

STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
IRIS EGAN	:	DETERMINATION DTA NO. 825114
for Redetermination of a Deficiency or for Refund of Personal Income Tax under Article 22 of the Tax Law for the Years 2006 and 2007.	:	

Petitioner, Iris Egan, filed a petition for redetermination of a deficiency or for refund of personal income tax under Article 22 of the Tax Law for the years 2006 and 2007.

A hearing was held before Timothy J. Alston, Administrative Law Judge, in Albany, New York, on October 25, 2013 at 10:30 A.M., with all briefs submitted by March 11, 2014, which date began the six-month period for the issuance of this determination. Petitioner appeared by Harris Beach, PLLC (Robert J. Ryan, Esq., of counsel). The Division of Taxation appeared by Amanda Hiller, Esq. (Christopher O'Brien, Esq., of counsel). Administrative Law Judge Alston was appointed counsel to the Tax Appeals Tribunal during the pendency of this matter and the same was transferred to Dennis M. Galliher, Administrative Law Judge. After review of the evidence and arguments, Judge Galliher renders the following determination.

ISSUE

Whether petitioner has established entitlement to relief, as an innocent spouse, from the tax liability asserted by the Division of Taxation.

FINDINGS OF FACT

1. Petitioner, Iris Egan, graduated from New York University with a degree in business. After graduating, she worked in a number of businesses, performing managerial functions and other office functions. She was licensed as a real estate broker, and performed managerial work for firms with apartment buildings. Petitioner has also been engaged in the thoroughbred horse breeding business.

2. In 1981, petitioner met Robert Egan and the two were married thereafter. During the time of their marriage, Mr. Egan formed numerous companies engaged in various businesses including armored trucking, ATM maintenance and cash replenishment, and check cashing services including on-site payroll check cashing. In total, Mr. Egan formed 33 businesses and owned all of them, either directly or indirectly, with the exception of EZ-RI Realty Group. All of these business were operated out of one large office building in Mt. Vernon, New York, under the aegis of Mount Vernon Money Management Corporation (MVMC).

3. Over the years, petitioner performed many duties for these businesses, including collecting rents, processing forms, working in payment (check cashing) centers, driving armored trucks, and performing payroll and other office clerical functions. Petitioner was actively involved in generating business and working at the various companies, describing the progression as “[w]e built a very big business together very successfully.” Petitioner worked full time in these businesses from the early 1980s until approximately 1993, at which point petitioner decided she would “semi-retire.” Thereafter, petitioner continued to work in the businesses, but did so on an as needed basis.

4. Petitioner and Mr. Egan filed a New York State Resident Income Tax Return (Form IT-201) for each of the years 2005, 2006 and 2007 under filing status “2” (Married filing joint

return). They also filed an Amended New York State Resident Income Tax Return (Form IT-201-X) for each of the years 2005 and 2006. These personal income tax returns, amended returns, and the various tax returns filed by the businesses described above, were prepared by an accountant. Petitioner did not participate in the actual preparation or filing of any of the returns, beyond providing receipts for charitable contributions to the preparer/accountant as requested. Petitioner signed all of the initial and amended personal income tax returns described above, but did not review or question the content and results set forth thereon, either before or at the time she signed.

5. The returns as initially filed for the years 2005, 2006 and 2007 reveal the following:

Form IT-201	2005	2006	2007
Total Wages	\$283,083.00	\$189,205.00	\$199,549.00
Wages: Robert Egan	\$192,855.00	\$95,446.00	\$94,155.00
Wages: Iris Egan	\$90,228.00	\$92,058.00	\$105,394.00
Interest Income	\$652,629.00	\$578,217.00	\$842,771.00
Capital Gain Income	\$1,400,477.00	\$2,219,169.00	\$360,468.00
Refund Claimed	\$14,695.00	\$109,038.00	\$122,048.00

6. The amended returns filed for the years 2005 and 2006 increased the amount of refund claimed for each of such years based on certain claimed Empire Zone refundable credits (QEZE credits). Specifically, the claimed refund amounts were increased from \$14,695.00 to \$56,250.00 for 2005 and from \$109,038.00 to \$118,875.00 for 2006. The refund amounts claimed for 2005, 2006 and 2007 reflect a departure from the Egans' tax filing history for previous years, in which they reported either small liabilities or small refund amounts typically carried forward as estimated payments against future liabilities.

7. The Division issued refund checks payable jointly to petitioner and Robert Egan in the amounts of \$109,038.00 for 2006 and \$122,048.00 for 2007. Each of the foregoing checks is endorsed in the name of the payees, Robert Egan and Iris Egan. Petitioner admitted that she, together with her husband, endorsed the check pertaining to 2006, and stated that the funds were deposited into a joint account held by petitioner and her husband at Citibank and were used for ongoing household expenses, including landscaping. While the refund check pertaining to 2007 as endorsed includes her name, petitioner stated that the endorsement signature thereon is not hers. She stated that she later learned that this check was deposited into a separate account held in her husband's name only, and that she does not know how the funds were spent.¹

8. By a letter addressed to Robert Egan and petitioner and dated October 20, 2006, the Division notified the Egans that their 2005 personal income tax return could not be processed due to missing forms and information relating, among other items, to the QEZE credits claimed on the 2005 return. Thereafter, the Division sent additional letters to Mr. Egan's attention, dated October 19, 2009, November 9, 2009, January 29, 2010, March 24, 2010 and August 24, 2010, seeking information concerning the QEZE credits claimed on the Egans' joint returns for the years 2005 through 2007.²

9. The information substantiating entitlement to the disallowed QEZE credits was not furnished as requested, and such credits were disallowed by the Division. As a consequence, the

¹ The record includes a refund check in the amount of \$14,695.00, issued to petitioner and Mr. Egan for the year 2005. This check was endorsed and deposited into the joint Citibank account. There is no testimony in the record concerning this check or to how the proceeds were spent. There is likewise no testimony in the record concerning the amended return filed for 2005 with its requested refund increase to \$56,250.00 or the amended return filed for 2006 with its requested refund increase to \$118,895.00.

² The QEZE credits claimed on the Egans' personal income tax returns were derived from MVMC Holding Corp., EC-KI Realty Corp., Annex Corp., and Mount Vernon Money Center Corporation, four subchapter S corporations solely owned by Mr. Egan.

Division issued to Mr. Egan and petitioner two notices of determination, dated May 24, 2010 (L-033452392-3) and August 2, 2010 (L-034064744-1), asserting respectively, tax due in the amounts of \$103,672.00 for 2006 and \$112,949.00 for 2007, plus interest.

10. Robert Egan was charged with bank fraud and was arrested in February 2010. In September 2010, he entered a guilty plea in the United States District Court for the Southern District of New York pursuant to which he was sentenced, on June 16, 2011, to a term of 11 years in federal prison upon one count of conspiracy to commit bank and wire fraud and six counts of bank fraud in connection with the operation of his various businesses. In addition, a judgment in the amount of \$85,151,890.16 was entered against Mr. Egan on September 16, 2011.

11. On September 27, 2011, petitioner filed Form IT-285 (Request for Innocent Spouse Relief [and Separation of Liability and Equitable Relief]). Included with petitioner's request for relief was an attached statement in which petitioner points out that the asserted deficiencies arose from the Division's disallowance of certain QEZE credits that resulted from the operations of four of her husband's businesses, with such credits claimed on the joint returns filed by petitioner and Mr. Egan by virtue of the fact that the businesses were subchapter S (i.e., flow-through) entities. Petitioner states that a Division desk audit concerning entitlement to the claimed QEZE credits was ongoing at the same time that Mr. Egan was addressing the federal charges detailed above, and that consequently Mr. Egan did not properly respond and provide requested substantiation to the Division to support the claimed credits.

12. Petitioner notes that the businesses were owned and operated by Mr. Egan and that she was not directly involved in their operation. Petitioner maintains that the businesses (and the Egans in turn) were entitled to the claimed credits. However, as a consequence of the federal proceedings against Mr. Egan, the entities in question together with all of Mr. Egan's businesses

were placed under the control of a court appointed receiver and entered into bankruptcy proceedings. In turn, petitioner has attempted to obtain business records to substantiate entitlement to the claimed credits and reduce or eliminate the deficiencies premised upon their disallowance. Petitioner states that her attempts have been largely unsuccessful since, a) the entities are defunct, b) the information necessary to substantiate entitlement to the claimed credits is four to seven years old, c) most of the business records for the entire group of over 30 business entities owned by Mr. Egan, including the business from which the claimed QEZE credits arise, are in the custody of a trustee and are stored in a warehouse facility and, d) that personnel (presumably former employees) are no longer available for assistance. Petitioner claims that as the result of Mr. Egan's arrest and conviction, she is facing a financial hardship due to the judgment against Mr. Egan, the loss of household income and the forfeiture of personal assets, such that she is now living on her retirement and social security income.

13. By a letter dated January 31, 2012, the Division denied petitioner's request for innocent spouse relief, separation of liability and equitable relief, upon the bases that:

a) as of the date of the request, petitioner was not divorced, widowed, or legally separated from Robert Egan, and had not lived apart from him for the 12 months preceding the request.

b) the request did not establish (by statement and/or supporting documentation) that paying the liability in full would result in economic hardship.

c) the request did not establish (by statement and /or supporting documentation) that petitioner did not know or have reason to know, at the time the joint returns were signed, of the items giving rise to the liability or that the liability reported on the return would not be paid.

CONCLUSIONS OF LAW

A. For the years at issue, New York's innocent spouse rule is set forth at Tax Law § 654(a), which provides that a spouse may receive relief from joint and several liability under Internal Revenue Code (IRC) § 6015 if: (a) a joint return has been made for the tax year; (b) on the return there is an understatement of tax attributable to erroneous items of one of the individuals filing the joint return; (c) the innocent spouse establishes that in signing the return he or she did not know or have reason to know of the understatement; (d) under all the facts and circumstances, it would be inequitable to hold the innocent spouse liable for the deficiency in tax resulting from the substantial understatement; and (e) the innocent spouse elects this relief within two years after any collection activity has begun. (IRC § 6015 [b][1].)

B. 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]).

C. The understatements of tax in this case stem from claimed QEZE tax credits resulting from the operations of four subchapter S entities owned by Robert Egan. These credits were reported by the Egans, as flow-through items, on their jointly filed income tax returns for the years 2005, 2006 and 2007, resulting in refunds for such years. Refund checks were issued by the Division in payment of the claimed refunds. Subsequently, however, the refunds were challenged on audit and disallowed upon the Egans' failure to provide requested information to substantiate the claimed QEZE credits underlying the refunds.

D. After careful consideration of the facts in this matter, it is concluded that petitioner is not entitled to innocent spouse relief. To qualify for innocent spouse relief, the claiming spouse must establish that in signing the return, he or she "did not know, *or have reason to know* of the understatement . . ." (italics added). Petitioner points out that the understatements in this case result from disallowed credits generated by business operations that were accounted for and calculated at the businesses' level, and then simply claimed as flow-through benefits on the joint returns she signed. Petitioner thus maintains she would have no way of knowing whether or not such credits were or were not correct as calculated and claimed. In contrast, however, the record includes no evidence that petitioner made any investigation or raised any questions at any time concerning the returns. The returns were prepared by an accountant, and petitioner simply signed the same (or acquiesced to her signature being affixed to the same), but never reviewed or inquired as to the contents of the returns. Notably, not only did petitioner sign the joint returns as initially filed, but she also signed the amended returns on which the amounts of refund were increased. The amounts of the refunds claimed stand in sharp contrast to the Egans' earlier year filings, which had resulted in either relatively small liabilities or small refund amounts (*see*

Finding of Fact 6). Under the circumstances it is reasonable to expect, at a minimum, that some inquiry would have been made, yet no questions were raised by petitioner.

E. Petitioner is an educated woman who holds a bachelor's degree in business and was a licensed real estate broker. While the credits in question flowed from four businesses the shares of which were owned by Mr. Egan, it remains that petitioner was, by her own admission, involved in building the Egans' businesses and in fact worked in such businesses over a significant period of time (*see* Finding of Fact 3). Petitioner's attempts to distance herself from the businesses fails to acknowledge her involvement in and knowledge of the businesses' operations, and stands in contrast to her testimony that she and Mr. Egan "built a very big business together very successfully." While petitioner had "semi-retired" as of the years in question, she continued to work in the businesses, though at a reduced amount of time and on an "as-needed" basis, and continued to receive substantial wage income from her work for the businesses during the years in issue (*see* Finding of Fact 5). A spouse's role as semi-retired, even giving complete deference to the other spouse's judgment concerning the couple's finances, standing alone, is insufficient to establish that a spouse has no "reason to know" or at least inquire (*see Resser v. Commissioner*, 74 F3d 1536 [1996]). Under the circumstances of this case, petitioner had at least a minimum duty or obligation to make some inquiry, yet the record contains no indication that petitioner made any effort to ascertain the accuracy of the joint returns, either initially or upon their amendment as described.

F. Petitioner argues that she could not have discerned the possibility that the claimed QEZE credits might be questioned and disallowed upon audit. In this respect, petitioner maintains that the complexity of the calculations supporting the QEZE credits would have effectively precluded her from making a meaningful assessment of their validity, even if she had

made any inquiries or attempted to review the returns. This line of argument concerning the complexity of calculations could be made with respect to virtually any deduction, credit or benefit accruing to individuals in the filing of their own returns but arising as the result of the activities of flow-through entities. More importantly, this claim does not obviate the obligation of one who signs a tax return to at least inquire as to its contents. This is especially true where, as here, the items giving rise to the refunds that were disallowed on audit were those that were claimed on the initial returns and increased on the amended returns. In fact, the credits claimed here were initially challenged by the Division for the year 2005, as described in Finding of Fact 8. This earlier year challenge supports the conclusion that petitioner ought to have at least questioned the ongoing claims for such credits for the years in issue here. Petitioner owed at least some duty of inquiry, yet she made none. Finally, and as noted earlier, petitioner's claim overlooks any involvement by her over the course of many prior years in building and establishing petitioners' businesses, not to mention her own business background and education.

G. "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] [italics added]). There is no evidence to support a conclusion that the claimed refunds resulted from the "oversubtle financial machinations" of petitioner's spouse, or that the disallowed refunds, resulting from claimed but unsubstantiated QEZE credits, represented anything other than apparently legitimate claims that were disallowed. In this regard, the record includes no evidence that Mr. Egan ever attempted to conceal the source for the refunds from petitioner, for the claimed credits giving rise to the same were plainly designated on the joint amended returns. There is no evidence that

petitioner was in any manner coerced with respect to signing the returns. Further, the record includes nothing that would associate or tie the particular understatement, premised as they are on claimed but unsubstantiated QEZE credits, to the illegal activities engaged in by petitioner's husband, beyond the fact that when faced with the charges for such illegal activities it is undoubted that Mr. Egan's attention was diverted such that he did not attend to the Division's requests for substantiating materials regarding the claimed QEZE credits. There has been no concession by petitioner that the understatement of tax, while attributable to or generated from the business activities of flow-through entities owned by her spouse, Robert Egan, constituted "erroneous" items set forth on the returns. Rather, the record in this matter only establishes that the refunds were disallowed for failure to substantiate the claimed QEZE credits upon which the refunds were premised.

H. In *Hinds v. Commissioner* (56 TCM 104[1988]), the court found that the wife was entitled to innocent spouse relief. However, the wife was led to believe that the returns were prepared by certified public accountants, the couple had a "fragile and strained" relationship due to the abusive conduct of the husband, and the wife lacked any business knowledge or experience. These factors are not present in this matter. In *Price v. Commissioner* (887 F.2d 959 [1989]), the court also found that the wife was entitled to innocent spouse relief. However, the husband had led his wife to believe that the returns were prepared by certified public accountants. In addition, when the wife reviewed the returns and raised her concerns about a large, unsubstantiated deduction, the husband assured her that the accountants would not have allowed it were it not legal. Unlike the present matter, the factual circumstances in *Price* involved a spouse who reviewed the returns, questioned a deduction and was deceived by her husband at the time the returns were filed.

I. In sum, petitioner has failed to meet the requirement that she did not know or have reason to know of the understatements contained in the income tax returns filed for the years in issue (*Matter of Revere v. Tax Appeals Tribunal*, [where a spouse was not relieved of his liability where he intentionally remained ignorant regarding the preparation of his joint tax returns because he did not want to get involved]; *Matter of Rubin v. Tax Appeals Tribunal*, 29 AD3d 1089 [2006][where a spouse was not relieved of her liability despite her claim that she had never been involved in the financial aspects of the marriage and relied on her husband and the professionals he retained to accurately prepare the tax returns, and there was no evidence that the husband had ever tried to conceal the excluded income]).³

J. The petition of Iris Egan is hereby denied and the Division's denial of petitioner's claim for innocent spouse relief is sustained.

DATED: Albany, New York
September 11, 2014

/s/ Dennis M. Galliher
ADMINISTRATIVE LAW JUDGE

³ Petitioner argues that the refunds in question did not, at the time they were received, constitute a "significant benefit" (i.e., a benefit in excess of normal support) to her (*see* 26 CFR § 1.6015-2[d]). On this score, and notwithstanding the significant amounts of income received by the Egans during the years in question (*see* Finding of Fact 5), it is difficult to relegate refunds in excess of \$100,000.00 for each year to the category of "insignificant."