the Taxpayer failed to provide evidence that the IRS has allowed her innocent spouse status for federal purposes, the Department refused to allow her that status for Alabama purposes.<sup>1</sup>

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<sup>1</sup> The case was held in abeyance after the August 2003 hearing to allow the Taxpayer time  
(continued)

The Administrative Law Division previously addressed the innocent spouse issue in *Waldrop v. State, Inc.* 00-404 (Admin. Law Div. 11/22/02). The taxpayer in that case was married to a bookie. The federal government convicted the taxpayer's spouse on gambling-related charges. The IRS subsequently assessed the couple, jointly, on the spouse's unreported gambling income. The Administrative Law Division granted the taxpayer innocent spouse status, citing a prior case that also involved income embezzled by a spouse. *Waldrop* reads in pertinent part as follows:

(The bookie) did not contest the IRS assessment because he has no assets. However, the (bookie's wife) applied to the IRS for innocent spouse or other relief under 26 U.S.C. §6015. That statute was enacted in 1998, and generally made it easier for individuals to qualify for innocent spouse relief. It also allows a spouse to elect for separate liability treatment pursuant to §6015(c), and also equitable relief pursuant to §6015(f). (footnote omitted) However, Alabama has not adopted §§6015(c) and 6015(f), and only allows for innocent spouse relief. See, §40-18-27(e).

The IRS subsequently granted the (wife) separate liability status pursuant to §6015(c). As indicated, however, Alabama only recognizes innocent spouse relief, not separate liability relief. The Department denied the (wife) innocent spouse status. The Taxpayer appealed.

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Alabama's innocent spouse statute was addressed in *Laney v. State of Alabama, Inc.* 02-156 (Admin. Law Div. 8/29/02). In that case, the taxpayer's wife embezzled large sums of money from her employer. The taxpayer claimed that he should be relieved of liability as an innocent spouse because he was unaware that his wife had embezzled from her employer, and he did not benefit from the ill-gotten income. The Final Order in the case reads in pertinent part as follows:

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

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to obtain documentation from the IRS that she had been allowed innocent spouse status. As indicated, the Taxpayer was unable to provide that evidence.

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 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. (footnote omitted)

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.

*Laney, Inc.* 02-156 at 2-3.

Applying the above legal standard, the husband was granted innocent spouse status because he did not know or have reasonable cause to suspect that his wife had embezzled money during the subject year. Likewise, in this case, the evidence shows that the Taxpayer did not know or have reason to suspect that her husband had illegal gambling income during the subject years. She also did not directly or indirectly benefit from his gambling income.

*Waldrop* at 2 – 4.

The rationale of *Laney* and *Waldrop* also applies in this case. The Taxpayer deposited her pay into her own bank account and used the money to pay various personal expenses. Her husband paid the household and other common expenses from the couple's joint account. The Taxpayer never wrote checks on the joint account, and was not aware how much money was in the account. The husband also managed the couple's investments.

The Taxpayers did not live extravagantly, and the husband did not buy the Taxpayer expensive clothes, jewelry, etc. The Department argued at the January 17 hearing that the couple had almost \$10 million in a joint investment account. The Taxpayer testified, however, that she was unaware of and never received money from that account. There is no evidence to the contrary.

The evidence establishes that the Taxpayer did not know or have reason to know that her husband had embezzled millions of dollars from the Bank. There is also no evidence that she benefited either directly or indirectly from the stolen funds. Consequently, she is entitled to innocent spouse relief.

The Taxpayer is relieved of liability from the 1998 and 1999 final assessments in issue. 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 January 24, 2007.

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BILL THOMPSON  
Chief Administrative Law Judge

bt:dr

cc: Mark Griffin, Esq.  
Craig M. Geno, Esq.  
Kim Peterson