TAX TRENDS AND DEVELOPMENTS

Division of Federal Income Tax Debt

Lezotte v. Lezotte, Unpublished per curiam opinion of the Court of Appeals, issued July 28, 2022 (Docket #360244)

By Joseph W. Cunningham, JD, CPA

Facts

- During most of their twenty-two year marriage, H & W owned a McDonald's franchise which provided them a relatively high standard of living.
- They sold the franchise in 2015 and netted approximately $850,000. However, rather than using the money to pay income tax due on the sale, the funds were invested in various business ventures all of which failed.
- H and W filed for bankruptcy which was concluded in July 2020.
- Regarding the federal tax debt remaining after bankruptcy, W claimed (1) that H had "hid financial circumstances from her" and (2) that H "controlled the finances and she had little input on" the disposition of the sale proceeds.
- Further, it was acknowledged that H often signed W's name – with her consent – on various documents including income tax returns.
- The trial court divided the income tax on the gain from the McDonald's sale equally between H & W in pertinent part because W "had enjoyed the financial benefits of the business during the marriage, including trips, jewelry, and clothing."
- W appealed.

Court of Appeals Decision

- The Court upheld the trial court decision.
- The Court noted that H had brought documents for W to sign and, further, that she had attended a meeting related to the bankruptcy proceedings.
- Thus, the Court ruled, "the trial court's division of marital debt was fair and equitable."

Comments on the Case

- It is not uncommon for one spouse to handle a couple's finances, including income tax matters.
- In many such instances the other spouse simply signs tax returns and other documents without reading and/or understanding what is being signed.
- Sometimes, such a spouse may qualify for innocent spouse status and, thereby, avoid responsibility for joint tax liabilities.
- But, one of the qualifying factors for innocent spouse status is that the spouse seeking such status did not significantly benefit from the unpaid tax.
- In the *Lezotte* case, Ms. Lezotte did not in fact benefit from the unpaid taxes since the investments of the net sale proceeds all failed.
- Rather the trial court appeared to rely on the fact that she "enjoyed the fruits of marital business decisions for seventeen years" and cannot "disavow herself from the debt that comes from those same business decisions."
- It was not indicated in the decision whether Ms. Lezotte had applied for innocent spouse protection.
- Because there were virtually no assets to divide, the result to Ms. Lezotte was harsh.
- The case serves as a reminder of how important it is for both spouses to have some level of understanding of their finances, including taxes, affecting them.
- Also, in a divorce action in circumstances where that did not happen, innocent spouse status should certainly be considered regarding federal income tax debt.

About the Author

Joe Cunningham *has over 25 years of experience specializing in financial and tax aspects of divorce, including business valuation, valuing and dividing retirement benefits, and developing settlement proposals. He has lectured extensively for ICLE, the Family Law Section, and the MACPA. Joe is also the author of numerous journal articles and chapters in family law treatises. His office is in Troy, though his practice is statewide.*

Email: JoeCunninghamPC@gmail.com

Website: https://JoeCunninghamPC.com