

STATE OF ALABAMA
DEPARTMENT OF REVENUE,

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STATE OF ALABAMA
DEPARTMENT OF REVENUE
ADMINISTRATIVE LAW DIVISION

§

v.

§

DOCKET NO. INC. 87-178

BARNEY & JO ANNE WIGGINS
Route 3, Box 51A
Andalusia, AL 36420,

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§

Taxpayer.

§

ORDER

The Revenue Department entered joint preliminary assessments of income tax against Barney and Jo Anne Wiggins ("Taxpayers") for the calendar years 1982, 1983 and 1984. Barney Wiggins ("Taxpayer") appealed to the Administrative Law Division and a hearing was conducted on September 14, 1988. James R. Clifton, Esq. was present and represented the Taxpayer. Assistant counsel Mark Griffin appeared for the Department. Based on the evidence submitted in the case, the following findings of fact and conclusions of law are hereby made and entered.

FINDINGS OF FACT

The Taxpayer and his wife filed joint Alabama income tax returns for 1982, 1983 and 1984. During those years, the Taxpayer was employed as a plumbing and electrical salesman and his wife worked in the Utility Department for the City of Andalusia.

The wife was fired in March, 1985 for embezzling funds from the City, and was convicted of the same offense in Covington County Circuit Court in March, 1986. The funds were embezzled during 1982, 1983 and 1984, but, as to be expected, were not included by

the Taxpayers on their joint Alabama income tax returns in those years.

The Department audited the Taxpayers and included the stolen money as income to the Taxpayers. The amounts taken by the wife were determined from an audit done on behalf of the City. Joint assessments were subsequently entered against the Taxpayers, including a fraud penalty in each year.

The Taxpayer argues that he should not be held liable for the additional tax due because he was unaware of his wife's actions and received no benefit from the embezzled funds. The Taxpayer further contends that in any case he should not be liable for the fraud penalty included in the joint assessments.

The Taxpayers lived economically and made no extraordinary expenditures during the subject years. The wife maintained and paid the monthly bills out of a joint checking account. The Taxpayer maintained a joint savings account into which a portion of his pay was deposited each month. The wife traded for a new Buick in 1982, and the Taxpayer financed a truck in 1983. The couple took only two short, relatively inexpensive vacations during the period. The only major expenditure by the Taxpayers was approximately \$2,000.00 for an addition to their residence, which was paid with cash from the checking account.

The Taxpayer testified that he had no knowledge of nor did he suspect that his wife was embezzling funds from the City. The Taxpayer's first knowledge of the embezzlement was when his wife

was fired in March, 1985. None of the stolen funds were deposited in either the joint checking account or the joint savings account, or otherwise used for the benefit of the family. The whereabouts of the stolen funds has never been established.

The Taxpayers were divorced in 1986. The Taxpayer received the house and paid his wife a lump sum for her portion of the joint savings account. The Taxpayer also pays \$500.00 a month in alimony. The wife is presently serving time for her embezzlement conviction.

CONCLUSIONS OF LAW

Code of Ala. 1975, §40-18-27 provides that a husband and wife filing a joint return are jointly and severally liable for the tax due thereon. However, the Taxpayer contends that he should be spared from liability based on the innocent spouse rule.

Prior to 1971, the innocent spouse rule was an equitable, common law principle applied by the federal courts to relieve an innocent spouse from joint liability under certain circumstances. Sharwell v. Commissioner, 419 F.2d 1057 (1969); Scudder v. Commissioner, 405 F.2d 222 (1969); Huelsman v. Commissioner, 416 F.2d 477 (1969). The rule was codified by Congress in 1971 with the passage of 26 U.S.C. §6013(e).

Section 6013(e) provides that a spouse will be relieved of liability when (1) a joint return has been filed, (2) the return has a substantial understatement of income attributable to one

spouse, (3) the other (innocent) spouse did not know and had no reason to know of the understatement, and (4) all facts considered it would be unfair to hold the innocent spouse liable for the tax attributable to such understatement. Alabama adopted the federal innocent spouse rule by amendment to Code of Ala. 1975, §40-18-27 in 1987.

It is clear that the innocent spouse rule should apply in the present fact situation. The Taxpayer had no knowledge of and had no reason to suspect that his wife was embezzling funds. Further, the Taxpayer in no way directly or indirectly benefitted from the embezzled money. The issue thus turns on whether the rule was applicable in Alabama during the subject years.

The Taxpayer argues that the 1987 amendment should be applied retroactively. However, a statute must be applied prospectively only unless the language clearly expresses the Legislature's intent for retrospective application. Morgan v. Morgan, 445 So.2d 297, cert denied, Ex parte Morgan, 445 So.2d 300. The 1987 amendment to §40-18-27 included no provision for retroactive application.

However, the innocent spouse rule should be applied in the present case notwithstanding the technically prospective application of the 1987 amendment. As noted, the rule originated as a court sanctioned method to provide equitable relief to certain innocent spouses. The rule was applied by the federal courts prior to 1971, and the passage of §6013(e) merely verified Congress'

support for the rule. Alabama's income tax system is modeled after the federal system. The same general guidelines and principles applicable to the federal system must also be applied in Alabama. State v. Gulf Oil Co., 256 So.2d 172. Thus, the innocent spouse rule applied by the federal courts before the passage of §6013(e) should also be applied in Alabama for the years prior to the statutory adoption of the rule by Alabama in 1987.

In Huelsman v. C.I.R., supra, which was decided prior to passage of §6013(e), the court stated the equitable reasoning behind the rule as follows:

Courts very often hold in tax cases, at the insistence of the Government, that substance should prevail over form. The form of this case is that petitioner signed in good faith tax returns with her husband which technically made her liable for the tax on their joint income. The substance is that the money which her husband embezzled without her knowledge was not income to her in the usual sense of the word and, by the finding of the Tax Court, did not benefit her directly or indirectly. Just as the government should pursue with diligence willful tax evaders so should it be diligent in protecting those who are innocent of wrongdoing.

The Department acknowledges the equitable nature of the rule, but attempts to differentiate between the federal cases cited by the Taxpayer and the facts of the instant case. The Department's brief, at page 2, states as follows:

As can be seen, the cases cited by Mr. Wiggins to indicate that the innocent spouse rule should apply even absent the 1987 amendment differ greatly from the facts in this case. Therefore, although the federal courts apparently established an equitable innocent spouse policy without the benefit of

statute, the equitable concerns in those cases are much greater than those in the case at hand.

However, while the facts may vary between the cited cases and the present case, the Taxpayer clearly fits within the technical parameters of the rule. The Taxpayer should not be held liable for tax on income about which he had no knowledge and from which he received no benefit. The purpose for the innocent spouse rule is to relieve a taxpayer of liability in such instances.

The above considered, the assessments in issue should be made final against the wife, Jo Anne Wiggins, only. Each assessment should include the fraud penalty and interest as required by statute.

Entered this 2nd day of November, 1988.

BILL THOMPSON
Chief Administrative Law Judge