

STATE OF NEW YORK

DIVISION OF TAX APPEALS

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In the Matter of the Petition	:	
of	:	
<b>PETER GERACE, SR.</b>	:	DETERMINATION DTA NO. 826468
for Redetermination of a Deficiency or for Refund of New York State Personal Income Tax under Article 22 of the Tax Law for the Years 2006, 2007 and 2008.	:	

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Petitioner, Peter Gerace, Sr., filed a petition for redetermination of a deficiency or for refund of New York State personal income tax under Article 22 of the Tax Law for the years 2006, 2007 and 2008.

A hearing was held before Dennis M. Galliher, Administrative Law Judge, in Rochester, New York, on December 10, 2015 at 10:30 a.m., with all briefs submitted by March 31, 2016, which date began the six-month period for the issuance of this determination. Petitioner appeared by the Law Office of Shelby, Bakshi & White (Justin S. White, Esq., of counsel). The Division of Taxation appeared by Amanda Hiller, Esq. (Peter B. Ostwald, Esq., of counsel).

***ISSUE***

Whether petitioner is entitled to innocent spouse or other equitable relief with respect to personal income tax liabilities for the years 2006 through 2008.

***FINDINGS OF FACT***

1. For each of the years 2006, 2007 and 2008, petitioner, Peter Gerace, Sr., and his wife,

Linda Gerace, filed a New York State Resident Income Tax Return (Form IT-201), under filing status two, i.e., “Married filing joint return.”<sup>1</sup>

2. On May 16, 2013, the Division of Taxation (Division) issued a Notice of Deficiency (L-039443096-7) to Mr. and Mrs. Gerace, asserting a joint liability for New York State personal income tax in the total amount of \$57,355.00, plus penalty and interest. The computation summary section of the notice provides that the total liability represents tax due for the years 2006, 2007 and 2008 in the respective amounts of \$12,719.00, \$27,977.00 and \$16,659.00, plus penalty and interest.

3. As more fully detailed in an Order previously issued in this matter on July 23, 2015, the following proceedings have occurred:

a) on or about December 3, 2013, petitioner filed with the Division a Request for Innocent Spouse Relief (and Separation of Liability and Equitable Relief) (Form IT-285), seeking relief from the joint liability asserted under the foregoing Notice of Deficiency.

b) by a letter dated January 31, 2014, the Division denied petitioner’s request for such relief.

c) petitioner challenged the foregoing denial as to both the merits of the underlying Notice of Deficiency and as to the denial of the request for innocent spouse relief by filing a Request for Conciliation Conference (Request) with the Division’s Bureau of Conciliation and Mediation Services (BCMS).

d) by a Dismissal Order (CMS No. 262853) dated August 8, 2014, BCMS dismissed petitioner’s Request in its entirety as not timely filed.

e) petitioner challenged the foregoing Dismissal Order by filing a petition with the Division of Tax Appeals.

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<sup>1</sup> Petitioner’s 2006 return was prepared on or about September 13, 2007, but appears to have been filed late, on or about June 1, 2011, as the result of oversight.

f) the Division responded to the petition on November 12, 2014 by filing an answer on the merits of the Notice of Deficiency and on the request for innocent spouse relief.

g) on March 27, 2015, the Division filed a motion seeking dismissal of the petition or summary determination sustaining the Dismissal Order in its entirety, upon the basis that the Dismissal Order properly dismissed the Request as untimely. Petitioner, in turn, opposed the Division's motion and cross moved for an order directing the Division to provide petitioner with a BCMS conciliation conference.

4. On July 23, 2015, this Administrative Law Judge issued an Order on the foregoing motion and cross motion, as follows:

a) the Division established proper mailing of the Notice of Deficiency and petitioner did not establish the filing of any timely protest against the merits thereof, thus leaving such notice fixed and final and not subject to review on the merits of the liability asserted thereunder. Accordingly, the Division's motion for summary determination as to the liability assessed via the Notice of Deficiency was granted.

b) the Division did not establish proper mailing of the notice denying petitioner's request for innocent spouse relief (the January 31, 2014 letter; *see* Finding of Fact 4-b), such that the time period within which petitioner could file a challenge to that denial did not commence to run. With no proof of the date of petitioner's actual receipt of the notice of the denial, BCMS improperly dismissed petitioner's challenge thereto as untimely. Accordingly, the Division's motion for summary determination as to petitioner's request for innocent spouse relief was denied, and this matter was to proceed to a hearing solely on the merits of petitioner's request for innocent spouse or other equitable relief.

c) petitioner's cross motion seeking a conciliation conference with BCMS was denied.

5. The parties agree that the only issue in this matter is whether petitioner qualifies for and is entitled to relief as an innocent spouse or other equitable relief.

6. Included in the record is the Form IT-285 (Request for Innocent Spouse Relief [and Separation of Liability and Equitable Relief]), filed by petitioner and seeking innocent spouse relief for the years 2006, 2007 and 2008. Page one of Form IT-285 identifies petitioner's spouse

as Linda Grace and indicates their marital status as “Married and still living together.” On Form IT-285, petitioner states that he and Mrs. Gerace had separate bank accounts, that most household expenses were paid from petitioner’s pension, and that the liability asserted by the notice issued to petitioner and Mrs. Gerace was the result of income “from NYS sales tax audit of [Mrs. Gerace].”

7. Petitioner’s Form IT-285 included the following explanation in support of his request for innocent spouse relief:

“The tax due resulted from a NYS Sales Tax audit of my spouses [sic] wholly owned S-Corporation LSG Enterprises, Inc., DBA Pietro’s Ristorante, EIN 16-1599839. The restaurant was subject to a purchases based mark up audit which used national averages according to the National Restaurant Association and Deloitte operations report. At that time many restaurants were subject to these audits.

The restaurant had employee theft which resulted in the higher than average food cost. Also Pietro’s was know[n] for generous portions and subject to WNY/Buffalo based pricing. My spouse did not agree to any settlement amount as she never hid any income from me or the taxing authorities. I never received significant or any economic benefit.

I would suffer undue economic hardship as I live on social security and a disability retirement income.”

8. Petitioner worked as the business manager and agent for a laborer’s union for some 29 years prior to his retirement, due to ongoing significant health issues, in 1996. Petitioner has not been employed since his retirement, and his income (itemized below) consisted of a fixed disability pension from his former employer, fixed social security disability benefit income<sup>2</sup> and some casino gambling winnings,<sup>3</sup> as follows:

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<sup>2</sup> The amount of petitioner’s social security disability benefit income increased slightly in the years 2007 and 2008 as the result of a small cost of living percentage increase to such benefit amount.

<sup>3</sup> The record includes no information concerning petitioner’s reported gambling income beyond the statement that the same were casino winnings.

Income Source	2006	2007	2008
Taxable Pensions	\$31,029.00	\$31,263.00	\$31,497.00
Social Security Benefits	\$18,197.00	\$18,799.00	\$19,237.00
W-2G Gambling Income	\$1,800.00	\$29,879.00	\$15,346.00
Total	\$51,026.00	\$79,941.00	\$66,080.00

9. Many years before those at issue herein, petitioner and another individual had opened a small restaurant in Buffalo, New York, known as “Mr. Ribs.” This restaurant served mainly barbequed ribs and chicken, and had approximately 30 seats for patrons. Petitioner and his partner in this venture operated Mr. Ribs for about three years, and then sold the restaurant. Mrs. Gerace was not involved in this venture.

10. Prior to 2001, Mrs. Gerace was a homemaker and was not employed. She and petitioner have lived in the same home for many years. Their home was described, in testimony, as a modest house in a suburban community, falling in the “mid-range” of houses in their neighborhood. Petitioners have made no additions or significant upgrades to their home.

11. In early 2001, Mrs. Gerace received a monetary recovery from a civil proceeding stemming from a personal injury accident.<sup>4</sup> At the urging of the Geraces’ oldest son, Peter, Mrs. Gerace decided to use the recovery proceeds from the civil action to open a restaurant. When Mrs. Gerace sought petitioner’s opinion on this venture, he advised her that he viewed opening a restaurant as “a terrible idea,” and that he “wanted no part of it” noting, based on his prior experience operating a restaurant, that it was “a lot of work.” Petitioner explained that he tried to discourage Mrs. Gerace from pursuing this endeavor, noting in particular that given his health issues he could not help her in the restaurant.

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<sup>4</sup> The details of the accident, the civil proceeding and the amount of the recovery are not specified in the record.

12. Notwithstanding her husband's opinion, Mrs. Gerace decided to go forward with opening a restaurant. On March 12, 2001, an entity known as LSG Enterprise, Inc., was formed. Mrs. Gerace was its sole officer and sole shareholder of all 200 shares of the corporation's issued and outstanding stock. With an initial investment of approximately \$100,000.00, consisting of the noted civil action recovery proceeds and some additional unspecified financing, Mrs. Gerace purchased furnishings and equipment and, in or about May of 2001, opened a high-end, fine dining establishment known as Pietro's Ristorante (Pietro's) in leased space located on Transit Road in East Amherst, New York. Petitioner had no ownership interest in Pietro's, did not loan money to Pietro's, and was not a creditor of the business.

13. Pietro's had approximately 15 to 20 employees. Mrs. Gerace served a variety of roles, including hiring employees, opening and closing the restaurant, and being the hostess and bookkeeper. In this latter role, Mrs. Gerace would organize and bring Pietro's records to Michael Rizzo, the certified public accountant who handled petitioner's and Mrs. Gerace's personal tax filings, and he would prepare the requisite tax filings (sales tax and corporation tax) for Pietro's. Petitioner's and Mrs. Gerace's son Peter served as Pietro's "Manager," performed various unspecified duties, and helped Mrs. Gerace, who had no prior bookkeeping experience, with the books and records.<sup>5</sup> The Geraces' younger son worked as the bartender at Pietro's.

14. Pietro's was open for dining from 5:00 p.m. to 10:00 p.m during the weekdays, with the bar area open somewhat later, and was open until 1:00 a.m. on weekends. Small musical combos provided music for dancing on the weekends. Pietro's was a local area favorite for a period of time, and was known for its large meal portions and large sized drinks. At the same

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<sup>5</sup> According to testimony at hearing, Pietro's utilized a point of sale (POS) computer system in its operations.

time, Pietro's was hampered by a small number of tables, by slow turnaround of diners, by its relatively high priced meals, and by the post-September 11, 2001 economic downturn.

15. According to Mr. Rizzo, Pietro's made money during its first few years of operation, and its profits were used to pay for the equipment in the restaurant. At various times, Mr. Rizzo discussed "price points" with Mrs. Gerace, and advised that she needed to reduce the restaurant's cost to provide its fare, suggesting that its drink and meal portion sizes were too generous, and were unsustainable. Pietro's eventually became unable to keep up with its expenses (payables), and was required to pay cash on delivery in order to obtain supplies from its vendors. Mrs. Gerace borrowed money from her aunts and from her father to pay various business expenses, including suppliers, in an attempt to keep the restaurant in business. However, the restaurant's cash flow became insufficient to continue operations and Pietro's was closed in early 2011.

16. In May of 2011, the Division commenced a sales tax audit of Pietro's for the quarterly periods spanning March 1, 2006 through November 30, 2008. Upon audit, the Division determined that Pietro's sales and purchase records were inadequate for purposes of conducting a detailed audit. The Division conducted a purchase markup audit by utilizing a restaurant industry markup factor and applying the same to Pietro's food, paper products and liquor purchases to arrive at audited gross (and taxable) sales for the audit period (\$3,385,133.29), and sales tax due thereon (\$296,199.16). After reducing audited sales tax due by the sales tax paid by Pietro's (\$206,479.54) on its reported taxable sales, the Division assessed the remaining balance (\$89,719.62) as additional sales tax due for the audit period.

17. Mrs. Gerace challenged the foregoing sales tax assessment by requesting a conciliation conference with BCMS. A conciliation conference was held, the Division's assessment was upheld in full, and Mrs. Gerace did not pursue a further appeal of such result.

18. The foregoing results of the sales tax audit were forwarded to the Division's income tax audit section. In turn, the Division concluded that the additional gross sales receipts determined as the result of the sales tax audit constituted additional business income to LSG Enterprises, Inc. The Division therefore increased the income of LSG Enterprise, Inc., by the amounts of such additional audited gross receipts for each of the years at issue, with such amounts flowing through to Mrs. Gerace as additional income by virtue of the subchapter S election made by LSG Enterprise, Inc. As a result, Mrs. Gerace's income was increased in the amounts of \$173,289.00 for 2006, \$387,319.00 for 2007, and \$225,880.00 for 2008, with such amounts required to be reported on the Geraces' joint personal income tax returns for each of such respective years, resulting in the additional tax set forth on the May 16, 2013 Notice of Deficiency issued to petitioner and Mrs. Gerace (*see* Finding of Fact 2).

19. Petitioner was not involved in the operation or management of Pietro's. He never worked at Pietro's, even on a fill-in basis, and had no role there in any capacity notwithstanding his prior experience operating Mr. Ribs. Petitioner did go to Pietro's for its opening night celebration. Thereafter, when Mrs. Gerace would have a particularly late night at the restaurant petitioner would, at his wife's request, go to the restaurant and unlock the doors so as to allow Pietro's chefs access to the premises to prepare for the evening's diners. Assisting his wife in this manner occurred very infrequently. On very rare occasions, petitioner would eat dinner at Pietro's, typically with his grandchildren.

20. Petitioner did not keep or assist in keeping Pietro's records, and did not access or review such records. As noted, petitioner had no ownership interest in LSG Enterprise, Inc., and hence had no authority to access or review its records. Petitioner was aware of the commencement of the Division's sales tax audit because Mrs. Gerace advised him of it and

showed him the audit appointment letter. He accompanied Mrs. Gerace and Mr. Rizzo to the initial meeting with the Division's sales tax auditors to provide personal support for his spouse, but was entirely uninvolved in such audit.

21. Petitioner's income remained essentially the same throughout the years in issue, and consisted of his fixed disability retirement income, his fixed social security disability benefits, and any casino winnings (*see* Finding of Fact 8). For income tax preparation and filing purposes, petitioner assembled his forms W-2, on which his income was reported, and gave them to Mrs. Gerace to take to Mr. Rizzo in order to include and report petitioner's income on the Geraces' joint income tax returns. Petitioner relied upon Mr. Rizzo in this respect and signed the returns, as prepared by Mr. Rizzo, when they were presented to him for signature. He did not extensively review the same.

22. Petitioner became aware of the difficulties facing Pietro's by virtue of learning that Mrs. Gerace was borrowing money for the business from her relatives. Petitioner never received or "saw" any income from Pietro's, and his belief was that more money was going out than was coming in at the restaurant. He advised Mrs. Gerace to close the restaurant upon learning that she was borrowing money from family members in order to keep it going.

23. As noted, Mrs. Gerace was not employed prior to her decision to open Pietro's. Consistent with this fact, most household expenses (mortgage, taxes, ongoing living expenses and the like) were, and had been for many years, paid for out of petitioner's income. This practice continued through and beyond the years in issue, and no household expenses were paid by or from Pietro's business proceeds. There were no lifestyle changes for petitioner and Mrs. Gerace, such as country club memberships, vacation homes or other luxury item purchases, or extensive travel. In fact, petitioner's and Mrs. Gerace's only vacation during the years in issue

consisted of one trip where they spent two days in Las Vegas and a few days thereafter visiting friends who lived in Arizona.

***CONCLUSIONS OF LAW***

A. Generally, spouses who choose to file a joint return are subject to joint and several liability for tax deficiencies under the Internal Revenue Code (IRC) and the New York Tax Law (IRC § 6013[d][3]; Tax Law § 651[b][2].) Since joint and several liability may prove to be unjust in certain circumstances, Congress and the New York State Legislature authorized relief from such liability under the innocent spouse provisions of IRC § 6015 and Tax Law § 654. New York's innocent spouse rule is contained in Tax Law § 654(a) and expressly incorporates the federal provisions regarding innocent spouse status found in IRC § 6015. The latter section provides that a spouse may receive relief from joint and several liability 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 did not know and had no reason to know that there was an understatement; (d) under all the facts and circumstances, it would be inequitable to hold the innocent spouse liable for the deficiency in tax attributable to such understatement; and (e) the innocent spouse elects this relief within two years after any collection activity has begun against him (IRC § 6015 [b][1]).

B. In the instant matter, it is immediately evident that three of the five elements for innocent spouse relief set forth in IRC § 6015 have been met: a joint return was filed for the tax years in issue; on each return there was an understatement of tax attributable to erroneous items of one of the individuals filing the joint return, here, Linda Gerace; and the innocent spouse, here

petitioner, Peter Gerace, Sr., elected to apply for innocent spouse relief within two years after any collection activity had begun.

C. As is often the case in these matters, it is petitioner's ability to establish the remaining two requirements that determines if innocent spouse relief should be granted. Petitioner needed to establish that, in signing the return, he did not know or have reason to know of the understatement of tax and that, under all the facts and circumstances, it would be inequitable to hold him liable for the deficiency resulting from the understatement.

D. The Division's regulation at 20 NYCRR 151.10(e)(1) mirrors IRC § 6015(b)(1) in providing for innocent spouse relief where there was a joint return filed and said return contains a substantial understatement of income tax attributable to the grossly erroneous items of one spouse. In such situations, the other spouse will be relieved of liability for tax attributable to such substantial understatement of income attributable to grossly erroneous items if (1) the other spouse establishes that he did not know or have reason to know that there was a substantial understatement of income, and (2) in taking into account all the facts and circumstances, including whether or not the other spouse benefitted directly or indirectly from the grossly erroneous items, it would be inequitable to hold him liable for the deficiency attributable to the substantial understatement (20 NYCRR 151.10[e][1][i], [ii]). The term "grossly erroneous item" is defined in the regulations to mean any item of New York adjusted gross income which is omitted from same (20 NYCRR 151.10[e][3][i]). The term "substantial understatement" is defined to mean the excess of the amount of tax required to be shown on the return over the amount of tax shown on the return (less any rebate provided for in Tax Law § 681[g]) (20 NYCRR 151.10[e][3][ii]).

E. The courts have consistently held that in cases involving omitted income, the spouse's actual knowledge of the underlying transaction is sufficient to preclude innocent spouse relief (*see Reser v Commr.*, 112 F3d 1258 [5th Cir 1997]; *Matter of Revere v Commr. of Taxation & Fin.*, 75 AD3d 860 [2010]). 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.*, at 863).

F. The innocent spouse defense, raised to obtain relief from joint and several liability on a joint return, was designed to prevent the inequity of holding one spouse liable for the over-subtle financial machinations of the other. (*Friedman v Commr.*, 53 F3d 523, 529 [2d Cir 1995].) Under the knowledge-of-the-transaction test applied in omitted income cases, it is determined that petitioner has established entitlement to innocent spouse relief under IRC § 6015 (b)(1)(C) and Tax Law § 654(a). As detailed hereafter, the facts and circumstances in this case establish and support this conclusion.

G. To qualify for innocent spouse relief, the claiming spouse (here petitioner) must first establish that in signing the return, he or she “did not know, and had no reason to know, that there was such understatement . . .” (IRC § 6015[b][1][C]). As noted, the understatement of income tax in this case resulted from the attribution of additional income to petitioner’s spouse. This attributed income stemmed from a sales tax audit of a restaurant owned and operated by petitioner’s spouse, and its finding that there were additional unreported sales made by the restaurant. Petitioner had no involvement with the restaurant, and his liability for the tax based on the attributed income resulted solely by virtue of the fact that he filed joint personal income tax returns with his spouse. As the record clearly bears out, not only did petitioner have no knowledge of any understatement of income, but in fact, the reasonable conclusion he would draw from the circumstances as he understood them would be that, if anything, there would have been negative income from his wife’s operation of the restaurant. In this respect, petitioner was entirely uninvolved with the operation of the restaurant. Petitioner did not access or review the books and records of the restaurant. In fact, he was not an owner, shareholder or creditor of the corporation that owned the restaurant (LSG Enterprise, Inc.), and had no authority to access the books and records of the corporation so as to have undertaken a review of the restaurant’s financial status, even if he had been inclined to do so.

Petitioner points out, as above, that the understatements determined in this case resulted from a sales tax audit of the operations of his spouse’s business, which operations were accounted for and calculated at the business’s level, and then simply flowed through to the joint returns petitioner signed. Petitioner correctly claims he would have had no way of knowing, other than by obvious changes in lifestyle brought about by his wife’s actions or by an increase in funds available to finance such lifestyle changes, that there was unreported income. At some

point, petitioner became aware that his spouse was infusing money, borrowed from members of her family, into the operation of the restaurant in order to keep it in business. The conclusion to be drawn under such circumstances, absent any indication or evidence of inflows of cash or of unusual expenditures on personal items (e.g., luxury cars, expensive vacations, vacation homes, and the like), is not that the restaurant was generating significant sums of income that were available to, used by or of benefit to petitioner and Mrs. Gerace, but rather that the restaurant was failing. This conclusion was ultimately borne out by the fact that the restaurant did, indeed, fail. The clearest conclusion under the facts is that any funds available to Mrs. Gerace, including restaurant receipts and monies borrowed from her relatives, were used to pay the restaurant's creditors so as to keep the business going. In light of the evidence adduced, and specifically noting the credible, forthright and consistent testimony given by petitioner, Mrs. Gerace and their accountant, Michael Rizzo, the record does not support a conclusion that money was being taken out of the business by or for the benefit of petitioner and Mrs. Gerace. Simply put, rather than taking money out of the restaurant, it appears Mrs. Gerace was pouring money into the restaurant, and there is no sense or evidence that any additional unreported sales from the restaurant were applied by Mrs. Gerace to anything other than restaurant expenses or that the same were available to petitioner for his personal use or benefit.

H. Petitioner's former co-ownership and operation of a small restaurant (Mr. Ribs) places him in no different position than anyone who is married to a person that owns and operates a restaurant independently and in their own right. In fact, petitioner's personal experience in restaurant ownership and operation led him to be fully and vocally in opposition to his spouse's decision to open and operate a restaurant, and he entirely distanced himself from its operations from the outset.

I. Petitioner admits that he made no investigation and raised no questions concerning the income tax returns he signed. At the same time, however, the restaurant's books and records and its returns based thereon, as well as petitioner's and his spouse's personal income tax returns, were prepared by an accountant. Petitioner provided his own income tax records (forms W-2) to the accountant, who in turn prepared the couple's personal income tax returns, and petitioner clearly relied on his accountant in this regard. Moreover, while petitioner admittedly never carefully reviewed the jointly filed returns he freely signed for each of the years in issue, it is extraordinarily unlikely that he could have somehow discovered the possibility of additional income that might be attributed to his spouse by the Division based upon a sales tax audit of his spouse's independently owned and operated restaurant, even if he had read every line of every page of each of the income tax returns at the time he signed them. Innocence is determined from a taxpayer's state of mind at the time of signing the income tax return (*Friedman v Commr*). Here, petitioner's lack of innocence cannot be found since he was never in a position to discover, at the time he signed the returns, that there was any unreported income or any consequent understatement of tax. The knowledge-of-the-transaction test would be rendered meaningless if it intended that spouses who had no evidence or indication of a possible understatement of income, but rather had strong evidence of the opposite, could be held liable. The circumstances of this case distinguish it from the *Revere* case, which noted that innocent spouse relief was not designed to protect willful blindness or to encourage the deliberate cultivation of ignorance (citing *Friedman v Commr*). In sum, this is not a case of feigned or postured ignorance (*Hayman v CIR*, 992 F2d 1256 [2d Cir 1993]).

J. Significant factors in determining whether a spouse had reason to know of a substantial understatement of tax include the innocent spouse's participation in the business's

affairs or bookkeeping; the culpable spouse's refusal to be forthright concerning the couple's income; and the presence of unusual or lavish expenditures. (*Sell v Commr.*, 64 TCM 304 [1992].) Here, the evidence established that petitioner did not participate in his wife's business affairs at all. Petitioner and Mrs. Gerace credibly testified that petitioner performed no management, accounting or bookkeeping functions for the business, and in fact almost never went to the restaurant, save for unlocking the doors as an infrequent convenience to his wife, so staff could begin preparations. From the credible testimony of both petitioner and Mrs. Gerace, their lives were consistently rather unremarkable. In this regard, nothing unusual was apparent from the returns as prepared by the couple's accountant or from their lifestyle, lending more credence to petitioner's contention that he could not have known of the existence of additional unreported income. From his perspective at the time the returns were filed, which is the moment innocence is determined (*Friedman v Commr*), nothing about the family's economic circumstances during the years in issue would have indicated to a prudent observer that there was a substantial understatement of tax on the personal income tax returns filed by petitioner and his spouse.

K. In addition to the foregoing conclusion that petitioner did not know or have reason to know of the understatements, it was also necessary for petitioner to establish that it would be inequitable to hold him liable for the deficiency attributable to the understatement (IRC § 6015[b][1]; 20 NYCRR 151.10[e][1][i], [ii]). Under the circumstance of this matter, and noting in particular the fact that petitioner is disabled and lives on a fixed income, a denial of innocent spouse relief would clearly be inequitable. In this regard, it is particularly significant that prior to, and after her unsuccessful business venture in Pietro's, Mrs. Gerace was not employed (*see* Finding of Fact 10). Thus, the Geraces have met their financial obligations and living expenses

from 1996 forward upon petitioner's fixed disability retirement and fixed social security disability income (*see* Findings of Fact 8, 23). The record shows that the determination and imputation of additional income to petitioner's spouse, upon the basis of the sales tax audit of Pietro's, and the resulting carried-over imputation (or attribution) of such additional income to petitioner by virtue of his filing of joint income tax returns with his spouse, resulted in no benefit to petitioner. As discussed above, the Geraces' economic circumstances remained very constant (absent the detriment resulting from Mrs. Gerace's unsuccessful venture into the ownership and operation of Pietro's) during the years in issue, and there is no evidence of lavish expenditures or spikes in income. It is therefore concluded that it would be inequitable to require petitioner to pay the income tax deficiency resulting from the imputed income in this case.

L. "The determination of the applicability of the innocent spouse provision can only be made through an examination of all of the facts and circumstances of the case, including an assessment of the credibility of the 'innocent spouse'" (*Sell v Commr*, 66 TCM 185[1993]). Given the analysis above, it is concluded that the facts and circumstances as established by petitioner's credible testimony together with the credible testimony of the other witnesses, have satisfied the statutory requirements for innocent spouse relief, and petitioner is therefore relieved of liability for any additions to tax for the years in issue attributable to the substantial understatements that were, in turn, attributed to Mrs. Gerace's grossly erroneous items. (Tax Law § 654.)

M. It is noted that Congress, and derivatively New York, authorized three distinct types of relief for taxpayers who file joint returns (IRC § 6015[b], [c], [f]). This case has been decided under the requirements of IRC § 6015(b). Relief under IRC § 6015(c) would not be available in this case, and the same was denied by the Division, since it only applies to taxpayers who are no

longer married, are legally separated or do not reside together. Finally, a taxpayer may seek equitable relief under IRC § 6015(f). Since equitable relief under that provision is only available when the relief under IRC § 6015(b) and (c) is not, it has been rendered moot in this matter.

N. The petition of Peter Gerace, Sr. is granted, the Division's denial of petitioner's request for innocent spouse relief is reversed, and so much of the Division's assessment of tax as pertains to petitioner and results from the Notice of Deficiency dated May 16, 2013 and numbered L-039443096-7 is hereby canceled.

DATED: Albany, New York  
September 29, 2016

/s/ Dennis M. Galliher  
ADMINISTRATIVE LAW JUDGE