

OFFICE OF TAX APPEALS
STATE OF CALIFORNIA

In the Matter of the Appeal of:
ANGELA NILSEN

) OTA Case No. 18011772
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) Date Issued: July 17, 2019
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OPINION

Representing the Parties:

For Appellant (Requesting Spouse): Angela Nilsen

For Nonrequesting Spouse: David A. Nilsen

For Respondent: Bradley J. Coutinho, Tax Counsel

For Office of Tax Appeals: William J. Stafford, Tax Counsel III

P. KUSIAK, Administrative Law Judge: Pursuant to California Revenue and Taxation Code (R&TC) sections 18533 and 19045, Angela Nilsen (appellant) appeals an action by Franchise Tax Board (FTB) in denying innocent spouse relief for the 2004 through 2006 tax years (tax years at issue).¹ Appellant waived her right to an oral hearing; therefore, the matter is being decided based on the written record.

ISSUES

1. Whether appellant demonstrated that she is entitled to innocent spouse relief under R&TC section 18533(b) or R&TC section 18533(f) for tax years 2004 through 2006.
2. Whether appellant demonstrated that she is entitled to conforming innocent spouse relief under R&TC section 18533(i) for tax year 2005.

¹ Appellant filed requests for innocent spouse relief for tax years 2004 through 2006 and tax years 2008 through 2011. FTB’s records, however, do not indicate that the couple had a joint liability for tax years 2008 through 2010; thus, appellant’s request for relief cannot be considered for those tax years. As for the 2011 tax year, FTB’s records indicate that appellant and Mr. Nilsen filed a joint return reporting no tax liability. FTB processed that return and accepted it as filed. Because there was no underpaid tax, innocent spouse relief cannot be granted. Accordingly, the only tax years at issue are 2004 through 2006.

FACTUAL FINDINGS

A. Background

1. Appellant and her husband, Mr. Nilsen, were married in 1972. They remain married, and are not separated.
2. Appellant is a high school graduate and took some college level courses, but she has no formal education in accounting or finance. Appellant worked in retail and banking services, but she did not work outside of the home for the last 30 years. She holds no professional licenses.
3. Mr. Nilsen ran a mortgage investment business, which commenced operations in 1980 as Cedar Funding, Inc. (Cedar Funding). In addition to making various types of loans, Cedar Funding was involved with the development of single-family subdivisions.
4. Cedar Funding filed for bankruptcy in 2008. In June 2008, the bankruptcy court ordered that all electronic records of Cedar Funding be turned over to the Chapter 11 trustee.
5. In April 2012, Mr. Nilsen pleaded guilty to one count of conspiracy to commit mail and wire fraud in relation to the business of Cedar Funding. He received a 97-month federal prison sentence and was ordered to pay restitution of approximately \$70 million. He started serving his prison sentence on June 1, 2012.²
6. Appellant currently cares for Mr. Nilsen, who now lives with appellant.
7. Appellant and Mr. Nilsen are retired.
8. As of August 13, 2018, appellant was 67 years old, and Mr. Nilsen was 68 years old.
9. Appellant's mother has dementia and Alzheimer's disease, and appellant is her mother's full-time care provider.
10. Appellant was never subjected to any physical or mental abuse by Mr. Nilsen.

B. Tax Returns and Deficiencies

1. The couple filed joint California and federal returns for each tax year at issue.
2. Mr. Nilsen prepared the couple's tax returns without the assistance of appellant.

² It appears that Mr. Nilsen was released from prison in 2018.

3. Appellant signed the returns without reviewing them. She was not forced or intimidated into signing the returns.
4. On their 2004, 2005, and 2006 returns, the couple claimed \$820,978, \$1,608,034, and \$2,543,822, respectively, in Schedule C business expenses related to Cedar Funding; some of those expenses included mortgage interest, labor, commissions, and supplies.
5. FTB initiated an audit in June 2008. During the audit, FTB determined that the couple did not establish the validity of the Schedule C business expenses described above and disallowed those deductions. FTB further determined that the couple did not report (i.e., omitted) Schedule K-1 income of \$10,661 for 2005 and \$50,456 for 2006.
6. After receiving no response to various information requests and a demand notice, FTB issued Notices of Proposed Assessment (NPAs) for the 2004-2006 tax years on February 11, 2009. The NPA for the 2004 tax year determines additional tax of \$77,499.00 and a demand penalty of \$19,374.75, plus applicable interest. The NPA for the 2005 tax year determines additional tax of \$160,558.00 and a demand penalty of \$40,139.50, plus applicable interest. The NPA for the 2006 tax year determines additional tax of \$259,197 and a demand penalty of \$64,799, plus applicable interest.
7. Neither appellant nor Mr. Nilsen timely protested the NPAs and they became final assessments.
8. After the NPAs became final assessments, FTB instituted collection actions.

C. Innocent Spouse Request

1. In October 2014, appellant filed a request for innocent spouse relief (FTB Form 705) for tax years 2004 through 2006 and tax years 2008 through 2011.
2. Appellant stated that she has no knowledge of how her husband calculated the financial amounts listed in the returns for the tax years at issue.
3. On February 7, 2015 and June 9, 2015, FTB sent appellant requests for further information. When FTB did not receive a response, it issued Notices of Action (NOA)-Denials for the 2004-2006 tax years, denying appellant's request for innocent spouse relief.

4. Appellant filed this timely appeal.

DISCUSSION

Issue 1 – Whether appellant is entitled to innocent spouse relief under R&TC section 18533(b) or R&TC section 189533(f) for tax years 2004 through 2006.

R&TC section 19006(b) provides that when a joint return is filed, each spouse is jointly and severally liable for the tax on the aggregate income on the return. (See Internal Revenue Code (IRC), § 6013(d).)³

Federal and California law provide that an individual who files a joint return may be relieved of all or a portion of the joint and several liability if the individual qualifies as an innocent spouse. (IRC, § 6015; R&TC, § 18533.) When a California statute is substantially identical to a federal statute (as in the case of the innocent spouse relief statutes), federal law interpreting the federal statute is considered highly persuasive in interpreting the California statute. (*Douglas v. State of California* (1942) 48 Cal.App.2d 835, 838.) Thus, federal authority is applied extensively in California innocent spouse cases. (See also R&TC, § 18533(g)(2).)

Generally, an individual claiming innocent spouse relief has the burden of establishing each statutory requirement by a preponderance of the evidence. (*Stevens v. Commissioner*, T.C. Memo. 1988-63; *Appeal of Dillet* (85-SBE-012) 1985 WL 15791.) Since the innocent spouse provisions are remedial in nature, they are construed and applied liberally in favor of the individual claiming their benefits. (*Friedman v. Commissioner* (2d Cir. 1995) 53 F.3d 523, 528-529.) Unsupported assertions, however, are not sufficient to satisfy an appellant's burden of proof. (*Appeal of Magidow* (82-SBE-274) 1982 WL 11930.)

There are four types of innocent spouse relief under R&TC section 18533: traditional relief under subdivision (b); a separate liability election under subdivision (c); equitable relief under subdivision (f); and conforming relief under subdivision (i) when innocent spouse relief has been granted by the federal government. Appellant concedes that relief is not available to her under subdivision (c) of section 18533 because the couple remains married and had not lived apart for at least 12 months when the innocent spouse request was submitted.⁴ Hence, our

³ All IRC references are to the Internal Revenue Code.

⁴ An incarcerated spouse is considered a member of the marital household, with a temporary absence. (Treas. Reg. § 1.6015-3(b)(3).)

analysis is limited to whether appellant qualifies for innocent spouse relief under subdivisions (b), (f), or (i) of R&TC section 18533.

I. Traditional Innocent Spouse Relief - R&TC section 18533(b)

R&TC section 18533(b) allows relief with respect to an understatement of tax attributable to the erroneous items of the other individual filing the joint return when the requesting spouse meets the following requirements:

1. A joint return was filed for the tax year at issue;
2. The return contains an understatement attributable to an erroneous item of the other spouse;
3. The requesting spouse established that in signing the return, he or she did not know of, and had no reason to know of, the understatement;
4. Taking into account all facts and circumstances, it would be inequitable to hold the requesting spouse liable for the deficiency attributable to the understatement; and
5. The requesting spouse's claim for relief is timely.

(R&TC, § 18533(b)(1).)

The requirements of R&TC section 18533(b)(1) are stated in the conjunctive. Thus, if the requesting spouse fails to meet any one of them, that spouse does not qualify for innocent spouse relief. (See *Alt v. Commissioner* (2002) 119 T.C. 306, 313, affd. (6th Cir. 2004) 101 Fed. Appx. 34 [interpreting IRC section 6015(b), the federal analog to R&TC section 18533(b)].)

FTB does not dispute that appellant filed joint returns with Mr. Nilsen for the 2004-2006 tax years (the first requirement) or that appellant's request was timely (the fifth requirement). FTB argues, however, that appellant did not satisfy the second, third, and fourth requirements.

With regard to the second requirement, to determine whether an erroneous item is attributable to a nonelecting spouse, one considers which spouse owned the property that generated the erroneous item and each spouse's level of participation in the activity which gave rise to the erroneous item.⁵ (*Juell v. Commissioner*, T.C. Memo. 2007-219.) Joint ownership, by

⁵ For traditional innocent spouse relief, an item must be *solely* attributable to the nonelecting spouse. (*Work v. Commissioner*, T.C. Memo. 2014-190 [for purposes of traditional innocent spouse relief, the attribution requirement was met for certain items that were "solely attributable" to nonelecting spouse; for other items that were not "solely attributable" to nonelecting spouse, the attribution requirement was not met]; see also *Deihl v. Commissioner*, T.C. Memo. 2012-176.)

itself, is not determinative of whether the erroneous item is attributable to one or both spouses. (*Ibid.*) A key factor is whether, and to what extent, the electing spouse voluntarily participated in the investment or activity that gave rise to the erroneous item. (*Ibid.*) Generally, an electing spouse who voluntarily agreed to enter into an investment or activity, or actively participated therein, is precluded from attributing the entire investment or activity to the nonelecting spouse. (*Ibid.*) An erroneous item is usually attributable to the individual whose actions gave rise to the item, without regard to the operation of community property laws. (*Varela v. Commissioner*, T.C. Memo. 2014-222; see Treas. Reg. § 1.6015-1(f)(1).)

As indicated above, the erroneous items at issue are the disallowed Schedule C business expenses and the unreported Schedule K-1 income.

Appellant has not worked outside of the home for the last 30 years. She is a high school graduate and has completed a few college-level courses; however, she never took any accounting or tax courses, and she does not hold any professional licenses. She contends that she had “no involvement” with the Cedar Funding business.

Appellant was not criminally charged in relation to the business matters of Cedar Funding, as was Mr. Nilsen. Nevertheless, other than copies of Schedules C and Schedules K-1 that list Mr. Nilsen as a “proprietor” or “partner” in the Cedar Funding business, appellant did not provide any business records (e.g., bank statements, cancelled checks, corporate invoices, business letters, business emails) or declarations from third-parties bolstering her assertion that the disallowed Schedule C business expenses are attributable to Mr. Nilsen and not to her. Overall, given the limited evidence in the appeal record, appellant failed to establish that the disallowed Schedule C business expenses for tax years 2004 through 2006 are solely attributable to Mr. Nilsen.

As for the unreported Schedule K-1 income for tax years 2005 through 2006, the limited evidence in the appeal record, including appellant’s declaration, does not clarify and substantiate the extent of appellant’s involvement with the Schedule K-1 business(es) and does not identify the relationship of the unreported Schedule K-1 amounts of \$10,661 and \$50,456 to (i) the Cedar Funding business, (ii) the couple’s rental properties listed on Schedule E of their 2005-2006 federal returns, or (iii) some other properties/investments. Further, we note that some of the Schedules K-1 list appellant as partner, along with her husband, Mr. Nilsen. Given the limited

evidence in the appeal record, appellant failed to establish that the Schedule K-1 amounts were solely attributable to Mr. Nilsen.

As a result, appellant failed to establish that the understatements at issue are solely attributable to Mr. Nilsen. Because appellant failed to satisfy the second requirement, she is not entitled to traditional innocent spouse relief.

II. Equitable Innocent Spouse Relief - R&TC section 18533(f)

R&TC section 18533(f) provides that FTB may relieve a taxpayer from a tax liability if: (1) taking into account all the facts and circumstances, it is inequitable to hold the taxpayer liable for the unpaid tax or understatement; and (2) the taxpayer does not otherwise qualify for relief under subdivisions (b) or (c). Determinations to deny equitable relief are reviewed *de novo*, and the requesting spouse bears the burden of showing that he or she is entitled to equitable relief. (*Porter v. Commissioner* (2009) 132 T.C. 203, 210.)

FTB asserts appellant did not establish that it would be inequitable to hold her liable for the understatement of income and overstatement of business expense deductions. The Internal Revenue Service (IRS) has outlined the factors it normally considers in deciding whether to grant equitable innocent spouse relief in IRS Revenue Procedure 2013-34.

Revenue Procedure 2013-34 sets forth a three-step process to be followed in evaluating requests for equitable innocent spouse relief: (1) section 4.01 lists seven threshold requirements which must be met; (2) section 4.02 lists the circumstances in which the IRS will make a streamlined relief determination; and (3) section 4.03 sets forth nonexclusive factors that the IRS will consider in determining whether equitable relief should be granted when a requesting spouse does not meet the requirements for the streamlined determination.

Threshold Requirements—Section 4.01

Section 4.01 of Revenue Procedure 2013-34 sets forth the following threshold requirements⁶ for a taxpayer requesting equitable relief:

1. The requesting spouse filed a joint return for the taxable year for which relief is sought;

⁶The Revenue Procedure and federal court cases indicate that, if the requesting spouse cannot satisfy all of the threshold conditions, then his/her claim for equitable relief must be denied. (See, e.g., *Reilly-Casey v. Commissioner*, T.C. Memo. 2013-292; *Stanwyck v. Commissioner*, T.C. Memo. 2012-180; *Franc v. Commissioner*, T.C. Memo. 2010-79; *O'Meara v. Commissioner*, T.C. Memo. 2009-71.)

2. Relief is not available to the requesting spouse under traditional innocent spouse relief or separate allocation innocent spouse relief;
3. The requesting spouse applies for relief within the applicable statute of limitations for requesting relief;
4. No assets were transferred between spouses as part of a fraudulent scheme by the spouses;
5. The nonrequesting spouse did not transfer disqualified assets to the requesting spouse;
6. The requesting spouse did not file the return with a fraudulent intent; and
7. The income tax liability from which the requesting spouse seeks relief is attributable (in full or in part) to an item of the individual with whom the requesting spouse filed the joint return. If the liability is partially attributable to the requesting spouse, then relief can be considered only for the portion of the liability attributable to the nonrequesting spouse. However, relief can still be considered regardless of whether the understatement, deficiency, or underpayment is attributable (in full or in part) to the requesting spouse, if a specified exception applies.

Here, there is no dispute that the first six threshold requirements are satisfied. In relation to the seventh threshold requirement, FTB concedes that some undetermined portion of each tax year liability is attributable to Mr. Nilsen and, therefore, appellant satisfied the seventh threshold requirement. Accordingly, we shall next analyze whether appellant meets the requirements for a Streamlined Determination under Section 4.02 or the Balancing Factors under Section 4.03 of Revenue Procedure 2013-34.

Streamlined Determination—Section 4.02

Section 4.02 of Revenue Procedure 2013-34 provides the following list of factors which, if met, permit a streamlined determination of equitable innocent spouse relief:

1. At the time the government makes its innocent spouse determination, the requesting spouse is separated (whether legally separated or living apart) or divorced from the nonrequesting spouse, or is a widow(er) and not an heir to the nonrequesting spouse's estate;
2. The requesting spouse establishes he or she would suffer economic hardship if relief were not granted; and
3. The requesting spouse establishes he or she did not know or have reason to know that there was an understatement or deficiency on the joint return or did not know or have reason to know as of the date the return was filed that the

nonrequesting spouse would not or could not pay the tax liability at that time or within a reasonable period of time after filing the return.

Here, appellant does not qualify under the streamlined procedures of section 4.02, as appellant and Mr. Nilsen remain married and are not separated. Hence, we focus on the nonexclusive factors of section 4.03.

Balancing Factors—Section 4.03

If the threshold requirements of section 4.01 are satisfied and the streamlined equitable innocent spouse relief of section 4.02 is unavailable, then section 4.03 provides a list of nonexclusive factors to be weighed in making a decision. They include: (1) marital status; (2) economic hardship; (3) the requesting spouse’s knowledge or reason to know of the erroneous item; (4) legal obligation arising from a divorce decree or other binding agreement; (5) significant benefit received by the requesting spouse; (6) compliance with income tax laws in subsequent tax years; and (7) mental or physical health. No single factor is determinative; the list of factors is not exhaustive, and the importance of each factor varies depending on the requesting spouse’s facts and circumstances. (Rev. Proc. 2013-34, § 4.03(2); *Kellam v. Commissioner*, T.C. Memo. 2013-186.)⁷

Based on the record and the above findings of fact, one factor weighs against relief,⁸ six factors are neutral, and no factors weigh in favor of relief. Accordingly, we find that appellant has failed to establish that she is entitled to equitable innocent spouse relief under R&TC section 18533(f).

⁷ The language of the “facts and circumstances” test of R&TC section 18533(b)(1)(D) is substantially the same as the language of R&TC section 18533(f), and the relevant factors to be considered under both provisions are the same. Accordingly, the determination as to whether it is equitable to hold a party claiming relief liable would be the same using either provision. Federal courts have concluded the same with respect to IRC sections 6015(b), and 6015(f), the federal analogs to R&TC sections 18533(b)(1)(D), and 18533(f). (*Alt v. Commissioner*, *supra*, 119 T.C. at p. 316; *Butler v. Commissioner* (2000) 114 T.C. 276, 291; *Barranco v. Commissioner*, T.C. Memo. 2003-18.)

⁸ Given the limited evidence in the appeal record, appellant has failed to establish that on the dates she signed the returns she did not know or have reason to know of the understatements at issue. This factor weighs against relief.

Issue 2 – Whether appellant demonstrated that she is entitled to conforming innocent spouse relief under R&TC section 18533(i) for the 2005 tax year.

R&TC section 18533(i) provides that an individual who files a joint return and is granted innocent spouse relief under IRC section 6015 shall be eligible for relief if three conditions are satisfied:

1. The individual requests relief under R&TC section 18533;
2. The facts and circumstances that apply to the understatement and liabilities for which the relief is requested are the same facts and circumstances that applied to the understatement and liabilities for which that individual was granted relief under IRC section 6015; and
3. The individual requesting relief under R&TC section 18533(i) furnishes FTB with a copy of the federal determination granting that individual relief under IRC section 6015.

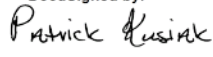
Appellant contends that the IRS granted her federal innocent spouse relief for the 2005 tax year and seeks conforming relief from FTB. Appellant's husband supports appellant's request for innocent spouse relief. Appellant's federal tax account transcript, however, demonstrates that the IRS did not grant federal innocent spouse relief to appellant for the 2005 tax year. In fact, it appears that there was neither a federal deficiency assessment nor a federal underpayment for the 2005 tax year. Accordingly, appellant is not entitled to conforming innocent spouse relief under R&TC section 18533(i) for the 2005 tax year.

HOLDINGS


1. Appellant did not demonstrate that she is entitled to innocent spouse relief under R&TC section 18533(b) and R&TC section 18533(f) for tax years 2004 through 2006.
2. Appellant did not demonstrate that she is entitled to conforming innocent spouse relief under R&TC section 18533(i) for tax year 2005.


DISPOSITION

FTB's actions are sustained.

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Patrick J. Kusiak
Administrative Law Judge

We concur:

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Tommy Leung
Administrative Law Judge

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Teresa A. Stanley
Administrative Law Judge