

Wife Receives More Favorable Innocent Spouse Treatment from U.S. Tax Court Than IRS

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When a husband and wife file a joint income tax return, they are each fully liable for the tax due on the return. Each is said to be “jointly and severally liable” for that tax liability. Joint and several liability can produce unfair results where one of the spouses engages in the fraudulent underpayment of income tax unknown to the other spouse. For example, where husband omits income or overstates a deduction on the return, thereby understating the tax due on the return, but does not disclose such omission or overstatement to his wife, the wife will be held liable for the understatement of tax unless the wife can show she is eligible for relief as an “innocent spouse.”

Internal Revenue Code Section 6015 provides relief from joint and several tax liability for an “innocent spouse” who can prove that he or she satisfies the requirements under Section 6015. One form of relief is found in Section 6015(b), which relieves a spouse of joint and several liability if that spouse meets the following requirements:

1. A joint return was filed for the taxable year
2. On the joint return there was an understatement of tax due to an erroneous item (omission of income or overstatement of deduction) of the other spouse
3. The innocent spouse can show that in signing the return she did not know, and had no reason to know, that there was such understatement
4. Considering all of the facts and circumstances, it is inequitable to hold the innocent spouse liable for the deficiency in tax attributable to such understatement, and
5. The innocent spouse elects the benefits of Section 6015(b) no later than two years after the date the IRS first begins collection of the tax deficiency

In a recent U.S. Tax Court case, *Taft v. Commissioner*, TC Memo 2017-66, the taxpayer husband liquidated his stock investment to fund an extramarital affair and hid these transactions from his wife.

The husband instructed his accountant to prepare and electronically file the couple's 2010 joint income tax return without his wife's review or approval of the return. The return reported the stock sales but failed to report the taxable dividends from the stock. The IRS later assessed a tax liability for the unreported stock dividends, which the wife did not know about. In 2011 the wife discovered the affair and filed for divorce. After the divorce became final in 2013, she filed her 2012 tax return showing a refund. The IRS credited a portion of the refund toward the joint 2010 income tax liability. The wife filed a request for innocent spouse relief asking the IRS to relieve her from the tax liability for the unreported dividends and return the rest of her refund.

However, the IRS determined that the wife met the requirements for less favorable relief under Section 6015(c), which allocates the full tax liability to the husband but does not allow for refunds. The wife filed suit in U.S. Tax Court under Section 6015(b), which does allow for refunds. The Court awarded relief to the wife under Section 6015(b) because she was able to show that she did not know or have reason to know of the husband's understatement of income. The Court evaluated several factors in making its determination. First, the wife had an associate's degree in nursing and no background in business, tax, or accounting. Second, the couple maintained separate bank accounts which the other spouse could not access and each did not open the other spouse's mail. Therefore, the wife did not know about the dividends and in general her limited financial role consisted only of paying certain household expenses. Third, the wife was unaware of the husband's elaborate scheme of spending money on his extramarital affair and therefore, she did not benefit from that spending. Finally, the husband secreted the preparation and electronic filing of the tax return from his wife. All of these factors showed that the wife had no reason to know about the husband's underreporting of the stock dividends and it would be unfair to hold her liable for the tax deficiency. The Court awarded the wife the return of her refund under Section 6015(b) even though the IRS argued she was only entitled to the less favorable innocent spouse treatment under Section 6015(c).