STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
DARIA M. CARNESI	:	DECISION DTA NO. 823507
for Redetermination of a Deficiency or for Refund of Personal Income Tax under Article 22 of the Tax Law for the Years 1992 through 1995.	:	

Petitioner, Daria M. Carnesi, filed an exception to the determination of the Administrative Law Judge issued on December 6, 2012. Petitioner appeared *pro se*. The Division of Taxation appeared by Amanda Hiller, Esq. (Christopher O'Brien, Esq., of counsel).

Petitioner did not file a brief in support of her exception. The Division of Taxation filed a letter brief in opposition. Petitioner filed a reply brief. Oral argument was not requested.

After reviewing the entire record in this matter, the Tax Appeals Tribunal renders the following decision.

ISSUE

Whether petitioner has proven entitlement to innocent spouse relief from New York State personal income tax under Tax Law § 651 (former [b] [5]).

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge, except for finding of fact "10," which has been modified. We have also made an additional finding of fact. The Administrative Law Judge's findings of fact, the modified finding of fact and the additional finding of fact are set forth below.

Following an audit, the Division of Taxation (Division) issued a Notice of Deficiency, dated September 29, 1997, to petitioner Daria Carnesi and her husband Kenneth Carnesi, which assessed personal income tax due of $96,389.76, plus penalty and interest, for the years 1992 through 1995.

During the audit period, Kenneth Carnesi was an attorney, practicing as a sole practitioner under the name Carnesi & Associates. He also operated a consulting firm named Banfinanz, Ltd., which was involved in advising European companies on the methods available to obtain financing from American banking institutions. Banfinanz, Ltd., was a subchapter S corporation wholly owned by Mr. Carnesi. Associated with his law practice and consulting firm were various expenses he incurred during the years of the audit, including expenses for personnel, the lease of the building where he operated his law practice and consulting firm, utilities and health care costs.

On February 11 and 13, 1997, an auditor from the Division telephoned Kenneth Carnesi for the purpose of informing him that an audit of his consulting business and legal practice was to be conducted for the years 1992 through 1995. On both occasions, the auditor left a message for Mr. Carnesi to contact the auditor. Mr. Carnesi did not return the auditor's telephone calls.

On March 10, 1997, the auditor sent a letter to Mr. Carnesi advising him of the audit and stating that an appointment had been scheduled for April 3, 1997 at the Division's offices. Mr. Carnesi did not appear at the scheduled appointment. On April 7, 1997, the auditor telephoned and again left a message requesting that Mr. Carnesi call him back. Mr. Carnesi again did not respond to the message. On April 22, 1997, the auditor sent proposed audit adjustments for the years 1992 through 1995 to Kenneth and Daria Carnesi at their home address. The cover letter accompanying the computations provided Mr. and Mrs. Carnesi with the opportunity to discuss

the audit findings in detail, and requested that they telephone the Division's office by May 12, 1997. No telephone call was received by the Division's office. On May 22, 1997 and June 27, 1997, two additional messages were left at Mr. Carnesi's office by the auditor, without response.

The basis of the proposed audit adjustments and subsequent notice of deficiency was the disallowance of all Schedule C claimed expenses for Mr. Carnesi's law practice and consulting firm and the disallowance of all itemized deductions claimed by Mr. and Mrs. Carnesi on their joint returns for the years 1992, 1993 and 1994. The personal income tax returns for these three years were all dated April 12, 1996 and received by the Division on April 30, 1996. As no return was filed for the year 1995, the auditor estimated income based upon the actual reported 1994 income appearing on Mr. and Mrs. Carnesi's personal income tax return for that year.

Due to the failure of Kenneth and Daria Carnesi to timely protest the subject Notice of Deficiency, the Division issued, on January 22, 1998, a Notice and Demand for the tax, penalty and interest due as determined on audit. Thereafter, a warrant was docketed on November 23, 1998 against petitioner and her husband. A lien was placed on their home, and following a sale of the house as a result of a mortgage foreclosure in March 2005, payment was made to the Division on November 13, 2006 in the amount of $338,852.28. In addition, petitioner's wages were garnished in the amount of $6,240.00 and the Division took possession of their son's Uniform Transfers to Minors Act (UTMA) custodial account in the amount of $5,279.00.

Petitioner filed a request for a conciliation conference on October 9, 2007, seeking a refund of one-half of the proceeds from the foreclosure sale, or $169,426.14, together with a return of her garnished wages in the amount of $6,240.00, on the basis that she is entitled to innocent spouse status. The Division stipulated at hearing to refund the money seized from the UTMA custodial account in the amount of $5,279.00.

Petitioner obtained a B.A. degree from C.W. Post University in 1978 and a paralegal certificate from Adelphi University in the same year. She was employed by New York Life Insurance Company as a contract analyst until 1985, when she left employment to stay at home to maintain the couple's household and care for their two young children. She did not work outside the home again until 2005.

During the years at issue, petitioner was not involved in the payment of the household expenses, except for groceries, clothes for the children and other basic necessities. Mr. Carnesi would give petitioner approximately $300.00 to $350.00 each week to cover these expenses. All other family expenses, such as the mortgage, utilities, automobile and medical insurance and the leases on the automobiles, were paid by Mr. Carnesi. Petitioner was unaware as to how these bills were paid, from what account they were paid or whether Mr. Carnesi had a personal account. Petitioner was certain that she did not have a joint bank account with her husband. Finally, petitioner took no role in Mr. Carnesi's law practice or consulting firm.

We modify finding of fact "10" of the Administrative Law Judge's determination to read as follows:

> Petitioner was not involved in the preparation of the joint personal income tax returns filed by the couple for the years 1992, 1993 and 1994. Mr. Carnesi prepared the returns, and with petitioner's consent, signed petitioner's name to the returns. Petitioner never reviewed the returns, or inquired as to the contents of the returns. Mr. Carnesi considered the itemized deductions and business expenses claimed on the personal income tax returns to be appropriate. Mr. Carnesi testified that it was his opinion that at the time the returns were filed, sufficient documentation existed to unquestionably substantiate at least 70 percent of the deductions shown on the returns. As to the remaining 30 percent of the deductions, Mr. Carnesi indicated that there was some basis of support for them, but that they were more subject to challenge than the other 70 percent.[1]

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[1] We modify this fact to more accurately reflect the record.

There was no dramatic change in the couple's lifestyle during the years at issue. There were no structural additions to the family home, they did not take vacations or entertain on a large scale. Petitioner mowed the lawn, did much of the landscaping and shoveled the snow in the winter.

We make the following additional finding of fact:

> Petitioner and Mr. Carnesi assert that the Internal Revenue Service ("IRS") examined their joint 2002 and 2003 federal tax returns and the deductions taken on such returns.[2] According to petitioner and Mr. Carnesi, the IRS accepted and permitted all of the deductions in question for those two years.

THE DETERMINATION OF THE ADMINISTRATIVE LAW JUDGE

The Administrative Law Judge reviewed the applicable provisions of the Tax Law that were in effect for the years at issue (Tax Law § 651 [former [b] (5) (A) and (B)]. The Administrative Law Judge articulated the criteria that must be met for a party to obtain innocent spouse relief for the years at issue. The Administrative Law Judge noted that the first requirement is that the taxpayer must have filed a joint tax return for the year(s) at issue. Since petitioner had not filed a New York State tax return for 1995, the Administrative Law Judge found that petitioner could not seek innocent spouse relief for that tax year. As joint returns were filed in the remaining years at issue, the Administrative Law Judge next considered whether the substantial understatement claimed on the tax returns could be attributable to "grossly erroneous items" of one spouse (Tax Law § 651 [former [b] (5) (B) (i)]).

The Administrative Law Judge held that an item on a return is not "grossly erroneous" if there was a legal or factual basis supporting the relevant position. The Administrative Law

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[2] The deductions taken on the federal tax returns examined by the IRS would be the same deductions that were at issue on the New York State tax returns, and those for which petitioner now seeks "innocent spouse" relief.

Judge found that the couple considered the subject deductions proper. Accordingly, the Administrative Law Judge held that the subject deductions were not "grossly erroneous items" and, as such, innocent spouse relief was not available. The Administrative Law Judge also held that petitioner did not establish that she did not know, or should not have known, about the misstatements on the joint returns filed.

ARGUMENTS ON EXCEPTION

In her exception, petitioner argues that based upon Kenneth Carnesi's testimony, a portion of the deductions taken on the relevant tax returns had no basis in fact or law, and therefore, should be deemed "grossly erroneous items." In addition, petitioner argues that she did not know, and had no reason to know, that the subject tax returns contained substantial understatements of income.

On exception, the Division relies upon the determination of the Administrative Law Judge.

OPINION

The sole issue before the Tribunal is whether petitioner qualifies for relief as an "innocent spouse" pursuant to Tax Law § 651 (former [b] [5] [A] and [B]). Due to the failure of Kenneth and Daria Carnesi to timely protest the original relevant Notice of Deficiency, the underlying liability relating to the years at issue is already fixed and not subject to review.

Tax Law § 651 (former [b] [5] [A]), in effect during the years at issue, provided that if:

> "(i) a joint return has been made under this subsection for a taxable year,
>
> (ii) on such return there is a substantial understatement of tax attributable to grossly erroneous items of one spouse,

> (iii) the other spouse establishes that in signing the return he or she did not know, and had no reason to know, that there was such substantial understatement, and
>
> (iv) taking into account all the facts and circumstances, it is inequitable to hold the other spouse liable for the deficiency in tax for such taxable year attributable to such substantial understatement, then the other spouse shall be relieved of liability for tax (including interest, penalties and other amounts) for such taxable year to the extent that such liability is attributable to such substantial understatement."

Petitioner and Kenneth Carnesi did not file a return for the year 1995. As such, petitioner is not entitled to innocent spouse relief for that year (Tax Law § 651 [former [b] (5) (A) (i)]; ***see Shea v C.I.R.***, 780 F2d 561 [6th Cir 1986]).

As for the years in which a joint return had been filed, petitioner must establish that the tax in question is a "substantial understatement" of liability. The term "substantial understatement" means any understatement that exceeds one hundred dollars (Tax Law § 651 [former [b] (5) (B) (ii)]). Since the Division does not challenge the assertion that the amount at issue on each of the relevant returns is a "substantial understatement," we need not address that issue.

The next step in considering whether innocent spouse relief is available is to determine if the substantially understated amounts are attributable to "grossly erroneous items" of one spouse (Tax Law § 651 [former (b) (5) (B) (ii)]). In this regard, the term "grossly erroneous items" means, in relevant part:

> "any claim of a New York deduction, exemption, credit or basis by such spouse in an amount for which there is no basis in fact or law . . ." (Tax Law § 651 [former (b) (5) (B) (i)]).

We note, that the wording of this provision is similar to its parallel provision in the Internal Revenue Code (***compare*** Tax Law § 651 [former [b] (5) (B) (i)]; 26 USC § former 6013

[e] [2]). Accordingly, it is appropriate to refer to the provisions of the Internal Revenue Code, Treasury Regulations and federal and New York case law to determine petitioner's eligibility for innocent spouse relief (***see*** Tax Law § 607 [a]).

In addressing the issue of what is a "grossly erroneous item," the U.S. District Court for the 2nd Circuit noted:

> "The Internal Revenue Code defines a 'grossly erroneous' deduction as one 'for which there is no basis in fact or law.' I.R.C. § 6013(e)(2). In other words, the claim may be said to be 'frivolous,' 'groundless,' 'fraudulent,' or 'phony.' *Bokum v. Commissioner,* 992 F.2d 1136, 1142 (11th Cir. 1993) (quoting *Stevens,* 872 F.2d at 1504 n. 6); *see also Shenker v. Commissioner*, 804 F.2d 109, 114 (8th Cir. 1986), *cert. denied,* 481 U.S. 1068, 107 S.Ct. 2460, 95 L.Ed.2d 869 (1987); *Flynn v. Commissioner,* 93 T.C. 355, 364, 1989 WL 107095 (1989). The grossly erroneous requirement prevents an innocent spouse defense from applying to every disallowed claim simply because it has been disallowed. *Cf. Bokum,* 992 F.2d at 1142.
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> The 'innocent spouse' defense was designed to prevent the inequity of holding one spouse liable for the oversubtle financial machinations of the other; the defense was not intended to permit one spouse to escape liability for an apparently legitimate claim that turns out to have been disallowed." (***Friedman v C.I.R.***, 53 F3d 523, 529 [2nd Cir 1995]).

The Administrative Law Judge found that Kenneth Carnesi believed that he had a legitimate claim to all of the deductions at issue. On exception, petitioner argues that Mr. Carnesi's testimony makes it clear that approximately 30 percent of the deductions taken did not have a legal or factual basis. Petitioner asserts that Mr. Carnesi testified that approximately 30 percent of the subject deductions were "exaggerated" amounts and, accordingly, have absolutely no basis in fact or law. However, a review of Mr. Carnesi's testimony cited to by petitioner does not lead to such a certain conclusion. Rather, Mr. Carnesi's testimony was that "70% of my deductions were unambiguous and unchallengeable and unquestionable . . ." (Hearing Tr. p. 105). However, with regard to the remaining 30 percent of the deductions, at no time did Mr.

Carnesi articulate that such were exaggerated or groundless. In his testimony, Mr. Carnesi asserted that 30 percent of the deductions taken on the returns may have been more difficult to substantiate than the other 70 percent, and that they "could have been argued about" (Hearing Tr. p. 103). Mr. Carnesi stressed that the IRS had audited the deductions and found them all to be acceptable. Mr. Carnesi's testimony was more in the nature of challenging the underlying audit findings of the Division, which rejected all of the deductions listed on the tax return, rather than asserting that a certain percentage of the deductions taken were inappropriate.

As noted, if the disallowed items had a factual or legal basis, innocent spouse relief is not available, since the understatement cannot be found to have been attributable to grossly erroneous items (***Purcell v C.I.R.***, 826 F2d 470 [6th Cir 1987], ***cert denied*** 485 US 987 [1988]). In the case at hand, petitioner made no showing that the disallowed business deductions lacked any basis in fact or law.

Since the deductions at issue had a factual or legal basis, petitioner is not entitled to innocent spouse relief.

Petitioner also challenges the Administrative Law Judge's conclusion that petitioner failed to show that she did not know, and had no reason to know, that the returns for the years 1992, 1993 and 1994 contained substantial understatements.

In reviewing the application of the law in this particular area, the Appellate Division concluded:

> "[A]s to the [taxpayer's] claim for innocent spouse relief, we note that the applicable statutory law evolved during the period in question (*see* Tax Law § 651 [former (b) (5) (A)]; § 654); however, the determinative issue for purposes of the instant claim has remained essentially the same. As the party seeking innocent spouse relief, the [relevant taxpayer] here bore the burden of establishing, among other things, that at the time the underlying amended joint income tax returns were signed, he did not know or have reason to know of the understatements

> (*compare* Tax Law § 651 [former (b) (5) (A)]; § 654; 26 USC § 6015 [b] [1] [C]; [c] [2]; *Matter of Rubin v Tax Appeals Trib. of State of N.Y.*, 29 AD3d at 1090; *Cheshire v Commissioner of Internal Revenue*, 282 F3d 326, 332-334 [5th Cir 2002], *cert denied* 537 US 881 [2002]). [The taxpayer's] claim of intentional ignorance regarding the preparation of his joint tax returns was not credited by the Tribunal and is not a legal defense to the assessed deficiencies. 'The "innocent spouse" exemption was not designed to protect willful blindness or to encourage the deliberate cultivation of ignorance' (*Friedman v Commissioner of Internal Revenue*, 53 F3d 523, 525 [2d Cir 1995]). 'In short, an innocent spouse is one who despite having made reasonable efforts to investigate the accuracy of the joint return remains ignorant of its illegitimacy' (*id.*)." (***Matter of Revere v Commissioner of Taxation & Fin.***, 75 AD3d 860, 863 [2010]).

We need not restate the Administrative Law Judge's factual analysis with regard to this question. However, we note that even if the deductions in question had been found to be grossly erroneous items, the relief sought was appropriately denied since petitioner deliberately distanced herself from any and all aspects of the couple's tax filings. The law does not support parties taking advantage of innocent spouse relief under these circumstances.

We find that petitioner has failed to meet the requirements of Tax Law § 651 (former [b] [5] [A]) and is not entitled to innocent spouse relief.

As stipulated by the Division, petitioner is entitled to a refund in the amount of $5,279.00, representing the money taken from her son's UTMA custodial account.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of Daria Carnesi is denied;

2. The determination of the Administrative Law Judge is affirmed;

3. The petition of Daria M. Carnesi is granted to the extent indicated in conclusion of law "I" of the Administrative Law Judge's determination, but in all other respects is denied; and

4. The Division of Taxation is directed to refund the amount of $5,279.00, plus appropriate interest, consistent with this decision.

DATED: Albany, New York
November 7, 2013

/s/ Roberta Moseley Nero
Roberta Moseley Nero
President

/s/ James H. Tully, Jr.
James H. Tully, Jr.
Commissioner

/s/ Charles H. Nesbitt
Charles H. Nesbitt
Commissioner