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Foti v. Foti, Commingling Of Separate Property By Tax Return, A Department Stands Alone Amid Federal Law And The Law Of Other Jurisdictions

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Foti v. Foti,[2] a four-sentence decision, misapplied the doctrine of quasi/judicial estoppel to convert separate property into marital property based on no more than a joint filing on a tax return. Citing *Mahoney – Buntzman v. Buntzman,*[3] the Fourth Department inexplicably held that, although the wife established that her father had gifted certain entities of real property to her, which remained separately maintained, the parties' joint federal tax return, in which the wife reported her interest in the entities as tax losses, estopped her from taking a a position during the divorce litigation that the properties were separate because "a party to litigation may not take a position contrary to a position taken in an income tax return."[4]

Foti's retooling of the doctrine of quasi/judicial estoppel that no more than the mere filing of a joint tax return traps and converts the separately *held* assets that were reported into marital property, starkly isolates it from not only the law of other Departments but also from the universe of federal authority and other jurisdictions, as well.

The Estoppel Doctrine Requires a Three-Prong Test to Be Met Conjunctively

In *Martin v. C.A. Productions Co.*,[5] the Court of Appeals set forth the three predicate criteria, to be met conjunctively, of judicial estoppel: a prior proceeding; a prior successful position taken therein; and a current inconsistent position due to a change of needs:

> By reason of the successful position thus taken by him in the prior action, the defendant comes within the rule that a claim made or position taken in a former action or judicial proceeding will estop the party from making any inconsistent

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[2] 114 A.D.3d 1207, 979 N.Y.S.2d 914 [4th Dept. 2014].

[3] 12 N.Y.3d 415, 422, 881 N.Y.S.2d 369 [2009].

[4] Foti, at 1208.

[5] 8 N.Y.2d 226, 203 N.Y.S.2d 845 [1960].

claim or taking a conflicting position in a subsequent action or judicial proceeding to the prejudice of the adverse party.

Jones Language Wootton USA v. LeBoeuf, Lamb, Greene & MacRae,[6] captures the essence of judicial estoppel:

> The doctrine of judicial estoppel or the doctrine of inconsistent positions 'precludes a party who assumed a certain position in a prior legal proceeding and who secured a judgment in his or her favor from assuming a contrary position in another action simply because his or her interests have changed.' As stated by the United States Supreme Court, 'where a party assumes a certain position in a legal proceeding, and succeeds in maintaining that position, he may not thereafter, simply because his interests have changed, assume a contrary position' (citations omitted). 'The doctrine rests upon the principle that a litigant 'should not be permitted . . . to lead a court to find a fact one way and then contend in another judicial proceeding that the same fact should be found otherwise.'

The component at the heart of this three-prong test is that the party asserting the inconsistent position in the subsequent action must have actually prevailed on that position in the prior action or proceeding for the doctrine to apply, not just merely have asserted that position; otherwise stated, if the proponent did not prevail on that position in the prior proceeding then the doctrine does not preclude the reassertion of the inconsistent position in a future proceeding.

Foti Cited only _Mahoney-Buntzman_ re Quasi/Judicial Estoppel, _Mahoney-Buntzman_ Relied upon Three Decisions, All Contrary to _Foti_

Foti cited only *Mahoney-Buntzman*, a case involving the application of judicial estoppel to tax returns, discussed below, wherein the Court of Appeals referenced three cases none of which extended or can be construed to have expanded the doctrine beyond the rule that judicial estoppel is not confined to positions taken in a formal courtroom but rather includes positions taken in administrative and insurance settings: *Meyer v. Insurance Co. of Am.*[7]; *Naghavi v. New York Life Ins. Co.*;[8] and *Zemel v. Horowitz*.[9]

Critically, *Mahoney-Buntzman* and each of the three cases issued narrowly tapered rulings limited to the subject monies. None of the cases held or even remotely hinted that quasi/judicial

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[6] 243 A.D.2d 168, 674 N.Y.S.2d 280 [1st Dept.,1998].

[7] 1998 WL 709854 [S.D.N.Y. 1998].

[8] 260 A.D.2d 252, 688 N.Y.S.2d 530 [1st Dept.1999].

[9] 11 Misc.3d 1058[A], 815 N.Y.S.2d 496 [Sup Ct, N.Y. County 2006].

estoppel sweepingly swallows whole the underlying assets that generated the income or the losses. *Foti* misconstrued *Mahoney-Buntzman* to reach a conclusion never articulated or even distantly implied by the Court of Appeals or the cases cited therein.

Mahoney-Buntzman v Buntzman

In *Mahoney-Buntzman*, the defendant and his father, David Buntzman, were embattled in extensive business litigation. Pursuant to their settlement agreement, the defendant agreed to accept $1.8 million to be reported for income tax purposes on a 1099 Form by one of the companies. To account for the increased tax liability that the defendant would incur as a consequence of that structure, the payment was increased by 17% rather than as a sale of an interest in stock.

The trial court and thereafter the Court of Appeals, in upholding the trial court, applied the doctrine of judicial estoppel to convert only the subject $1.8 million payment into a marital asset.[10] The trial court stated:[11]

> One form of estoppel, quasi estoppel, forbids a party from accepting the benefits of a transaction or statute and then subsequently taking an inconsistent position to avoid the corresponding obligations or effects ... In this case, in order to resolve a family dispute by obtaining a tax benefit for an entity owned by his father, defendant represented in a Federal Income Tax return that a $1,800,000 payment received by him constituted business income. Having obtained that benefit for a third party, he is estopped from asserting a separate property claim as to that payment or any property obtained with those funds ... which "has cost h[im] a much larger benefit" in this matrimonial action ... (cites omitted).

- Meyer v Insurance Co. of America

Nor does *Meyer v. Insurance Co. of America* support the conclusion in *Foti*:

> Meyer's sworn statement in her tax return may be the absolute truth, or she may have made the statement falsely in order to obtain business loss tax benefits to which she was not entitled. With Meyer's death, the Court cannot say for sure which it is. The Court can say, however, that Meyer and her estate is[sic] bound by her sworn representations in her tax return; Risa Meyer is estopped from now taking a position inconsistent with Meyer's representations to the IRS.

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[10] The Appellate Division had not weighed in on this issue.

[11] Mahoney Buntzman v Buntzman, 13 Misc.3d 1216(A), 824 N.Y.S.2d 755 [N.Y.Sup. 2006].

Meyer relied on settled authority that the doctrine applies with equal measure to nonjudicial proceedings. None of the courts extended the doctrine beyond the subject funds:

> Ginor v. Landsberg, No. 97-9061, 1998 WL 514304 at *1 (2d Cir.1998) ... (taxpayers are estopped from pressing a new interpretation of a note's terms having previously made a contrary assertion to the IRS) (citing Davidson v. Davidson, 947 F.2d 1294, 1297 (5th Cir.1991) (estopping party from taking a position in bankruptcy proceedings that was inconsistent with representations made to the IRS on tax returns));
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> Robb-Fulton v. Robb, 23 F.3d 895, 898-99 (4th Cir.1994) (estopping a party from taking position in bankruptcy proceedings that was inconsistent with representations made to the IRS on tax returns);
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> Nowak v. Nowak, 183 B.R. 568, 570-71 (Bankr.D.Neb.1995) (prohibiting plaintiff from asserting statements in bankruptcy proceeding inconsistent with representations made to the IRS);

- Zemel v Horowitz

Limiting its holding to the specific transaction regarding inconsistent reporting of a purported stock sale, *Zemel v. Horowitz* held that judicial estoppel applies to IRS representations:

> [O]n their tax returns, plaintiffs did not report any gain from the sale of the stock, which would have been required under applicable tax laws had they actually sold the stock, and loaned the proceeds to Horowitz. Instead, plaintiffs represented to the Internal Revenue Service, under oath and subject to the penalty of perjury, that they had sold stock which they subsequently acquired, the equivalent of a "short sale."
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> [W]here [] the original position is represented in a context not precisely falling in the "judicial" forum category, the same principles are nevertheless applied, and often designated "quasi estoppel" or "estoppel against inconsistent positions." These estoppel principles forbid a party from receiving the benefits of a transaction or statute, and then subsequently taking an inconsistent position to avoid the corresponding effects. Thus, whether using the appellation of judicial estoppel, quasi estoppel, or estoppel against inconsistent positions, courts have consistently held that a party is estopped from adopting in court a position contrary to that previously asserted on his or her tax returns.

- Naghavi v New York Life Ins. Co.

In *Naghavi v. New York Life Ins. Co.*, the doctrine was applied to the discrete inconsistent insurance and tax representations:

> The [] affidavit of defendant's underwriter, accompanied by a page from defendant's underwriting manual stating that no disability policy would be issued to any person earning less than $16,000 per year, established, as a matter of law, the materiality of plaintiff's misrepresentation in his application that his earned income for the prior and current years was and would be $100,000 ... Although plaintiff contends that when commissions he allegedly earned from business activities abroad are taken into account, he actually did have annual income of $100,000 in the years in question, we deem him to be bound by his contrary representations in the income tax returns he filed for those years, the application for insurance having defined "earned income" in terms of amounts "reportable for personal federal income tax purposes" (cites omitted).

Nimkoff v Nimkoff

Citing *Angelo v. Angelo*,[12] discussed below, the First Department, in *Nimkoff v Nimkoff*,[13] upheld the trial court's decision that "the filing of joint federal and state tax returns should not be regarded as creating a joint tenancy with a right of survivorship in the resulting refunds" that, absent an agreement stating otherwise, tax returns "must be regarded as separate property of which each party is entitled to a pro rata share."

Spencer v Spencer

Even the use of separate property to support one's family does not commingle it into marital property. Citing long settled authority on commingling,[14] in *Spencer v. Spencer*,[15] the First Department upheld a finding of noncommingling in an instance where the owner of the separate property "continued to maintain th[e] asset as separate throughout the marriage."

Johnston v Nakis

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[12] 74 A.D.2d 327, 333, 428 N.Y.S.2d 14 [2nd Dept.1980].

[13] 120 AD3d 1099, 992 N.Y.S.2d 400 [1st Dept 2014].

[14] McGarrity v. McGarrity, 211 A.D.2d 669, 622 N.Y.S.2d 521 [2nd Dept.,1995]; Alaimo v. Alaimo, 199 A.D.2d 1039, 606 N.Y.S.2d 117 [4th Dept.,1993]; Feldman v. Feldman, 194 A.D.2d 207, 605 N.Y.S.2d 777 [2nd Dept.,1993].

[15] 230 A.D.2d 645, 646 N.Y.S.2d 674 (1st Dept.,1996); see Feldman v. Feldman, 194 A.D.2d 207, 216, 605 N.Y.S.2d 777 (2d Dept.1993).

In *Johnston v Nakis*,[16] the Supreme Court, sitting in the Fourth Department, struggled valiantly before rejecting the plaintiff's contention that, under *Foti*, certain of the wife's accounts became marital "by reason of the fact that the activity in these accounts was reported to the federal and state taxing authorities on joint tax returns." Most significant in *Johnston* is that the Supreme Court could have entirely bypassed the *Foti* thicket, thereby avoiding confrontation with its parent Department, to effortlessly achieve the same conclusion because the parties had stipulated during trial that the accounts that the husband now claimed as marital, under *Foti*, remained the wife's separate property. It is eminently clear that the Supreme Court yielded to the importance of developing the issue.

Johnston struggled mightily to defend its Department, however, following a review of law and reason from federal courts and courts of other jurisdictions, the Supreme Court respectfully concluded that *Foti* could not have possibly meant what it held: "The court is fortified in its conclusion that the Appellate Division in Foti did not determine conclusively that the filing of a joint return transmutes gifted separate property business entities into marital property, as opposed to simply raising an issue of fact whether the judicial estoppel should be applied, by decisions from other states"[17]; "the choice to file jointly and report the tax losses on the gifted business entities is not conclusive."[18] Noble.

Johnston's analysis quoted *Angelo,* above, a very early post Equitable Distribution Law decision from the Second Department, which acknowledged that filing joint returns is intended to achieve no more than to confer a benefit on a married couple and not a gift:

> The filing of a joint income tax return must be viewed in the circumstances of the general financial background of the marriage; moreover, it should be construed as a response to the tax statutes designed to confer a benefit to the married couple. In itself the exercise of the option by the spouses to file a joint return should not be interpreted as the conclusive memorial of the intent to create a joint tenancy or to make a gift by one for the other. We should look beyond the simple execution of the return to the circumstances of the marriage.

Johnston also noted *Nimkoff*, that "in the absence of an agreement to the contrary, joint tax refunds generally are 'regarded as separate property of which each party is entitled to a pro rate share.' "

Johnston's examination of a litany of authority compelled its acknowledgment of the universal understanding and treatment of this issue, that commingling may not be backed into by

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[16] 46 Misc 3d 651, 997 N.Y.S.2d 257 [Sup Ct 2014].

[17] Johnston, at 666.

[18] Johnston, at 665.

way of a joint tax filing:

> The Angelo case is remarkable because it involved the question of ownership of the joint tax refund itself. The fact that ... the joint refund is considered separate property of each spouse entitling each to his or her pro rata share, does not, without more, establish commingling of separate funds with marital funds. If the election to file jointly does not "conclusively" imply a gift of one spouse's pro rata share to the other spouse, filing jointly cannot, by itself, imply a gift of the underlying separate accounts partially generating a return (or reduction in tax indebtedness). Something more is required to evidence an intent to create a joint tenancy in the accounts, which in this case are substantial. (cites omitted).
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> [I]n Holden v. Holden, 667 So.2d 867 (1st Dist.Ct.App.Fla.1996), the court held that, "[b]y itself, the filing of a joint federal income tax return that includes the separate non-marital income of one spouse does not convert the separate income into marital property," reasoning that any contrary holding "would force married persons to file separate income tax returns, and to pay higher income taxes, simply to protect the non marital status of their separate property".
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> See also, Cerny v. Cerny, 440 Pa.Super. 550, 554, 656 A.2d 507, 509 (Superior Ct.Pa.1995) ("act of filing a return is not financial activity. One does not create or alter property by filing a tax return, as one does in opening or contributing to a bank account or other investment instrument. A tax return is merely a business record, and has no independent capacity to create or preserve wealth");
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> In re Marriage of Thomas, 199 S.W.3d 847, 864 (S.D.Mo.App.2006) ("the fact that the parties' joint income tax returns reflect income, expenses, and interest relating to the corporation ... does not illustrate an intention to transmute Husband's interest in the corporation into marital property").
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> See Callaway v. C.I.R., 231 F.3d 106, 117 (2d Cir.2000) ("filing of joint tax return does not alter property rights between husband and wife"[19]) ("Callaway's decision to file jointly, see I.R.C. § 6013(a), had no effect on James' separate ownership of his Mountain View items");

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[19] In re Barrow, 306 BR 28, 30 [Bankr WDNY 2004]; In re McKain, 455 BR 674, 687 [Bankr ED Tenn 2011]; Cinema '84 v C.I.R., 294 F3d 432 [2d Cir 2002]; In re Hejmowski, 296 BR 645, 648 [Bankr WDNY 2003]; In re Edwards, 400 BR 345, 347 [D Conn 2008]; Matter of Honomichl, 82 BR 92, 94 [Bankr SD Iowa 1987]; In re Taylor, 22 BR 888, 890 [Bankr ND Ohio 1982] ("Ohio law also governs the question of the spouses' relative property rights in the federal and state income tax refunds which are the subject of this dispute.")

Zeeman v. United States, 395 F.2d 861, 865 (2d Cir.1968) (I.R.C. § 6013(a)'s purpose "was to give all married persons the same tax reward on combined income that married persons in community property states enjoyed before its enactment, ... [which enactment] was accomplished without changing their private ownership rights");

McClelland v. Massinga, 786 F.2d 1205, 1210 (4th Cir.1986) ("mere filing of a joint tax return by a husband and wife does not render the property taxed or the tax paid joint property");

In re Hejmowski, 296 B.R. 645, 648 (W.D.N.Y.2003) (describing Callaway as holding that, "if one spouse has ownership of an asset, such as a business, that has tax attributes for the two taxpayers jointly, the fact of joint filing does not give the other spouse a property interest in the business"), disagreed with on other grounds, In re Duarte, 492 B.R. 100 (E.D.N.Y.2011). Nothing in N.Y. Tax Law § 651 suggests a contrary result.

Federal Authority Holds that Filing Joint Tax Returns Does Not Alter Property Rights between Spouses

In *United States v Natl. Bank of Commerce*,[20] the United States Supreme Court held:

" '[I]n the application of a federal revenue act, state law controls in determining the nature of the legal interest which the taxpayer had in the property.' " Aquilino v. United States, 363 U.S. 509, 513, 80 S.Ct. 1277, 1280, 4 L.Ed.2d 1365 (1960), quoting Morgan v. Commissioner, 309 U.S. 78, 82, 60 S.Ct. 424, 426, 84 L.Ed. 585 (1940). See also Sterling National Bank, 494 F.2d, at 921. This follows from the fact that the federal statute "creates no property rights but merely attaches consequences, federally defined, to rights created under state law." United States v. Bess, 357 U.S. 51, 55, 78 S.Ct. 1054, 1057, 2 L.Ed.2d 1135 (1958). And those consequences are "a matter left to federal law." United States v. Rodgers, 461 U.S., at 683, 103 S.Ct., at 2137.

One court emphasized that a joint tax return is "wholly devoid of any operative words of conveyance."[21]

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[20] 472 US 713, 722, 105 S Ct 2919, 2925, 86 L Ed 2d 565 [1985], quoted in Johnston v. Nakis, 46 Misc 3d 651, 997 N.Y.S.2d 257 [Sup Ct 2014].

[21] In re Wetteroff, 453 F2d 544, 547 [8th Cir 1972], cert. denied 409 U.S. 934, 93 S.Ct. 242, 34 L.Ed.2d 188, rehearing denied 409 U.S. 1050, 93 S.Ct. 532, 34 L.Ed.2d 503 (1972).

There Is No Duty To Maximize Taxes

The U.S. Supreme Court and the Second Circuit fortify the rebuttal doctrine of convenience in Banking Law §675(b) by emphasizing that a taxpayer does not run afoul of either the law or the spirit of the law in seeking to minimize tax liability. In *Helvering v. Gregory*,[22] Judge Learned held:

> Anyone may so arrange his affairs that his taxes shall be as low as possible; he is not bound to choose that pattern which will best pay the Treasury; there is not even a patriotic duty to increase one's taxes. U.S. v. Isham, 17 Wall. 496, 506, 21 L.Ed. 728; Bullen v. Wisconsin, 240 U.S. 625, 630, 36 S.Ct. 473, 60 L.Ed. 830.

In *U.S. v. Thompson/Center Arms Co.*,[23] the U.S. Supreme Court adopted Judge Hand's reasoning in a dissent in *Commissioner v. Newman*:[24]

> In our system, avoidance of a tax by remaining outside the ambit of the law that imposes it is every person's right. Over and over again courts have said that there is nothing sinister in so arranging one's affairs as to keep taxes as low as possible. Everybody does so, rich or poor; and all do right, for nobody owes any public duty to pay more than the law demands: taxes are enforced exactions, not voluntary contributions. To demand more in the name of morals is mere cant.

Sayers v Sayers,* the Fourth Department Rules after *Johnston

In *Sayers v. Sayers*,[25] a Fourth Department decision following *Johnston*, the husband appealed from an order that denied his motion for a downward modification of his maintenance obligation. Holding that the Supreme Court's misapplication of *Foti* was "of no moment", the Appellate Division, with no acknowledgment of *Johnston*, redoubled its intention to maintain the rule in *Foti* and distinguished *Sayers*:

> [C]ontrary to the court's determination, plaintiff was not taking a position contrary to a position taken on previously filed tax returns. Plaintiff and his current wife filed joint income tax returns, listing their income and earnings. At the hearing on his motion, plaintiff attempted to distinguish his income and earnings from those of his current wife. He at no time contradicted information contained in the tax

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[22] 69 F.2d 809, 810 (2d Cir. 1934), aff'd, 293 U.S. 465 [1935].

[23] 504 U.S. 505, n.4, 511 [1992]

[24] 159 F.2d 848, 850-851 [2d Cir. 1947], cert. denied, 331 U.S. 859 [1947].

[25] 129 A.D.3d 1519, 11 N.Y.S.3d 760 [4th Dept.,2015].

return.

Conclusion

Foti strains reason as set forth in decisional authority at all levels nationwide. It imposes an unwarranted evidentiary burden upon the party who already bears the burden of proving separate property.

Transmutation or commingling of separate property into marital property requires an affirmative act on the part of the holder of the separate property that either consciously or by operation of law makes such a conveyance. Reporting revenue in order to benefit from a lower tax rate does not constitute such an affirmative act, as a matter of law.