

STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
PATRICK R. BENNETT	:	
AND GWEN K. BENNETT	:	DECISION
for Redetermination of Deficiencies or for Refund of New	:	DTA NOS. 818612 AND
York State Personal Income Tax under Article 22 of the	:	818613
Tax Law for the Years 1991, 1992, 1993, 1994 and	:	
1995.	:	

Petitioners Patrick R. Bennett, P.O. Box 1000, #38551-054, Otisville, New York 10963, Gwen K. Bennett, 3837 Peterboro Road, Oneida, New York 13421 and the Division of Taxation filed exceptions to the determination of the Administrative Law Judge issued on April 3, 2003. Petitioners appeared by Harry L. Hood, CPA. The Division of Taxation appeared by Christopher C. O'Brien, Esq. (Kevin R. Law, Esq., of counsel).

The Division of Taxation filed a brief in support of its exception. Petitioners filed a brief in support of their exception and in opposition to the Division of Taxation's exception. The Division of Taxation filed a brief in opposition to petitioners' exception and in reply. Petitioners filed a reply brief. Oral argument, at the request of both parties, was held on June 23, 2004 in Troy, New York.

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

ISSUES

I. Whether the Division of Taxation properly assessed Patrick R. Bennett additional personal income tax for the years 1991 through 1994, including additional tax asserted at hearing.

II. Whether petitioner Gwen K. Bennett is entitled to relief from New York State personal income tax for the years 1991 through 1994 as an innocent spouse pursuant to Tax Law § 651.

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge. These facts are set forth below.

On or about September 17, 1999, the Division of Taxation (“Division”) sent petitioner Gwen K. Bennett an appointment letter which informed her that her New York State income tax returns for the years 1996 and 1997 had been selected for audit.

By letter dated April 4, 2001, the Division closed the case and issued no deficiency notice.

The Division began its audit of petitioner Patrick R. Bennett by consulting with Paul Szlosek, an employee of the Bennett Funding Group and chief witness for the United States Attorney’s office in its criminal case against petitioner. Mr. Szlosek shared information with the Division which was used to substantiate the Federal government’s case against Mr. Bennett. Based on this information, the Division believed that petitioner owed additional income tax for the years in issue.

The Division sent Mr. Bennett appointment letters on December 15, 1999 and February 9, 2000, respectively, to his last known address at 3837 Peterboro Road, Oneida, New York 13421. Mr. Bennett was in a Federal prison at the time awaiting sentencing after his conviction, but his

wife was residing at that address. Although there was no response to the appointment letters, as recently as July 6, 2000 Patrick Bennett's address was listed on the U.S. District Court Judgment as 3837 Peterboro Road, Oneida, New York 13421. It was also listed as his address on the tax returns for the years in issue.

In order to preserve its rights in Patrick Bennett's pending bankruptcy case, the Division closed its audit case against Patrick Bennett on March 30, 2000 due to the failure of petitioner to respond to the audit appointment letters, either in person or by representative. The Division issued a notice of deficiency, dated April 3, 2000, to Patrick R. Bennett and Gwen K. Bennett for personal income tax for the years 1991, 1992, 1993, 1994 and 1995, setting forth additional tax due in the sum of \$949,239.60, interest of \$608,692.87 and penalty in the amount of \$823,988.82 for a total amount due of \$2,381,921.29. The notice of deficiency was mailed to petitioners at 3837 Peterboro Road, Oneida, New York 13421 by certified mail, but delivery was "refused." At hearing, the Division conceded that the year 1995 was no longer in issue and it has canceled the liability due for that year. However, as discussed below, the Division introduced a notice of claim for additional tax due at the hearing based upon further investigation of the diversions of monies by Patrick Bennett.

Petitioner Patrick R. Bennett was the chief financial officer, director, and shareholder of Bennett Management and Development Corp. ("BMDC") and also an officer and director of Bennett Funding Group ("BFG") from the late 1970s to 1996. BFG was a family business based in Syracuse which leased photocopying machines, primarily to offices in state and local governments. The leases were often sold to investors who were promised a low-risk stream of cash.

As a result of certain dealings in these business operations, an indictment was handed up against Patrick R. Bennett, among others, in October of 1998, which alleged that petitioner sold fictitious leases to investors and sold legitimate leases more than once to different investors. Allegations in the indictment termed this a “pyramid scheme” and utilized the same allegations to support charges of mail and securities fraud. The indictment also alleged that petitioner funneled cash through a shell company, supporting money laundering charges. In addition, petitioner was charged with mischaracterizing BFG’s profitability on its financial statements in order to deceive banks and investors that loaned money to BFG, constituting bank and securities fraud. Finally, the indictment charged that petitioner deceived Securities and Exchange Commission (“SEC”) investigators which supported charges of perjury and obstruction of justice, also known as the “public integrity” counts.

After two trials, petitioner was convicted of only a portion of the charges. In the first trial, petitioner was convicted of the “public integrity” crimes of perjury and obstruction of justice, while the jury hung on all other issues. The second jury convicted petitioner of money laundering, bank and securities fraud related to the doctoring of the financial statements, monetary transactions in property derived from specified unlawful activity, conspiracy to obstruct the SEC investigation, obstruction of proceedings before the SEC, perjury and returned a forfeiture verdict of \$109,088,889.11. The jury was hung on all other charges.

These convictions, listed in the Judgment issued by the United States District Court, dated June 26, 2000, included references to specific numbered counts in the indictment submitted in evidence by the Division. The convictions were based upon findings that petitioner Patrick R. Bennett, between 1991 and 1995, had caused checks in the amount of more than 11 million

dollars to be made payable to Bennett Finance Group (counts I, II, III and IV), Bennett Leasing Fund and Bennett Leasing Fund II and, although he was not the payee on said checks, caused the proceeds to be deposited to accounts in his name. Additionally, the juries found that Patrick R. Bennett unlawfully, willfully and knowingly executed schemes to defraud various banks in order to obtain money, credits, assets, securities and other property. Further, the juries found that petitioner Patrick R. Bennett willfully transacted in criminally derived property over \$10,000.00 in value and made several deposits of these funds into his personal brokerage account at Cowan and Co.

The convictions against Patrick R. Bennett were upheld on appeal but the United States Court of Appeals vacated the sentence imposed by the trial court judge and remanded for resentencing. In *United States v. Bennett* (252 F3d 559, *cert denied* 535 US 932, 122 S Ct 1307), the Court found that the trial judge erred in making an upward departure, i.e., adding time to a defendant's sentence as prescribed in guidelines, based on Gwen Bennett's failure to surrender properties to which she claimed ownership and had a statutory right to contest their forfeiture. Patrick Bennett was resentenced on May 24, 2002, but the terms were not disclosed in the record.

As a result of Patrick Bennett's criminal conviction, the Division assumed any additional income to petitioner for the years in issue not properly reported on his personal income tax returns was taxable by the State of New York.

As more fully set forth above, the Division made two requests for information and records for the years 1991 through 1995 to which Patrick Bennett made no reply. In order to protect the State's interest, a notice of deficiency was issued to petitioners on April 3, 2000 for the years

1991 through 1995. The notice of deficiency sent to petitioners' address at 3837 Peterboro Road, Oneida, NY 13421, was returned to the Division with a United States Postal Service sticker attached which indicated the letter had been "refused."

By letters dated May 10 and May 12, 2000, petitioner's representative, Harry L. Hood, CPA, responded to the Division, informing it that petitioners had received the notice of deficiency and that Patrick Bennett was in jail. Mr. Hood included Patrick Bennett's new address of Box 1000, Otisville, NY. Although some documentation was produced by Mr. Hood, the Division never received any information from petitioners regarding Patrick Bennett's brokerage account which the United States Attorney used in the criminal conviction and the Division utilized to generate its deficiency. The Division's auditor, Mr. Greco, received his information from Bennett Funding Group's director of accounting, Mr. Szlosek, who was also instrumental in the government's criminal case against Mr. Bennett. Mr. Greco was informed that the primary brokerage account examined was one with Cowan and Co., a clearing agent used by petitioner's brokers, Jameson, Dewitt & Associates.

Mr. Szlosek had been retained by the trustee in bankruptcy for the Bennett Funding Group based on his knowledge of the internal affairs of the many companies which made up BFG. Mr. Szlosek's role in the bankruptcy proceedings was to investigate and identify discrepant items. Among items he discovered were checks paid by the BMDC to various Bennett finance companies as directed by petitioner Patrick Bennett. However, many of those checks, although payable to other entities, were actually deposited into Patrick Bennett's personal accounts.

Patrick Bennett purportedly executed a nonnegotiable revolving credit facility note on December 10, 1990 which afforded him a credit line of ten million dollars from BMDC.

Pursuant to this agreement, between 1991 and 1994 Patrick Bennett claimed that he borrowed substantial sums of money for which he executed promissory notes totaling over \$10,776,849.00.

In his examination of the chart of accounts of BMDC, Mr. Szlosek discovered that an item entitled "Patrick Bennett Loans Receivable" did not exist prior to February 22, 1995 and that all entries which indicated a recording date prior to that date were backdated and actually created on July 11, 1995. Patrick Bennett directed an employee of the company, Lori Moth, to gain access to the computer system using a private code so that his private accountant could input the false information concerning the loans receivable account.

Mr. Szlosek's investigation uncovered the fact that checks issued by BMDC to the Bennett finance companies were first entered in the accounting system as a rental expense. These funds were then diverted to Patrick Bennett's own accounts. However, as the SEC investigation approached, these bogus rental expenses were converted to loans receivable by the creation of an account on the books of BMDC.

Canceled checks revealed that the payments made by BMDC to various Bennett finance companies as payees were endorsed by Patrick Bennett and then deposited into his Cowan and Co. investment account at Jameson, Dewitt & Associates. This information was corroborated by the deposits indicated on Patrick Bennett's account statement.

Mr. Szlosek prepared a chart which set forth all the checks issued by BMDC to the various Bennett finance companies for "rental expense" and subsequently endorsed by Patrick Bennett and deposited into his personal account at Cowan and Co. The sum of these diversions in 1991, 1992, 1993 and 1994 was \$10,744,471.07.

In addition, the chart prepared by Mr. Szlosek indicated that deposits were made to a Cowan and Co. account in the names of Patrick Bennett and David Vinciguerra, an account executive at Jameson, Dewitt & Associates. During 1993 and 1994, \$1,017,000.00 was diverted from BMDC into this account, when it was paid presumably to one of the Bennett finance companies. In all, the diversions from BMDC to accounts in Patrick Bennett's name totaled \$11,761,471.00 for purposes of calculating additional income and upon which the notice of deficiency was issued herein.

Subsequent to the issuance of the notice of deficiency, additional income was discovered. In addition to the diversions to his Cowan accounts above, Patrick Bennett also diverted funds from BMDC and BFG by checks, cash and wire transfers to himself and entities controlled by him or in which he had an interest in the sum of \$11,532,685.00 during the years 1991 through 1994. These transfers were discovered by Mr. Szlosek in his investigation and documented by him contemporaneously therewith. This additional unreported income to Patrick Bennett became the basis for the notice of claim for additional tax due introduced at the hearing.

The following table sets forth the corrected taxable income and recomputed tax liability for each of the years:

	1991	1992	1993	1994
Total Unreported Income	\$3,369,941.77	\$5,940,623.60	\$1,543,194.09	\$12,440,397.20
Corrected Tax	275,996.49	471,028.68	125,908.15	1,030,973.83
Tax Paid	8,452.63	2,486.00	2,214.00	40,410.00
Additional Tax	267,543.86	468,542.68	123,694.15	990,563.83
Penalties				

685(e)(1)	137,998.25	234,271.34	61,847.08	515,486.92
685(e)(2)	146,259.44	218,108.98	50,625.90	355,338.61
685(I)	1,000.00	1,000.00	1,000.00	1,000.00
Interest	283,560.23	436,217.95	101,251.80	682,821.54
Total	\$836,361.78	\$1,358,140.95	\$338,418.93	\$2,545,210.90

As part of his investigation, Mr. Szlosek examined various payments received by BFG and the trustee in bankruptcy from Patrick Bennett between 1990 and 1999 in the sum of \$2,197,740.44. In addition, Patrick Bennett caused his residence to be transferred to BMDC in or about 1994. The value ultimately received for this real property was not clearly established in the record.

Neither petitioner testified at hearing. Patrick Bennett was incarcerated at the time and Gwen Bennett was unable to get representation suitable to her. Instead, petitioners submitted numerous affidavits through their representative, Mr. Hood. In addition, although Mr. Hood was present at the hearing, he submitted an affidavit of his own following the hearing.

Petitioners filed joint New York State personal income tax returns for the years 1991 through 1994. During that period, petitioner Gwen Bennett was a full-time housewife raising two children. She had a high school education and generally worked menial jobs. She had very limited knowledge of petitioner Patrick Bennett's business dealings, but was aware of the total New York income listed on the returns for each of the years in issue. Although there was some fluctuation in income during the years in issue, the family lifestyle did not materially change between 1991 and 1994, maintaining homes and cars of comparable value. During the years in

issue, Gwen Bennett managed the home and used money deposited into a checking account for payment of expenses.

Gwen Bennett did not question, or have the ability to question, the content of the long and complex returns filed on behalf of her and Patrick Bennett during the audited years. She knew very little of her husband's business dealings. The extent of her involvement was to accompany him to company social functions on occasion. She was aware that Patrick Bennett's family was highly visible in the business community.

Petitioner Gwen Bennett did not have any authority or control over petitioner Patrick Bennett's account no. 6K-81039 with Jameson, Dewitt & Associates, nor was she an authorized signatory on said account. Patrick Bennett averred in his affidavit, sworn to April 11, 2002, that he maintained and stored the statements for this account at his office.

THE DETERMINATION OF THE ADMINISTRATIVE LAW JUDGE

In his determination, the Administrative Law Judge rejected petitioners' argument that the Division had erroneously submitted the indictment from Patrick Bennett's first criminal case in which he was convicted of perjury and obstruction of justice. Although petitioners asserted that reliance on that indictment was erroneous because there was a second indictment which contained different charges, the Administrative Law Judge found that petitioners did not submit any evidence to substantiate their claims. The Administrative Law Judge noted that the judgment rendered by the District Court on June 26, 2000 specifically listed the offenses and counts on which Patrick Bennett was convicted, which were the offenses and counts contained in the indictment introduced into evidence by the Division. The Administrative Law Judge concluded that the indictment submitted by the Division accurately reflected the counts and

offenses on which Patrick Bennett was convicted in his second jury trial, which was upheld on appeal.

The Administrative Law Judge also rejected petitioners' argument that the Division could not rely on the convictions because none of the offenses of which Patrick Bennett was convicted involved tax or fraud. The Administrative Law Judge found that the convictions were based on actions by Patrick Bennett which demonstrated his receipt of additional income that was not reported on his New York State personal income tax returns for the years in issue.

The Administrative Law Judge noted that while both the notice of deficiency and the assertion of additional tax due at hearing were made beyond the three-year statute of limitations provided by Tax Law § 683(a), Tax Law § 683(c)(1)(B) provides that an assessment may be made at any time where a false or fraudulent return has been filed with the intent to evade tax. Therefore, in order for the Division's assessment for tax years 1991 and 1992 to be timely, the Division was required to prove fraud. However, the Administrative Law Judge stated that for the years 1993 and 1994, the Division need prove only that there was an omission of income exceeding 25 percent of New York adjusted gross income for its assessment to be timely, as it was made within six years after the returns were filed (*see*, Tax Law § 683[d][1]). For 1993 and 1994, the Administrative Law Judge noted that the burden of proving that the notice is erroneous rested with petitioners.

The Administrative Law Judge reviewed the audit and its results at length. The Administrative Law Judge pointed out that the standard articulated by the courts of New York concerning audits of income is that indirect auditing methods are proper where the taxpayer's income is not accurately reflected in his books and records. The Administrative Law Judge

further noted the well-settled principle that even though books and records appear to be adequate on their face, that fact does not preclude the use of reconstruction methods.

The Administrative Law Judge found that Mr. Szlosek, Bennett Funding Group's director of accounting, described through his testimony and documentation the elaborate scheme employed by Patrick Bennett to divert monies into his personal accounts by causing BMDC to issue checks to various Bennett finance companies and then endorsing the checks so that the funds would go to him instead. The Administrative Law Judge concluded that the chart of accounts of BMDC was altered to include loans to Patrick Bennett long after they were extended and backdated to look like they were original entries, contemporaneously recorded. The Administrative Law Judge held that the canceled checks in evidence demonstrated that Patrick Bennett endorsed checks from BMDC, and the information from his account statements indicated that the funds were deposited there. The Administrative Law Judge pointed out that several counts in the criminal indictment of which Patrick Bennett was found guilty specifically referred to instances where he endorsed checks payable to the Bennett Finance Group and deposited them into at least two of his personal accounts at Cowan and Co. The Administrative Law Judge held that this confirmed criminal behavior formed a strong foundation for the conclusion that the additional tax found due by the Division's auditor and Mr. Szlosek was valid. The Administrative Law Judge determined that the methodology was merely extended for the assertion of additional tax at hearing and the Division had met its burden of proof on that claim as well.

The Administrative Law Judge characterized the affidavits submitted by petitioners in support of their position as vague or confused in their attempts to demonstrate how Mr.

Szlosek's reconstruction of events was incorrect. The Administrative Law Judge held that the inability to cross-examine the affiants assured that the allegations could not be clarified, elaborated upon or challenged. Therefore, the Administrative Law Judge accorded very little weight to them.

The Administrative Law Judge also found that the revolving credit agreement and promissory notes executed by Patrick Bennett in the sum of \$10,776,849.00 were manufactured years after the fact, and little weight was accorded to the assertion by petitioners' representative that these "loans" were originally characterized as "rental expense."

The Administrative Law Judge found that as a director, shareholder and chief financial officer of BMDC, Patrick Bennett diverted funds of the corporation to his personal use which were taxable to him as a constructive dividend.

The Administrative Law Judge found that while the Division bears the burden of proving fraud for the years 1991 and 1992, it does not have to prove fraud by direct evidence. It can establish it by circumstantial evidence which looks at the taxpayer's conduct on the whole in the context of the events in issue and draw inferences from said conduct. The Administrative Law Judge pointed out that a consistent and substantial understatement of income has been found to constitute strong evidence of fraud. He also observed that Patrick Bennett consistently failed to make books and records available (even though two years passed between the issuance of the Notice of Deficiency and the formal hearing) and was found guilty of offenses which involve the diversion of funds to himself or for his benefit which were not accounted for on his New York State income tax returns for each of the years in issue. The Administrative Law Judge concluded that given the counts upon which Patrick Bennett was convicted and the facts underlying those

counts, there was ample, clear and compelling proof that monies were illegally diverted into his personal account that should have been going elsewhere, and Patrick Bennett did not account for this income on his personal income tax returns. Based on these facts, the Administrative Law Judge upheld the Division's assertion of the fraud penalty.

The Administrative Law Judge cautioned, however, that since the criminal convictions were not tax-related offenses, it was not proper to invoke the doctrine of estoppel as the identical issue was not decided in the prior action nor did petitioners have a fair opportunity to litigate the issue of Patrick Bennett's liability for the income tax at the criminal proceeding.

The Administrative Law Judge found that the Division has demonstrated that there was an omission of income in excess of 25 percent of New York adjusted gross income on the personal income tax returns of petitioners for the years 1993 and 1994. Therefore, the Administrative Law Judge concluded that the Notice of Deficiency for those years was timely.

The Administrative Law Judge next considered whether petitioner Gwen Bennett had established her claim to relief under Tax Law § 651(former [b][5][A]) as an innocent spouse. The Administrative Law Judge noted that the criminal case against Patrick Bennett had no bearing on Gwen Bennett's liability. There were no criminal charges against her and the remarks made by Judge Martin concerning her complicity were dicta and of no value herein. The Administrative Law Judge found that the entire notice of deficiency was based upon diversions of funds into private brokerage accounts of Patrick Bennett from corporations about which Patrick, not Gwen, had intimate knowledge. Therefore, the additional income was wholly attributable to the secret endeavors of Patrick Bennett, the records for which were kept by Patrick Bennett at his place of business.

Pointing out Gwen Bennett's high school education and occupation as a housewife, the Administrative Law Judge found that she signed the joint returns and did not question or understand the complex documents containing numerous attachments. The Administrative Law Judge found no significant change in her lifestyle during the period in issue, and observed that the Division provided no independent evidence of Gwen Bennett's liability for the tax other than its reliance on Judge Martin's dicta. The Administrative Law Judge concluded that it would be inequitable to hold Gwen Bennett liable for the substantial understatement of income for which her husband was fully liable and which he sought to keep secret from all.

The Administrative Law Judge also concluded that petitioners were not denied their constitutional right to due process by virtue of the Division's requests for information and the hearing held in this matter.

ARGUMENTS ON EXCEPTION

On exception, the Division argues that petitioner Gwen Bennett has failed to meet her burden of proving that she qualifies for innocent spouse treatment under Tax Law former § 651(b)(5)(A). The Division maintains that petitioner's affidavits should be discredited because she failed to appear and testify. The Division asserts that it only relied on the statements made by Judge Martin concerning petitioner Gwen Bennett as rebuttal evidence to discredit her affidavits.

In opposition, petitioner Gwen Bennett argues that the Administrative Law Judge correctly found that she met the four-part test for being considered an innocent spouse. As to the statements made by Judge Martin in the criminal proceeding regarding her husband, petitioner points out that she was not a party to her husband's criminal proceeding. Despite petitioner's

failure to appear and testify at the hearing, she maintains that she was entitled to use affidavits to establish that she was an innocent spouse and she claims that the Division has provided no evidence to dispute their accuracy.

Petitioner Patrick Bennett, in support of his exception, argues that the Administrative Law Judge misconstrued the information presented to him. Petitioner asserts that the criminal charges of which he was convicted concern only intercorporate transactions and did not include any funds received personally by petitioner. Petitioner maintains that it was prejudicial for the Division to have introduced the first indictment handed down against petitioner into evidence, as the indictment submitted by the Division was from the first trial on which a mistrial was declared. Petitioner argues that on his second trial, he was convicted only of minor counts of the indictment. Further, petitioner maintains that the Administrative Law Judge did not afford petitioner an opportunity to introduce critical evidence concerning the inapplicability of the indictment to these proceedings.

Petitioner Patrick Bennett characterizes the testimony of the Division's witness as false and claims that the Administrative Law Judge should have fully credited petitioner's affidavits as he was unable to attend the hearing due to his incarceration. Petitioner also asserts that the Administrative Law Judge failed to credit petitioner with more than \$12,000,000.00 of loan repayments to his company, thus demonstrating that the transactions at issue were valid loans to him. Additionally, Mr. Bennett maintains that the Division has not met its burden to prove that the increased assessment it asserted at the hearing had a rational basis.

The Division, in opposition, argues that petitioner Patrick Bennett was not prejudiced by the introduction of the indictment against him, nor can he realistically argue that the criminal

convictions against him, based on findings that he diverted funds to BMDC and that substantial portions of these funds were disbursed to or for his benefit, cannot be relied upon to support the Division's Notice of Deficiency. The Division asserts that the Administrative Law Judge properly found that the Division's auditor provided credible testimony at the hearing and that the Administrative Law Judge was correct to give little weight to the affidavit submitted by petitioner's representative subsequent to the hearing that sought to attack the auditor's credibility. The Division maintains that although petitioner was not present at the hearing due to his incarceration, it was not a violation of petitioner's right to due process for the Administrative Law Judge to give little weight to his affidavit. The Division argues that the Administrative Law Judge properly found that petitioner was liable for income tax on constructive dividends received from his diversion of funds for his own use and benefit. As for the additional tax asserted due at hearing, the Division maintains that it provided specific proof of the diversion of funds that supported the additional assessment.

The Division also asserts that the affidavits provided by petitioner Gwen Bennett, while admissible, should be accorded little weight as she failed to present herself at the hearing to testify and make herself available for cross-examination.

OPINION

Patrick Bennett was convicted of, among other charges, money laundering, bank fraud and securities fraud. His conviction, although not his sentence, was upheld on appeal. At the hearing in this matter, the Division presented the testimony of Paul Szlosek, who was instrumental in the government's criminal case against Mr. Bennett. Thus, there is ample basis in the record for the Administrative Law Judge to have concluded that Patrick Bennett had

additional income during the years at issue in the form of constructive dividends that he did not report as part of his New York State income. Petitioner Patrick Bennett has offered no evidence below, and no argument on exception, that demonstrates that the Administrative Law Judge's determination as to him is incorrect. We find that the Administrative Law Judge completely and adequately addressed the issues presented to him and we see no reason to modify them in any respect.

Tax Law § 651(b) (former [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.

For purposes of this statute, the term "grossly erroneous items" means: any item of New York adjusted gross income attributable to such spouse which is omitted from New York adjusted gross income and 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[b][former(5)(B)(i)]). The term "substantial understatement" means any understatement which exceeds one hundred dollars (Tax Law § 651[b][former(5)(B)(ii)]).

There is no dispute that petitioner Gwen Bennett filed a joint tax return with her husband for the years 1991-1994. Further, on each return there was a substantial understatement of tax attributable to grossly erroneous items of Patrick Bennett.

Gwen Bennett did not appear to testify at the hearing. Rather, she submitted affidavits of herself, Patrick Bennett and David Vinciguerra to the effect that she did not know of and had no reason to know that in filing the tax returns for the years 1991-1994, they contained substantial understatements of tax attributable to grossly erroneous items of Patrick Bennett. That is troubling in that it did not afford the Division an opportunity to question her regarding her knowledge of Patrick Bennett's income at the time that the tax returns in issue were prepared and filed. Despite this shortcoming, the Administrative Law Judge found that the record contained ample proof that Gwen Bennett was an innocent spouse. We agree with his conclusion.

The Administrative Law Judge noted that Gwen Bennett was not involved in her husband's businesses. Further, there was no evidence that she had access to the books and records of such businesses nor that she had any knowledge of the returns prepared on behalf of such business endeavors. The nature of the criminal activity engaged in by Patrick Bennett consisted of transfers between entities owned or controlled by him, with ultimate deposits into brokerage accounts under his control and not under the control or ownership of Gwen Bennett.

Even if Gwen Bennett became aware of the activities of her husband which ultimately led to his conviction for criminal actions, there is no evidence that she was involved in his activities, no evidence of any criminal charges having been brought against her and no evidence that, at the time the tax returns in question were filed, she was aware that monies diverted by her husband were improperly excluded from the tax returns. The returns filed by the Bennetts for each of the

years at issue were prepared by a paid preparer. They were complex, including not only wage income of Patrick Bennett but interest and dividend income, capital gains and losses and partnership distributions.

We also find that the Administrative Law Judge correctly disregarded the statements made by Judge Martin in the sentencing of Patrick Bennett. Gwen Bennett was not a party to that proceeding and, even if the statements of the sentencing judge could be given weight, they do not relate to the state of Gwen Bennett's knowledge at the time of filing the returns at issue.

As a result, we find that the Administrative Law Judge correctly determined that it would be inequitable to hold Gwen Bennett liable for the additional tax, penalty and interest owing as the result of her husband's substantial understatement of income for the years 1991-1994.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of Patrick R. Bennett and Gwen K. Bennett is denied;
2. The exception of the Division of Taxation is denied;
3. The determination of the Administrative Law Judge is affirmed;
4. The petition of Patrick R. Bennett is granted with respect to 1995, as indicated in finding of fact "5" of the Administrative Law Judge's determination, but is otherwise denied;
5. The petition of Gwen K. Bennett is granted as indicated in conclusion of law "D" of the Administrative Law Judge's determination, but is otherwise denied;
6. The Notice of Deficiency, dated April 3, 2000, is cancelled with respect to Gwen K. Bennett for the years 1991 through 1995; and

7. The Notice of Deficiency, dated April 3, 2000, is modified by cancellation of the liability for 1995, but is otherwise sustained as to Patrick R. Bennett along with additional tax asserted at hearing.

DATED: Troy, New York
December 16, 2004

/s/Donald C. DeWitt
Donald C. DeWitt
President

/s/Carroll R. Jenkins
Carroll R. Jenkins
Commissioner