

WILLIAM C. & LAURA HAVENS
7469 MEADOW WOOD DR.
MOBILE, AL 36619-3673,

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STATE OF ALABAMA
DEPARTMENT OF REVENUE
ADMINISTRATIVE LAW DIVISION

Taxpayers,

§

DOCKET NOS. INC. 07-980

v.

§

STATE OF ALABAMA
DEPARTMENT OF REVENUE.

§

FINAL ORDER

The Revenue Department assessed William C. and Laura Havens, jointly, for income tax for 1998 through 2002. The Taxpayers separately appealed to the Administrative Law Division pursuant to Code of Ala. 1975, §40-2A-7(b)(5)a.

A hearing was conducted in William Havens' appeal, Docket Inc. 07-926, on March 18, 2008. A Final Order was entered in that case on March 20, 2008 affirming the final assessments against William Havens, individually.

This case involves the appeal filed by Laura (Havens) Mulholland. A hearing was conducted in the case on October 9, 2008. Jeff Crabtree represented the Taxpayer. Assistant Counsel Duncan Crow represented the Department.

The issue is whether Laura (Havens) Mulholland ("Taxpayer") is entitled to innocent spouse relief for the years in issue pursuant to Code of Ala. 1975, §40-18-27(e).

The Taxpayer and William Havens (hereafter "ex-husband") had been married for over twenty years during the years in issue. The ex-husband worked full-time at a funeral home and part time at the Alabama Eye and Tissue Clinic during the subject years. The Taxpayer suffered from cancer during those years, but worked part-time cleaning houses when not disabled by chemotherapy.

The ex-husband was also the treasurer at the Scottish Rite in Mobile. He embezzled at least \$213,000 from the Scottish Rite during the years in issue. His crime was subsequently discovered, and he served a total of sixteen months in federal and State prisons.

An examiner with the Department's Investigations Division assisted the State and federal authorities in investigating the criminal case against the ex-husband. She testified at the October 9 hearing that the Taxpayer and her ex-husband had a joint checking account during the subject years, but that the ex-husband also opened several checking accounts in his individual name. (The accounts were technically joint accounts in the name of the ex-husband and the Scottish Rite.) He surreptitiously transferred money from the Scottish Rite account into his individual accounts. He subsequently used the embezzled funds to primarily buy personal items and pay personal debts.

None of the embezzled funds were deposited into the couple's joint account. The Taxpayer testified that her ex-husband handled their joint account and paid all of their bills, which were mailed directly to the ex-husband at work. He also prepared and filed their tax returns. The Taxpayer only signed the returns as directed by the ex-husband.

The Taxpayer testified that she and her ex-husband's lifestyle did not change during the subject years, and that he never purchased her any expensive gifts. She explained that she did not know or suspect that her ex-husband was embezzling money until she opened his gun vault (probably in 2002) and found over 100 guns. She asked

her ex-husband about the guns, and he told her he had purchased the guns with money borrowed from the Scottish Rite.

Shortly after the Taxpayer discovered the guns, attorney E. J. Saad became involved in the matter. Saad was the Scottish Rite's attorney, and had also previously represented the Taxpayer and her ex-husband. It was apparently discovered at that time that the ex-husband had embezzled money from the Scottish Rite. He repaid \$40,000 to the Scottish Rite, but was eventually prosecuted, convicted, and sent to prison. The Taxpayer was not charged or otherwise implicated in the crime. The couple have since divorced.

An Alabama taxpayer may be allowed innocent spouse status to the same extent allowed under federal law. Section 40-18-27(e). Under federal law, a person qualifies as an innocent spouse if (1) they filed a joint return which had 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. §6015.¹

The initial inquiry in this case is whether the Taxpayer knew or had reason to know that her ex-husband had embezzled money during the years in issue. The

¹Before 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 only allows for innocent spouse relief at §40-18-27(e). 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).

“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 Taxpayer in this case had no reason to know or even suspect that her ex-husband had embezzled funds during the years in issue. There is no evidence that the couple’s lifestyle changed, or that the ex-husband purchased the Taxpayer extraordinary or otherwise expensive gifts during the subject period.

The Department contends that the couple took a \$1,100 cruise, but that is not unusual for a couple making \$40,000 to \$50,000 a year. The Department also presented evidence that the ex-husband had spent large sums of money on various items such as clothes, jewelry, etc. But the ex-husband used the embezzled money in his individual accounts to pay those bills, and there is no evidence that the Taxpayer benefited from the items purchased.

The ex-husband also for obvious reasons did not want anyone, including his wife, to know that he was stealing money from the Scottish Rite. He deposited the

embezzled funds into checking accounts in his own name, and never transferred any of the funds to the couple's joint account. When the Taxpayer confronted her spouse in 2002 about the numerous guns in his gun safe, he told the Taxpayer for the first time that he had purchased the guns with money borrowed from the Scottish Rite. His illegal activities were discovered soon thereafter.

Importantly, the Taxpayer was suffering from cancer and periodically underwent chemotherapy treatments during the subject years. She nonetheless continued to clean houses when physically able. She earned \$2,000 to \$4,000 a year from her work. If she had known about and benefited from the tens of thousands of dollars a year her spouse was taking from the Scottish Rite, logic dictates that she would have stopped working altogether. She did not.

In summary, the Taxpayer was not involved in the couple's business affairs, i.e., she did not handle their checking account, pay their bills, or do their taxes. There were no lavish or extraordinary expenditures that could have put the Taxpayer on notice that her spouse was stealing money. Finally, the ex-husband attempted to hide his scheme by putting the embezzled funds into bank accounts separate from his joint account with the Taxpayer. Under the circumstances, the Taxpayer is entitled to innocent spouse relief.

The Taxpayer is removed from liability for the 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 6, 2009.

BILL THOMPSON
Chief Administrative Law Judge

bt:dr

cc: Duncan R. Crow, Esq.
Jeffrey Crabtree, Esq.
Tony Griggs