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THE INNOCENT SPOUSE PROVISIONS OF THE INTERNAL REVENUE CODE: IN SEARCH OF EQUITY

JAMES E. PANNY* and MARC L. FAUST*

The authors review decisions made under Section 6013(e) of the Internal Revenue Code, and conclude that this section has not provided the relief which its enactors intended. They suggest a more liberal reading of this section, so that decisions made will comport with the remedial nature of the statute. The authors also recommend a legislative revision of this section.

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I. INTRODUCTION

The general rule when a husband and wife file a joint return is that each is jointly and severally liable for any deficiencies or penalties.¹ Prior to the addition of subsection (e) to section 6013 of the Internal Revenue Code, liability was automatic. The majority of the courts would not even consider a claim of innocence by one of the two parties.²

These courts, though noting the harshness of the results, chose to take an inflexible approach to the apparently clear mandate of the statute. In the words of the Tax Court in *Louise M. Scudder*,³

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1. I.R.C. § 6013(d)(3) reads: "if a joint return is made, the tax shall be computed on the aggregate income and the liability with respect to the tax shall be joint and several."

2. "[A] husband and wife filing a joint return were automatically jointly and severally liable for income tax deficiencies and fraud penalties incurred even though the deficiencies and penalties were due to misstatement by one spouse and the other spouse was innocent." *United States v. Zimmerman*, 478 F.2d 59, 61 (7th Cir. 1973).

3. 48 T.C. 36 (1967), *rev'd*, 405 F.2d 222 (6th Cir. 1968).

"the inflexible statute leaves no room for amelioration."⁴ Gradually, a minority of courts became appalled at the harshness of the results and granted relief to the so-called "innocent spouse."⁵ Some courts resorted to fictions in allowing relief to innocent spouses. Realizing that the "only way [a spouse] could have avoided liability, according to the Tax Court, would have been to have proven that [the spouse] had not filed the returns jointly with [the guilty spouse],"⁶ some courts resorted to questionable defenses such as mistake,⁷ duress⁸ and fraud or trickery⁹ in order to relieve an innocent spouse from liability. For the vast majority, however, relief was unavailable.

Finally, in 1971, subsection (e) was added to section 6013 of the Internal Revenue Code of 1954.¹⁰ This so-called "innocent spouse" provision grants relief if certain requirements are met: (1) a joint return must be filed; (2) there must be an omission from gross income attributable to the "guilty" spouse; (3) the omission must constitute an amount in excess of 25 percent of the amount stated in gross income; (4) the innocent spouse must establish that he/she neither had knowledge of the omission nor "reason to know" of it; and (5) the court must consider all the facts and circumstances (most notably, whether the innocent spouse "significantly benefited" from the omission) and decide whether it would be inequitable to hold the innocent spouse liable.

4. *Id.* at 41.

5. *E.g.*, *Huelsman v. Commissioner*, 416 F.2d 477 (6th Cir. 1969); *Scudder v. Commissioner*, 405 F.2d 222 (6th Cir. 1968); *United States v. Cooper*, 71-1 TAX CT. REP. (CCH) § 9321 (M.D. Fla. Mar. 1, 1971).

6. Note, *The Innocent Wife and Joint Tax Returns*, 22 ALA. L. REV. 591 (1970).

7. *Payne v. United States*, 247 F.2d 481 (8th Cir. 1957).

8. *Lola I. Brown*, 51 T.C. 116 (1968).

9. *Marie A. Dolan*, 44 T.C. 420 (1965) (dictum).

10. I.R.C. § 6013(e)(1) reads:

(e) Spouse Relieved of Liability in Certain Cases.—

(1) In general—Under regulations prescribed by the Secretary, if—

(A) a joint return has been made under this section for a taxable year and on such return there was omitted from gross income an amount properly includable therein which is attributable to one spouse and which is in excess of 25 percent of the amount of gross income stated in the return.

(B) the other spouse establishes that in signing the return he or she did not know of, and had no reason to know of, such omission, and

(C) taking into account whether or not the other spouse significantly benefited directly or indirectly from the items omitted from gross income and taking into account all other facts and circumstances, it is inequitable to hold the other spouse liable for the deficiency in tax for such taxable year attributable to such omission, then the other spouse shall be relieved of liability for tax (including interest, penalties, and other amounts) for such taxable year to the extent that such liability is attributable to such omission from gross income.

"The legislative history of this section indicates that it was designed to bring government tax collection practices into accord with basic principles of equity and fairness."¹¹ While relief has been granted to more spouses than was possible under prior law, there still remains a significant gap between practice and principle. Unfortunately many truly innocent spouses still are denied relief.

This comment will analyze the existing law, giving attention to current deficiencies. From the brief description of the prerequisites to relief noted above, it is clear that there is room for judicial construction of specific terms. What is an "omission"? When will a court find that a spouse "had reason to know" of an omission? What factors become important in finding such inquiry notice? What is a "significant benefit"? When will it be "inequitable" to hold an innocent spouse liable? The answers are not clear. The authors also will show the interrelationship between some of the "independent" requirements. Finally, the authors will propose a more equitable test for absolving an innocent spouse from deficiency liability. This new test appears necessary since the implementation of section 6013(e) has resulted in a reversal by the courts of their trend toward finding some leeway for equitable results. That is, the courts have reverted to a strictly literal reading of the statute with little or no opportunity to act in an equitable manner when the situation requires statutory interpretation.¹²

It should be noted at the outset that section 6013(e) relates to basic liability for deficiencies. With the addition of this section, other changes make it possible for the not-so-innocent spouse to be relieved from penalties, such as those for fraud, even though he or she may still remain liable for the basic deficiency.¹³

In this area, as in any area of the law, the question of who bears the burden of proof is of utmost importance. It will become manifest that this is critical, especially since one of the parties is required to be "without knowledge."

11. *United States v. Dioguardi*, 350 F. Supp. 1177, 1179 (E.D.N.Y. 1972).

12. The usual response by the courts to new situations is to state simply that Congress has called for a strict construction of section 6013(e). *E.g.*, *Ann J. Anderson*, 34 T.C.M. (CCH) 508, 515 (1975).

13. I.R.C. § 6653(b) reads in part:

If any part of any underpayment (as defined in subsection (c) of tax required to be shown on a return is due to fraud, there shall be added to the tax an amount equal to 50 percent of the underpayment. . . . In the case of a joint return under section 6013, this subsection shall not apply with respect to the tax of a spouse unless some part of the underpayment is due to the fraud of such spouse.

II. JOINT RETURN-COMMUNITY PROPERTY CASES

The requirement that a joint return be filed becomes an issue primarily where the taxpayers are residents of community property states. Due to the peculiarities of that form of property law, income otherwise attributable to only one spouse becomes part of the includable income of an innocent spouse even though separate returns are filed. The Code has a special rule in this regard which provides that "the determination of the spouse to whom items of gross income (other than gross income from property) are attributable shall be made without regard to community property laws. . . ."¹⁴ What this means is that income from, for example, a husband's job will be attributable to him alone for 6013(e) purposes even though state law will give the wife title to one-half of the income. This special rule for community property inhabitants, however, does not resolve the problem of lack of a joint return. In fact, inequities are still present in this area. In the case of *Bettie Jayne Coffman*,¹⁵ for example, the husband and wife were separated for the tax year in question. The 25 percent requirement was met, the spouse had no knowledge and derived no benefit. The Commissioner sought to hold the spouse liable for failure to include on her separate return that portion of her husband's income which, under the state's community property laws, was attributable to her. The equities pointed toward relief from liability. The "innocent" spouse was unable to invoke section 6013(e) because separate returns were filed, but the wife became liable as Texas, their domicile, is a community property state.

"The statute simply does not provide relief where a separate return was filed,"¹⁶ is the response of the courts. The Tax Court has once again reverted to the often inequitable "strict construction" theory from which a few courts had revolted just prior to the enactment of section 6013(e).¹⁷

*Mary Lou Galliher*¹⁸ is another case pointing out the inequities of the requirement that a joint return be filed. This case involved a broken marriage which ended in divorce in the year following the tax year in question. Once again Texas community property law created the still-existent inequity. The petitioner was found to have no specific knowledge concerning her husband's income for the year

14. I.R.C. § 6013(e)(2)(A).

15. 33 T.C.M. (CCH) 1416 (1974).

16. *Mary Lou Galliher*, 62 T.C. 760, 763 (1974).

17. See cases cited in note 3, *supra*.

18. 62 T.C. 760 (1974).

in question. "Petitioner did not significantly benefit from the income earned . . . and was under the care of physicians and physically unable to work or participate in his activities in that year."¹⁹ Even though the petitioner had filed a separate return, she argued for the application of section 6013(e) in "view of the remedial nature of the statute and the similarity of the inequity it addresses to her case."²⁰ The court rejected her argument while pointing out that "[i]t is true that in noncommunity property States the situation in the case at bar would not arise."²¹

Petitioner also mounted an equal protection attack on the statute due to the operation of the community property laws. The court also rejected this argument while noting that "the Supreme Court long ago upheld the constitutionality of distinctions arising from community property laws."²² Strict construction again prevailed.

Another problem arises in community property cases because gross income from property is not treated as attributable to only the "guilty" spouse. The inequity occurs where the "innocent" spouse has little or nothing to do with the actual generation of such income.²³ In *Allen v. Commissioner*²⁴ the Fifth Circuit agreed with the rule laid out by the Tax Court below that "where omitted income is generated by the performance of *substantial services* by one spouse, that income should be attributed to that spouse for purposes of section 6013(e)(1)."²⁵ This seems to be in accord with Congressional intent as to this phrase.²⁶ Exactly just what is meant by "substantial services" opens up another issue which the court in *Allen* was able to avoid by finding that the petitioner had failed the test.²⁷

Another issue stemming from the joint return requirement arises when only one of the two spouses signs the return. This does not mean that there is no "joint return." Rather, if the non-signing spouse intended that a joint return be filed, a court will so hold. For example, in *Daniel Cecere*,²⁸ a return for the tax year in question was filed in the names of both spouses. The wife, however, did not sign

19. *Id.* at 761.

20. *Id.* at 761-62.

21. *Id.* at 762.

22. *Id.* at 763, citing *Poe v. Seaborn*, 282 U.S. 101, 117, 118 (1930).

23. See, e.g., *Allen v. Commissioner*, 514 F.2d 908 (5th Cir. 1975).

24. *Id.*

25. *Id.* at 913 (emphasis added).

26. S. REP. No. 1537, 91st Cong., 2d Sess. 4 (1970).

27. In *Allen*, this argument failed primarily because petitioner did not offer any evidence to support her proposition. 514 F.2d at 913. The importance of who bears the burden of proof will be discussed in more detail in section VI, *infra*.

28. 34 T.C.M. (CCH) 1593 (1975).

the return. In finding the necessary intent to file a joint return, the court considered the fact that the nonsigning wife's income and deductions were included in the tax return.²⁹

III. KNOWLEDGE OF INNOCENT SPOUSE

A. Actual Knowledge

In order to be relieved from liability, the innocent spouse claimant must establish that he or she had no actual knowledge of the "guilty" spouse's activities.³⁰ Even if it can be established that the innocent spouse had no actual knowledge, this does not, of course, end the analysis as to the innocent spouse's knowledge. The claimant still shoulders the additional responsibility of showing no "reason to know" of the omission from gross income.³¹

In a case where the claimant spouse is shown to have actual knowledge the courts will go no further with their analysis. In *Herbert I. Joss*,³² the "guilty" wife's third husband sought relief from a tax deficiency liability. The wife's divorce decree from her second marriage continued, in effect, a separation agreement calling for her to receive \$23,000 per year until death or remarriage. While married to petitioner, the wife continued to receive \$23,000 for the tax year in question. Petitioner's claim that this was a gift because there was no obligation was rejected by the court,³³ thus probably determining the result as far as the section 6013(e) question was concerned. His testimony, in revealing his knowledge of the existence of the receipt of funds, alone was sufficient to preclude relief.³⁴

While it is not necessary to investigate the area of knowledge once it has been determined that there was no omission, some courts have followed up their analysis by stating that where an amount is mentioned, this alone demonstrates knowledge. For example, in *Georgiana Spaulder*,³⁵ the tax deficiency resulted from an erroneous claim of a deduction. The court quickly resolved this issue with the

29. *Id.* at 1599.

30. I.R.C. § 6013(e)(1)(B).

31. *Id.*

32. 56 T.C. 378 (1971).

33. *Id.* at 383, 385.

34. *Id.* at 388. This case points toward the real hardship in this area and the fact that inequities still exist. While petitioner may have known of the receipt, there is testimony to the effect that he attempted to persuade his wife to return the funds. Also, petitioner had substantial savings of his own. *Id.* at 382. "Petitioner never received any cash from checks drawn on Gwendolyn's account during [the tax year] or any other direct funds from Gwendolyn." *Id.* at 381. There was clearly no benefit, let alone a significant one, but petitioner was still assessed a deficiency.

35. 31 T.C.M. (CCH) 723 (1972).

remark that since there was a deduction on the return, it cannot be said that the claimant did not have knowledge.³⁶

Actual knowledge is easily found where it is established that the spouse claiming innocence was physically present at a place where a transaction giving rise to a deficiency took place. In *Alfred Altman*,³⁷ the claimant's husband received a large sum of money from his mother. After determining that the transfer did not amount to a gift, the court noted that the claimant wife was present during the transaction. Presence amounted to knowledge, and relief was denied.³⁸ This alone "is sufficient to prevent [claimant's] being entitled to the relief provided for in section 6013(e)."³⁹

Besides mere presence, there are several cases where claimants were denied relief because of a more active participation in either the actual generation of the funds in question or the subsequent handling thereof. In *Cecelia M. Harmon*,⁴⁰ the husband and wife (the innocent spouse claimant) conducted two small businesses. The wife operated a liquor store which was directly across the street from the car repair shop which her husband ran. Funds emanating from the repair business were omitted from the joint return for the tax year in question. The wife made out the bank deposit slips for both businesses. From this fact it necessarily followed that she had knowledge. Consequently section 6013(e) relief was denied.⁴¹

In *Clarence E. Haywood*,⁴² the wife's claim for section 6013(e) relief was frustrated by several factors. First, she helped her husband to cash postal money orders which he had converted from his employer. Second, she was a practicing accountant and bookkeeper and had played an active role in preparing the tax returns from which the converted monies were omitted.

This case, as do many others,⁴³ involved a truly "guilty" spouse who was primarily responsible for the subject omission. The husband was engaging in a fairly complex scheme of embezzling funds from his employer. The company used postal meters; when they were due to be reset, he obtained a check from the company in excess of the amount due the post office. He would receive the excess in the form of money orders and stamps which he subsequently

36. *Id.* at 724.

37. 31 T.C.M. 91 (1972).

38. *Id.* at 96.

39. *Id.*

40. 33 T.C.M. (CCH) 436 (1974).

41. *Id.* at 437.

42. 33 T.C.M. (CCH) 1311 (1974).

43. *E.g.* Doris Swofford, 34 T.C.M. (CCH) 691 (1975) (gambling); Daniel Cecere, 34 T.C.M. (CCH) 1593 (1975) (extortion).

converted to his own use. The money was then spent by both spouses in casinos, bars, race tracks and other "vacation" activities. Most importantly, however, the innocent spouse claimant, on at least two occasions, actively participated by cashing postal money orders for her husband by placing her name on the orders as purchaser and then returned the money to him. In light of this, the court decided that it could not "accept petitioner's testimony that she did not know that her husband had others [sic] sources of income . . . which were not reflected on their joint returns."⁴⁴ By way of explanation, the court listed four specific reasons for its finding of knowledge: (1) she handled the family financial affairs, including preparation of the joint returns; (2) she wrote checks and paid the bills; (3) she was an accountant; and (4) she saw her husband cash money orders in large amounts. Her active participation combined with her particular expertise to preclude recovery.

*Daniel Cecere*⁴⁵ was another case in which a claim of innocence was not supported by the record. Here, however, denial of relief was based on the petitioner's inability to show that she had not benefited significantly from the unreported income.⁴⁶ The case is somewhat of an anomaly in that the knowledge issue was disposed of rather summarily when the court believed her testimony as to knowledge and ruled accordingly.⁴⁷ At other times, a court will take great care in determining the issue by examining various factors to determine not only actual knowledge but inquiry knowledge as well.⁴⁸

Predictably, it is not always easy to determine if a court is really talking about inquiry knowledge when it says it finds full knowledge or vice versa. In *Doris Swofford*,⁴⁹ the "guilty" husband was involved in the operation of a gambling organization. Under the previous cases, it would be easy to find actual knowledge through active participation. The claimant was seen on at least two occasions participating in the "cut-loose" which was an integral part of her husband's operation. The court held that the wife had "full knowledge" of omissions, therefore she was not an innocent spouse.⁵⁰

The court went further, though, and considered other factors.

44. 33 T.C.M. (CCH) at 1316.

45. 34 T.C.M. (CCH) 1593 (1975).

46. The innocent spouse claimant failed to meet her burden of proving that she did not significantly benefit from the omitted income.

47. 34 T.C.M. (CCH) at 1599-1600.

48. Of course, exactly how much evidence a petitioner must present on this issue is hard to predict. Here, petitioner's testimony, standing alone, was sufficient. Usually it is not. This will be discussed in greater detail in the section on burden of proof, *infra*.

49. 34 T.C.M. (CCH) 691 (1975).

50. *Id.* at 695.

It was noted that the innocent spouse claimant had control of several checking accounts in their home area. The Service had acquired the checks for goods and services and also had garnered knowledge as to cash payments for various items. The court noted as a factor in its decision that "petitioner deposited and expended more funds than she had available from her savings and earnings."⁵¹ Although unnecessary, it seems that "inquiry notice" was also found.

One thing is clear. A finding of actual knowledge ends the inquiry.⁵² If the requirement that the claimant have no actual knowledge is established he or she must go on to the next step, which is to establish that he or she had no "reason to know" of the omission.⁵³

B. *Inquiry Notice*

The innocent spouse claimant must establish that he had no reason to know of the omission. Many factors are found in the various cases in this area and the authors will here attempt to show which are important and what combinations may or may not tilt the equities one way or the other. Most confusing, however, is the fact that the courts are not very consistent in their approach. That is, the same set of factors appearing in two cases will sometimes lead to contrasting results with the onerous burden of proof often becoming the most crucial of all the "factors."

In 1975, the Tax Court decided *Ann J. Anderson*.⁵⁴ In this unusual case the court discussed many of the older factors, and, in addition, brought a new factor to the fore. The Commissioner determined tax deficiencies for the years 1969 and 1970 on joint returns. Petitioner sought relief, under the "innocent spouse" provision of section 6013(e), from liability for these deficiencies. The Tax Court properly considered each year separately. In 1969 petitioner had neither knowledge nor reason to know of her husband's illegal activities.⁵⁵ However, Mrs. Anderson was held to have been put on notice in 1970.⁵⁶

Over a period of time petitioner's husband had embezzled a significant sum of money from his employer.⁵⁷ Failure to report these sums led to the deficiencies in question. During the second of the

51. *Id.*

52. A finding that petitioner was aware of items of gross income not being reported was sufficient to preclude relief. *Id.* at 695 n.16.

53. I.R.C. § 6013(e)(1)(B).

54. 34 T.C.M. (CCH) 508 (1975).

55. *Id.* at 513.

56. *Id.* at 515.

57. Petitioner's husband originally owned the company and stayed on as an employee when he sold out to a third party. *Id.* at 509.

tax years in question petitioner's husband was discharged from his job and later that same year he was indicted for embezzlement. The court's finding, that in this year petitioner had knowledge and inquiry notice of the omission, is unfair although it is predictable.

In its examination of petitioner's claims the court noted that petitioner was not an active participant in the company's affairs. "Petitioner was not familiar with the business operations of [the company]." ⁵⁸ The court noted that she was a school teacher and had never seen a business checkbook. The first factor, then, would appear to weigh in favor of finding no reason to know.

The next factor considered was involvement with the family's finances. Petitioner and her husband had a joint checking account. Mrs. Anderson wrote most of the checks but she did not keep the records. Her husband had his own personal checking account which he utilized to handle the company's business operations. Petitioner too had her own personal checking account, and when her husband was fired she used her personal account to pay all of the bills. None of the embezzled money was placed in an account over which petitioner had control. The returns in question were prepared by a third party. Petitioner signed the returns without examining them. These factors weigh in favor of a finding that petitioner had no reason to know of the omissions.

After stating the basic facts, the court analyzed the 1969 activities first. The court accepted the testimony of Mrs. Anderson and her husband that she had no actual knowledge of the omission. ⁵⁹ The next logical step was determining if she had reason to know of the omission.

Here the court looked to what can be considered the third "factor" of the case—standard of living in the community with reference to reported income. Since there was no serious discrepancy between standard of living and reported income ⁶⁰ this factor could not be used to charge petitioner with knowledge. "The Andersons' standard of living during 1969 was in line with reported income for that year and was comparable to that of other families in the community with similar incomes." ⁶¹ The court specifically listed five "subfactors" which supported petitioner's contention that she was without inquiry notice: (1) petitioner put trust and confidence in her husband as to financial matters; (2) petitioner only had access to funds necessary to maintain the household; (3) the Andersons made only

58. *Id.*

59. *Id.* at 512-13.

60. The couple did spend approximately \$500 more than reported income. *Id.* at 510-11.

61. *Id.* at 513.

modest expenditures on gifts; (4) the family residence was modest, heavily financed, and no improvements had been made; and (5) the family car was a 2 year-old Chevrolet.

The court found that in 1969 petitioner had no reason to know of the omission of the embezzled funds. Analysis for 1970 followed and all the listed factors remained present. One additional factor, however, tilted the scales toward inquiry notice.

Again, the court accepted petitioner's testimony that she had no actual knowledge at the time she signed the 1970 joint return. However, her husband had been indicted in November of 1970 for embezzling from his employer. At this time she may not have been put on notice because "Anderson assured petitioner that the money remained in the business, or had been reinvested in the business, and petitioner received this same assurance from Anderson whenever she attempted to discuss the matter with him."⁶² It is presumed, in light of the court's willingness to accept her naked testimony as to actual notice, that the indictment alone may not have been sufficient to put petitioner on notice of the omission. Additional elements, however, led the court to hold against petitioner.

During the summer of 1970, because she feared that her husband's former employer would try to take possession of their home, petitioner asked her husband to transfer to her his interest in the house which they then held as tenants by the entireties. In July, 1970, Mr. Anderson transferred to petitioner his interest in the house.⁶³ Early the next year, before petitioner signed the 1970 tax return, Mr. Anderson pled nolo contendere to the charge of embezzlement. The court ruled that these facts precluded relief since petitioner must show that there were no "facts within [her] knowledge from which a reasonably prudent taxpayer . . . would have known of the omission."⁶⁴

The significance of the indictment as reason to know of omitted income lies in the fact that the Tax Court stated that it was a case of first impression; however, the ruling did not turn on the fact of indictment because considerable reliance was placed on the fact of conviction.

Petitioner's assertion that he (sic) was convinced by Anderson that the money remained in the business, or had been reinvested in the business, does not convince us that she had no reason to know of the omission. . . . While petitioner may have been con-

62. *Id.* at 510.

63. *Id.* at 514.

64. *Id.* at 515.

vinced by this explanation originally, we cannot accept her continued reliance on such a sketchy explanation *in light of her husband's conviction*.⁶⁵

It appears that the question remains open as to whether an indictment alone gives someone reason to know of omitted income. This is especially so where the innocent spouse claimant receives plausible explanations that the funds in question have not in fact benefited the couple.

At first, conviction appears to be a sure indicator of reason to know of omissions. But what of a conviction following a plea of *nolo contendere*? This is not an admission of guilt. There are many reasons why an otherwise innocent person may plead no contest (for example, expectations of a lighter sentence or the fact that the accused does not have an alibi). It may have been easy to find reason to know in the instant case, but courts which consider this question should at least make a preliminary inquiry into the circumstances surrounding the plea.

In *Patricia S. Hayes*,⁶⁶ the husband gained income from various individuals in the course of his business dealings which was not reported on the couple's joint returns for the years 1963, 1964, and 1965. After stating that it was "convinced by the petitioner's testimony that she did not actually know of the omission of such income,"⁶⁷ the court found that the innocent spouse claimant had no reason to know of the omissions.

In coming to this conclusion the court considered a number of factors including the wife's business acumen. It recognized that although she had only completed the tenth grade, she had some familiarity with business matters and had taken a number of book-keeping courses at vocational school. Although the court did not address this matter specifically it would appear that the claimant spouse's business acumen should be a factor in assessing whether a particular set of facts should lead the spouse to conclude that something is amiss. It is submitted that, ordinarily, this would be one of several factors that a court should discuss when confronted with the primary issue.

The court also considered whether there was active participation. Mrs. Hayes was aware of some of the people who had business dealings with her husband and, in some cases, was generally aware of the transactions involved. "However, the details of these transac-

65. *Id.* (emphasis added).

66. 34 T.C.M. (CCH) 976 (1975).

67. *Id.* at 981.

tions, which appear to be complex in some cases, were not revealed to her."⁶⁸ The court declared that this did not put her on notice.⁶⁹

The family finances aspect likewise was resolved in the petitioner's favor. Mrs. Hayes did in fact control the "family" checking account and she kept other financial records, and "[n]othing in the accounting mechanism involved in handling and balancing the personal checking account and in sorting income from expenses would bring to the petitioner's attention the unreported business income of [her husband]."⁷⁰ While petitioner may not have been totally naive, the court reaffirmed the principle that: "Complete knowledge of the family's finances is not required of the petitioner."⁷¹

The court briefly considered the spouses' standard of living in the community and found that no evidence was presented as to lavish or unusual expenditures. Thus, there was no extravagance which might put petitioner on notice that there might be unreported income. This factor, then, was also in favor of the innocent spouse claimant.

In *Ann J. Anderson* the court discussed whether a wife had reason to know of unreported income because of her husband's indictment and conviction on an embezzlement charge.⁷² In this light it is interesting to note that Mrs. Hayes was aware that her husband was being investigated by the Internal Revenue Service.⁷³ This knowledge even caused her to question the expenses and income for the year. The accountants who prepared the return satisfied her that everything was in order. The Tax Court decided that these facts were insufficient to put Mrs. Hayes on notice. This would appear inconsistent with the *Anderson* case which can be read as stating that a mere indictment is equivalent to inquiry notice. It is submitted, however, that since conviction was the true basis for denial of relief in that case, the *Hayes* court's approach of apparent satisfaction following inquiries is logically consistent and equitable in result.

The United States Circuit Court of Appeals for the Fifth Circuit had occasion to discuss seven factors in granting relief to an innocent spouse in *Sanders v. United States*.⁷⁴ The wife in this case paid

68. *Id.*

69. "Complexity of the transaction" is an important factor in many of the cases in this area. Here, however, it was merely mentioned briefly, apparently since the issue of knowledge was disposed of without having to reach the issue of complexity.

70. 34 T.C.M. (CCH) at 981.

71. *Id.*

72. 34 T.C.M. (CCH) 508 (1975); see text accompanying notes 62-65, *supra*.

73. 34 T.C.M. (CCH) at 981.

74. 509 F.2d 162 (5th Cir. 1975).

assessed deficiencies of over \$30,000 for the tax years 1968 and 1969. She then successfully brought suit for a refund in district court.⁷⁵

The seven factors can be summarized as follows: (1) The financial affairs of the claimant's husband were complex; in fact, it took the Internal Revenue Service a great deal of time to unravel them. (2) The wife's subjective condition lessened her awareness of the importance of the facts before her. She had a high school education and had devoted her life to being a housewife. She also suffered from severe emotional problems and her heavy use of alcohol compounded these difficulties. (3) Petitioner's husband rarely confided in her regarding his business affairs. (4) The petitioner placed great trust and reliance in their accountant, whom she had recommended to her husband. (5) The wife's participation was without any actual knowledge. Although the petitioner typed letters for her husband regarding transactions resulting in unreported income, she was an experienced typist who typed without comprehending the material. (6) The claimant did handle the family finances through balancing the checkbooks and there was a large deposit in excess of reported income. The court did not consider this sufficient to convey notice, however. (7) Although there were expenditures which on their face would seem lavish or unusual, when balanced against the family's standard of living, petitioner did not have reason to know of the omission.

This last point is of particular interest. The court's exact phrasing was: "One person's luxury can be another's necessity, and the lavishness of an expense must be measured from each family's relative level of ordinary support."⁷⁶ The innocent spouse claimant was not put on notice because "the Sanders were apparently enjoying a fairly high and generally improving standard of living."⁷⁷ During the years in question, the Sanders acquired a new home and made interior and exterior improvements. They bought new and expensive cars in each year. They made gambling trips to Las Vegas and purchased a new condominium in the Bahamas. Apparently the rich are permitted much greater enjoyment of unreported income before they are charged with notice.

One other noteworthy point coming from the case is the court's acceptance of the fact that there is a subjective element involved, despite the fact that the test is purported to be the well-renowned "reasonable man" standard, which is supposedly objective in na-

75. 369 F.Supp. 160 (N.D. Ala. 1973).

76. 509 F.2d at 168.

77. *Id.*

ture.⁷⁸ "[T]he state of the spouse's cognitive faculties becomes a permissible inquiry."⁷⁹ Thus, whenever the reasonable man test is urged upon the court by the Service, the practitioner can use this case to induce the court to implement a subjective approach. Furthermore, the use of the "complexity factor" makes sense. It would be incongruous to note that after years of inconclusive inquiry and expert analysis by the Service, a mere housewife should be held to have reason to know of omitted income.

One of the most often cited cases on innocent spouse relief is *Patricia E. Mysse*.⁸⁰ The "guilty" spouse was a managing officer and cashier in a small town bank in Montana. He also had a small insurance agency. As in most of the innocent spouse cases, he was an embezzler, having taken approximately \$105,000 from 1963 through 1966. The husband and petitioner-wife had a joint checking account from which they made withdrawals for support of the family.⁸¹ Between 1963 and 1966, in addition to these *support* expenses, the "guilty" husband paid the income taxes, the college expenses for two sons, mortgage payments on the home, and the cost of merchandise on charge accounts. He also bought a Jaguar and four Oldsmobiles for the couple and their three sons, along with a diamond ring, furniture and clothing—all on an average reported income of a little over \$19,000 per each of the tax years.

After first stating that it was willing to take the innocent spouse claimant's word that she had no actual knowledge of the misappropriated money, the Tax Court went on to consider whether the claimant had reason to know of the unreported income. The court examined the claimant's standard of living in relation to those of the community. The bank's vice president and major shareholder, who was a neighbor of petitioners, testified that he never thought that the family spent more than its income could justify. The government's main contention was that the wife should have known something was amiss because expenses exceeded reported income.⁸² In responding to this suggestion the court looked to the legislative history of a related provision of section 6013(e).⁸³ The court noted

78. The Fifth Circuit rejected the test put forth by the government. The Service had proposed that a spouse would be found to be without reason to know if "she was 'completely without fault and could not possibly have discovered the omission before executing the returns.'" *Id.* at 166, quoting Appellant's Brief at 17.

79. *Id.* at 169.

80. 57 T.C. 680 (1972).

81. For the four years in question, deposits totalled \$40,011.91 and withdrawals totalled \$40,782.92.

82. 57 T.C. at 697.

83. I.R.C. § 6013 (e)(1)(C).

that Congress intended that unreported income which was used for "ordinary support" should not be treated as having benefited an innocent spouse claimant.⁸⁴ Reasoning from the legislative intent on this point the court ruled that it was "reasonable to conclude also that such use of the unreported income does not ordinarily give the spouse reason to know of the income's existence within the meaning of the statute."⁸⁵ Thus, the innocent spouse claimant was held not to be on inquiry notice. It would seem now that the Tax Court has made a new factor of use of the funds for ordinary support. It is submitted, however, that this is merely a concomitant of the inquiry as to the presence of lavish or unusual expenditures. If there are none, it would seem that the label would be expenses for "ordinary support."

*Raymond H. Adams*⁸⁶ added another factor—"forthrightness" of the guilty spouse. Here the husband was the innocent spouse claimant. His wife prepared the returns and had her own separate income. She refused to show the innocent spouse claimant the returns upon which she omitted income earned by her. Although he had no actual knowledge of the omitted income, he "was put on notice of the omissions by his former wife's refusal to be forthright about the family income."⁸⁷ The court also assumed that the books and records were at least available to him since he presented no evidence to the contrary.

In analyzing the various factors, it becomes apparent that the presence of different combinations at different times, when examined by different courts, makes prediction very difficult. Only one factor taken alone will invariably lead to a finding of reason to know: that is, when the innocent spouse claimant is totally involved or at least actively participating.

In *Quinn v. Commissioner*,⁸⁸ for example, the claimant's husband fraudulently acquired \$500,000 which was not declared as income. The husband was the sole beneficiary of a trust which had title to real estate occupied by a savings and loan association of whose board of directors the husband was chairman. The innocent spouse claimant was a member of the board and a senior vice president. The husband's request for an advance payment of rent by the savings and loan association was rejected. Nevertheless, he secured from the association a check for an amount in excess of \$500,000.

84. 57 T.C. at 698, citing S. REP. NO. 1537, 91st Cong., 2d Sess. 3 (1970).

85. *Id.* See also Sam Shapolsky, 31 T.C.M. (CCH) 260 (1972). The interrelationship between significant benefit and knowledge is discussed in great detail in section V.D. *infra*.

86. 60 T.C. 300 (1973).

87. *Id.* at 303.

88. 524 F.2d 617 (7th Cir. 1975).

As a second basis for its denial of the innocent spouse claim, the court concluded that the wife had reason to know.⁸⁹ The innocent spouse claimant "had every reason to know that [her husband] received the advance rental payment. She attended several board meetings where it was discussed; and explanation of the item was contained on the return she signed even though the amount was not included in taxable income."⁹⁰

In *Louis Most*,⁹¹ the wife who claimed to be an innocent spouse under section 6013(e) worked in her husband's office from time to time. There she met a client on several occasions who was suing her husband for conversion. Active participation in her husband's business led to denial of the innocent spouse claim through reason to know.⁹²

If the claimant is a compensated treasurer of a corporation which is a "family" business, reason to know easily will follow.⁹³ In this situation, the claimant not only is an active member with access to corporate books and records, but it is the claimant's duty to be aware of the contents of those books.

Another important element is the complexity of the transaction involved. In addition to the many complex business dealings which require particular expertise to plan and carry out, many cases involve white-collar crimes which are carefully thought out and often evade discovery for several years. "The crime most often involved is embezzlement, which generally cannot be detected without a considerable amount of detailed investigation such as an audit by the Service would trigger."⁹⁴ Just as active participation should invariably lead to a finding of reason to know, the more complex the transaction and the more difficult it is for the Internal Revenue Service to unravel the true nature of the transaction leading to omitted income, the more ready courts should stand to grant relief where this element is determinative. Perhaps this is in keeping with the

89. The first basis was the fact that there was no omission of greater than 25 percent of the amount stated. On the return, reference was made to these funds as a loan from the savings and loan.

90. 524 F.2d at 626.

91. 31 T.C.M. (CCH) 1062 (1972).

92. The case also involved the harsh placement of the burden of proof on the innocent spouse claimant. Mrs. Most failed to take the stand and the court obviously was of the opinion that this failure cannot ever satisfy the burden. "Her failure to testify creates the normal inference that had she testified her testimony would have been unfavorable to her position." 31 T.C.M. (CCH) at 1068.

93. Jerome J. Sonnenborn, 57 T.C. 373 (1971). The couple owned 100 percent of a corporation and received corporate checks far in excess of reported income.

94. Note, *Innocent Spouses' Liability for Fraudulent Understatement of Taxable Income on Joint Returns*, 56 VA. L. REV. 1268, 1282 (1970).

basic standard itself—the reasonable man test. The ordinary individual should not have his business acumen equated with, say, the average Internal Revenue Service Special Agent. The most distressing fact is that this one factor is often overlooked by courts and it is submitted that it should take on primary importance. In *Robert L. McCoy*,⁹⁵ the innocent spouse claimant's husband realized income upon incorporation of a partnership whose liabilities exceeded the adjusted basis of transferred assets. The petitioner was aware of the existence of the partnership but she did not actively participate in the business. Likewise, she "perused" the return but did not aid in its preparation. The claimant argued that, as a layman, she was unaware of the tax consequences of incorporating the deficit partnership, and since such transaction did not realize a gain in cash she had no reason to know. This seems to be a perfect case for stating that because of the *complexity* of the transaction, the claimant had no reason to know of the omitted income.

The Tax Court in this case ignored this factor. "[M]ere ignorance" of the legal tax consequences of the transactions would not relieve the spouse from liability.⁹⁶ The court quoted from language of Representative Byrnes, a floor manager of Pub. L. 91-679, to the effect that "complete ignorance of the omission" is required.⁹⁷ This is plainly at variance with other decisions which have concluded that a spouse can have knowledge of some of the facts related to the unreported income without being charged with knowledge of the income itself.⁹⁸

Ultimately, each case is determined on its own facts. Courts should not be too quick to make decisions based on the first factor that appears to go against the innocent spouse claimant. All factors should be considered. When they are not, the courts are not fulfilling the Congressional intent of this "remedial" provision. The courts should consider: (1) the extent of any *active* participation (*e.g.* Did the spouse work in the "business"?); (2) the degree to which the claimant is involved in the "family finances" (Did the claimant keep the books? Were there joint checking accounts?); (3) the couple's standard of living, both historically and in relation to others in the community; (4) The "subjective" condition of the innocent spouse claimant (What is the level of education? Are there any physical or emotional problems?); (5) the complexity of the

95. 57 T.C. 732 (1972).

96. *Id.* at 734.

97. *Id.* at 734-35, *citing*, 116 CONG. REC. 43351 (1970).

98. *E.g.*, Patricia S. Hayes, 34 T.C.M. (CCH) 976 (1975); Patricia E. Mysse, 57 T.C. 680 (1972).

transaction (How long was the Service investigation?); (6) whether expenses "greatly" exceed reported income; (7) whether the claimant knew of any indictment or investigation.

IV. OMISSIONS—THE TWENTY-FIVE PERCENT RULE

A. Omissions

To be relieved from liability, it must be shown that there was an "omission" from gross income of "an amount properly includable therein."⁹⁹ In practice, the meaning of the word "omission" in the various cases is not at all as simple as it may seem. Because of the specifics of section 6013(e), the determination is critical. A finding of no omission ends the inquiry, regardless of whether there is "knowledge" or any of the other elements is satisfied, even if it would be "inequitable" to deny relief.

The most common claim that is denied is one where an innocent spouse claimant asserts a belief that denial of a claim for a deduction should qualify as an omission. The courts now hold uniformly that this is not the type of omission that is contemplated in the Code.¹⁰⁰ Since the deduction itself is on the return, it cannot be said that the innocent spouse claimant did not have knowledge of the omission.¹⁰¹

There is an indication that if there is even the slightest reference to the income in question, the amount is *not* omitted. *Estate of Klein v. Commissioner*¹⁰² is an example of how extreme this may be.

In *Klein* the parties stipulated that the wife-claimant met the requirement of no knowledge and no significant benefit, and that it would be inequitable to hold her liable. However, there had to be an omission. "The applicability of [section 6013(e)] does not depend entirely on the equities of each particular situation. Rather, the innocent spouse must meet specific criteria in order to qualify for this statutory protection."¹⁰³

The husband in *Klein* was a partner whose distributive share of the net income of the partnership for the year in question was approximately \$90,845, as shown in the partnership return. On the couple's joint return, he reported roughly \$91,500. The amount

99. I.R.C. § 6013(e)(1)(A).

100. *E.g.*, *Estate of Klein v. Commissioner*, 537 F.2d 701 (2d Cir. 1976); *Gordon J. Hyde*, 64 T.C. 300 (1975); *William J. Jacobs, Jr.*, 33 T.C.M. (CCH) 379 (1974); *Georgiana Spaulder*, 31 T.C.M. (CCH) 723 (1972).

101. *Georgiana Spaulder*, 31 T.C.M. (CCH) 723, 724 (1972).

102. 537 F.2d 701, 705 (2d Cir. 1976).

103. *Id.* at 702.

omitted from gross income in this case was partly due to disallowance of deductions of the *partnership return*.

The government contended, and the Tax Court agreed,¹⁰⁴ that the joint return must be read as if it included the partnership return. The United States Court of Appeals for the Second Circuit also agreed and held that the amount is not omitted from gross income stated in the return if it is disclosed in the return or in a statement attached to the return in a "manner adequate to apprise the Secretary or his delegate of the nature and amount of such item."¹⁰⁵

The connection between the two returns cannot be of any lesser nature than in this case. The Second Circuit's rationale stems from "special rules" discussed later and the fact that Schedule H of the Form 1040—labelled "Income from Partnerships, Estates, Trust and Other Sources"—provides only one line for the amount. This, in short, allows for reporting only a "net" figure. Given this limitation, the court noted that the form does not in any way intend to show the taxpayer's gross income when a taxpayer has partnership income. The court therefore held that in this case the partnership return must be considered as part of the personal income tax return.

In the usual case, it is easy to see that a deduction disallowance has nothing whatsoever to do with whether an amount was omitted from gross income, which is the area of primary focus of section 6013(e).¹⁰⁶ The Fifth Circuit has recently discussed this issue:

Of course, all errors made by the taxpayer, whether they result in an upward or downward adjustment, must be balanced together in determining the income tax deficiency due. But it is only one variety of error, an omission, to which section 6013(e) may apply. In determining whether the quantity of the error is great enough to justify innocent spouse relief . . . only errors of omission should enter the computation.¹⁰⁷

It is submitted that this is an inequitable but unavoidable reading of section 6013(e)(1)(A). It is true that deductions have nothing to do with gross income "stated in the return" and the court's conclusion that this does not qualify as an omission is not disputed. Furthermore, actual omissions may not qualify the innocent spouse for relief. In the cases of *Quinn v. Commissioner*¹⁰⁸ and *Klein v. Commissioner*¹⁰⁹ where the alleged omissions were from loans listed

104. 63 T.C. 585 (1975).

105. 537 F.2d at 705, quoting I.R.C. § 6501(e)(1)(A).

106. See S. REP. No. 91-1537; 91st Cong., 2d Sess. (1970).

107. *Allen v. Commissioner*, 514 F.2d 908, 915 (5th Cir. 1975).

108. 524 F.2d 617 (7th Cir. 1975).

109. 537 F.2d 701 (2d Cir. 1976).

elsewhere and from disallowed deductions on a return other than the joint return, the courts denied relief to the taxpayer. A close look at section 6013(e) shows that the omission from gross income refers to the *joint return*, not to anything extraneous. Likewise, by strict construction, omission must be from gross income, not from the return as was the case in *Quinn*. Confusion may stem from the concluding phrase "stated in the return." But this again refers to gross income, not anything extraneous thereto.

Furthermore, the "special rules"¹¹⁰ state that the amount in question shall be determined in accordance with the procedures of section 6501(e)(1)(A).¹¹¹ In pertinent part, this section states that:

In determining the amount omitted from gross income, there shall not be taken into account any amount which is omitted from gross income stated in the return if such amount is *disclosed in the return*, or in a *statement* attached to the return, in a manner adequate to appraise the secretary of the nature and amount of such item.¹¹²

This reference is unfortunate because the main thrust of the section is concerned with relief for an "innocent spouse." The knowledge of an innocent spouse claimant should be important in determining "equitable" relief under subsection (B), not the knowledge of the IRS. The remedial purposes of this provision can be frustrated by a strict construction.

In *Norman Rodman*,¹¹³ the omission from gross income resulted from an error in computation of cost of goods sold. Again the special rule in section 6013(e)(2)(B), which points to section 6501(e)(1)(A), precluded relief as an innocent spouse.¹¹⁴ "[A]n error in the cost of goods sold is not the equivalent of an omission from gross income within the meaning of such term."¹¹⁵

B. *The Twenty-Five Percent Rule*

Even if the amount is properly determined as an omission, such amount must be "in excess of 25 percent of the amount of gross income stated in the return."¹¹⁶ Failure to attain this minimum level

110. I.R.C. § 6013(e)(2).

111. *Id.*

112. I.R.C. § 6501(e)(1)(A)(ii).

113. 32 T.C.M. (CCH) 1307 (1973).

114. "In the case of a trade or business, the term 'gross income' means the total of the amounts received or accrued from the sale of goods or services . . . prior to diminution by the cost of such sales or services." I.R.C. § 6501(e)(1)(A)(i).

115. 32 T.C.M. (CCH) at 1320.

116. I.R.C. § 6013(e)(1)(A).

can come from a failure to exclude a large amount, for example, omitting embezzled funds. Thus, minor errors by those of relatively low incomes may go without relief. On its face, this appears discriminatory and not at all in keeping with the basic remedial nature of the statute.¹¹⁷ It is not surprising that this particular element has come under attack on constitutional grounds. Constitutional challenges to the sections of the Internal Revenue Code seem doomed to defeat, however.¹¹⁸

In *Quinn v. Commissioner*,¹¹⁹ the court referred to fraudulently acquired funds in the joint return as loans. The innocent spouse claimant argued that if section 6013(e) did not protect her, it was an unconstitutional violation of the fifth amendment as it deprived her of property without due process of law. The United States Court of Appeals for the Seventh Circuit noted that in order to obtain relief under this argument the taxpayer must not only show that the conditions placed on the relief are unconstitutional, but also that relief is constitutionally required. The reason stated was that section 6013(e) essentially is a "relief" provision and that but for this section, the taxpayer would be liable in any event. The taxpayer could not, of course, overcome this barrier imposed by the court.

The authors submit that this twenty-five percent threshold requirement should be deleted from the Code. One of the stated purposes for this requirement was an interest in judicial economy. It was thought that only where omitted income represents a significant amount should relief be provided.¹²⁰ On the other hand, the mechanical application of this requirement will lead, and has led, to unjust results where an innocent spouse claimant meets all other requirements including that of an otherwise "inequitable" result.¹²¹

The twenty-five percent requirement is not needed to deter the bringing of petitions involving relatively insignificant amounts. As a general rule, "cases involving small dollar amounts will not be worth taking up on appeal."¹²² Perhaps the basic impediment to

117. The statute was enacted to remedy specific inequities. S. REP. NO. 15-1537, 91st Cong., 2d Sess. (1970). See also *Allen v. Commissioner*, 514 F.2d 908 (5th Cir. 1975); *Sanders v. United States*, 509 F.2d 162 (5th Cir. 1975).

118. For example, in *Mary Lou Galliher*, 62 T.C. 760 (1974), the innocent spouse claimant challenged the differing tax treatments which arise by virtue of the community property laws of some states. The court dismissed this argument by noting that "the Supreme Court long ago upheld the constitutionality of distinctions arising from community property laws." *Id.* at 763 (citing *Poe v. Seaborn*, 282 U.S. 101, 117, 118 (1930)).

119. 524 F.2d 617 (7th Cir. 1975).

120. S. REP. NO. 91-1537, 91st Cong., 2d Sess. (1970).

121. I.R.C. § 6013(e)(1)(C); see, e.g., *Wissing v. Commissioner*, 441 F.2d 533 (6th Cir. 1971).

122. Comment, *The Innocent Spouse Act*, 45 TEMPLE L.Q. 448, 459 (1972).

reform in this area is the widely accepted notion that the Tax Code was just not meant to aid the average wage-earner.

V. THE REQUIREMENTS OF SECTION 6013(e)(1)(C)

Section 6013(e)(1)(C) of the Innocent Spouse Act sets forth the "final" package of elements and tests which must be satisfied if one is to prove he or she is an "innocent spouse" and thus be relieved from liability for the deficiency in tax attributable to an omission of income on the joint return.¹²³ It is in this subsection that Congress has truly responded to the cry from the courts to provide them with a means for ending the harsh and inequitable consequences which they were obliged to impose upon innocent spouses, merely because the spouse had executed a joint return upon which the spouse's mate failed to report all income.¹²⁴ Therefore, although this subsection provides the "final" set of requirements which the spouse must satisfy if she is to be granted relief, it is nevertheless the foundation of the entire Act and should be given the maximum attention by the courts.

The ultimate determination to be made under section 6013(e)(1)(C) is whether it is inequitable to hold the other spouse liable for the deficiency in tax. In making this determination, the court is to take into account: a) whether or not the other spouse significantly benefited from the omissions of income; and b) *all* other facts and circumstances.

123. I.R.C., § 6013(e)(1)(C) provides that the spouse is relieved of liability if (C) taking into account whether or not the other spouse significantly benefited directly or indirectly from items omitted from gross income and taking into account all other facts and circumstances, it is inequitable to hold the other spouse liable for the deficiency in tax for such taxable year attributable to such omission.

124. The Senate Committee on Finance stated as its reason for recommending the passage of H.R. 19774 (Innocent Spouse Provisions) the fact that "numerous cases have arisen which the imposition of joint liability upon an innocent spouse has resulted in the committee's opinion grave injustice." S. REP. No. 1537, 91st Cong., 2d Sess. 2 (1970). [Hereinafter referred to as S. REP. No. 91-1537.]

In *Louise M. Scudder*, 48 T.C. 36, 41 (1967), the petitioner's husband embezzled funds from a partnership. The petitioner neither knew of, nor benefited from these funds, yet the statute precluded the court from granting her relief. Under these circumstances, the Court felt compelled to state:

Although we have much sympathy for petitioner's unhappy situation and are appalled at the harshness of this result in the instant case, the inflexible statute leaves no room for amelioration. It would seem that only remedial legislation can soften the impact of the rule of strict liability for income taxes on the many married women who are unknowingly subjected to its provisions by filing joint returns.

The Senate Finance Committee cited the *Scudder* case, as an example and stated: "This proposal seeks to correct the unfairness in the situations brought to the attention of this committee and to bring government tax collection practices into accord with basic principles of equity and fairness." S. REP. No. 91-1537 at 2.

A. Significant Benefit

"[W]hether or not the other spouse significantly benefited directly or indirectly from the items omitted from gross income" is set out in the Code merely as an element to be considered by the tribunal in making the ultimate determination whether it is inequitable to hold the spouse liable for omitted income.¹²⁵ Rather than treat the significant benefit test as one of a number of factors to be examined, the courts have generally treated it as the ultimate answer to the question of liability. It is not unusual for a court to make a finding of significant benefit and then fail to mention whether the imposition of liability is equitable.¹²⁶ It appears, therefore, that the majority of the courts treat a determination of significant benefit as synonymous with a determination that it is not inequitable to hold the spouse liable.

The significant benefit doctrine has proven to be a vague concept which neither Congress nor the courts have been able to define uniformly. The Senate Committee on Finance defined "significant benefit" as not including the ordinary support of the innocent spouse. However, unusual support or transfers of property to the spouse would constitute "benefit."¹²⁷

While the terms "ordinary" and "unusual support" are open to a wide range of interpretation, the courts, in the spirit set forth by the Tax Court in *Sanders v. United States*,¹²⁸ have been flexible in their construction. In the *Sanders* case the court noted that "Congress intended the exception [§ 6013(e)] to remedy a perceived injustice, and we should not hinder that praiseworthy intent by giving the exception an unduly or restrictive reading."¹²⁹ Therefore, the cases which have indulged in a detailed factual analysis to determine whether the petitioner has received a "significant benefit" have, in fact, applied relief liberally.¹³⁰

125. Whether it is inequitable to hold a person liable for the deficiency in tax . . . is to be determined on the basis of all the facts and circumstances. In making such a determination a factor to be considered is whether the person seeking relief significantly benefited, directly or indirectly, from the items omitted from gross income. . . .

Treas. Reg. § 1.6013-5(b)(1974).

126. See *Wissing v. Commissioner*, 441 F.2d 533 (6th Cir. 1971); *Blaine S. Fox*, 61 T.C. 704 (1974); *Georgiana Spaulder*, 31 T.C.M. (CCH) 723 (1972); *Louis Most*, 31 T.C.M. (CCH) 1062 (1972).

127. S. REP. NO. 91-1537 at 3. See Treas. Reg. § 1.6013-5(b) ("normal support is not a significant benefit for purposes of this determination"); H.R. REP. NO. 1734, 91st Cong., 2d Sess. 3-4 (1970).

128. 509 F.2d 162 (5th Cir. 1975).

129. *Id.* at 166-67.

130. See *Saunders v. United States*, 509 F.2d 162 (5th Cir. 1975); *Dakil v. United States*,

The Tax Court, in one of the first cases to examine "significant benefit,"¹³¹ held that the petitioner did not significantly benefit from over \$100,000 of unreported income which the petitioner's spouse embezzled over a four year period. The Internal Revenue Service, offering the following figures, contended that because the unreported income was more than 139% greater than the reported income and the total expenditures exceeded by over \$100,000 the total reported income, the petitioner had to have received a significant benefit.¹³²

Rejecting the government's argument and disregarding the additional facts that the petitioner and her spouse spent the unreported income for two of their three sons' college educations, five cars (including a Jaguar), a diamond ring, furniture and monthly mortgage payments on their home, the *Mysse* court determined that "[a]ny benefit which [petitioner] received from the funds constituted no more than ordinary support."¹³³

The court while noting that a spouse "cannot close her eyes to unusual or lavish expenditures," decided that "in this case, we find no lavish expenditures."¹³⁴ Since ordinary support does not constitute a significant benefit, the petitioner was relieved.¹³⁵

496 F.2d 431 (10th Cir. 1974); Patricia S. Hayes, 34 T.C.M. (CCH) 976 (1975); Jennie Allen, 61 T.C. 125 (1973); Patricia E. Mysse, 57 T.C. 680 (1972); Sam Shapolsky, 31 T.C.M. (CCH) 260 (1972).

131. Patricia E. Mysse, 57 T.C. 680 (1972). See also Sam Shopolsky, 31 T.C.M. (CCH) (1972), where the court held that funds received by the petitioners as housewife and mother were no more than normal support.

132. Patricia E. Mysse, 57 T.C. 680, 697 (1972). The income and expenditure figures for the relevant years are as follows:

	Income Reported	Income Unreported	Total Expenditures	Expenditures in Excess of Reported Income
1963	\$ 20,025.26	\$ 8,079.10	\$ 14,725.15	\$ (5,300.11)
1964	19,811.48	17,000.00	24,960.88	5,149.40
1965	20,281.58	45,295.58	23,634.47	3,352.89
1966	16,525.32	36,501.18	24,612.94	8,087.59
Total	\$ 76,643.64	\$106,875.86	\$ 87,933.44	\$ 11,289.80

133. *Id.* at 699. The court appeared to be influenced by two additional factors. First, the petitioner's spouse was suffering from a terminal illness and subsequently committed suicide. Second, the spending habits of the petitioner did not raise the suspicion of neighbors or employers.

134. *Id.*

135. But see Louis Most, 31 T.C.M. (CCH) 1062 (1972); Georgiana Spaulder, 31 T.C.M. (CCH) 723 (1972). In *Most*, it was held that because the petitioner used some of the unre-

The Report of the House Ways and Means Committee,¹³⁶ in addition to recognizing that ordinary support does not constitute benefit, also provided that unusual transfers of property to the spouse should be taken into consideration in determining whether the spouse benefited from items omitted from gross income. The court in *Jennie Allen*¹³⁷ construed the House Report to mean that "in order for [the court] to conclude that the petitioner benefited significantly, [it] must find that petitioner received some benefit in addition to ordinary support."¹³⁸

In *Jennie Allen*, the petitioner, upon divorcing her spouse, received under the property settlement, a house, furniture, a used Cadillac, five horses, a \$2,000 promissory note, and stock in a life insurance company. The government contended that receipt of the above assets were unusual transfers which constituted a significant benefit to the spouse. The court recognized, however, that the assets carried with them corresponding liabilities, such as mortgage payments on the house, and upkeep on the cars and horses. The court, noting also that the husband had failed to make the \$150 per month support payments under the terms of the divorce decree and that the property had been accumulated over 24 years of marriage, held that the value of transferred property was not so great as to be considered unusual.¹³⁹

The Tax Court in *Patricia S. Hayes*,¹⁴⁰ under a similar set of facts, reached a similar conclusion. The petitioner was being held accountable for income omitted from the joint return by her husband during the years 1963, 1964, and 1965. In 1971, the petitioner divorced her husband and pursuant to that divorce received the family residence. The government argued that during the years in question mortgage payments on the marital home were made with the unreported income. The court held that the petitioner had not benefited significantly, stating: "The mere fact that on her divorce she received their home upon which mortgage payments had been made during these years, will not cause this requirement to

ported income for personal living expenses, he significantly benefited. In *Spaulder*, the court stated that since the petitioner's spouse provided support for the family it could not be said that the petitioner did not benefit.

136. H.R. REP. NO. 1734, 91st Cong., 2d Sess. 3-4 (1970).

137. 61 T.C. 125 (1973).

138. *Id.* at 131.

139. *Id.* See Ann J. Anderson, 34 T.C.M. 508, 514 (1975). "The transfers of the household furniture and the 1967 Chevrolet, pursuant to the separation agreement, constitute no more than ordinary support and must be weighed against the factors of divorce and the absence of alimony payable to petitioner."

140. 34 T.C.M. (CCH) 976 (1975).

fail. . . . At most these payments were in the nature of 'normal support.'"¹⁴¹

While the courts in *Allen* and *Hayes* were unable to hold that upon divorce the transfers of property to the petitioners conferred a significant benefit, divorce can be the means by which liability unwittingly is placed on the spouse. In *Raymond H. Adams*,¹⁴² the husband contended that he was an innocent spouse. During the marriage from 1956 to 1961 the wife had omitted income which increased her net worth by \$286,990. While the husband-petitioner did not benefit from these funds during the marriage, upon divorce he received assets pursuant to the property settlement valued at \$257,000. In view of the fact that prior thereto his net worth was \$33,000, the court in *Adams* held that he significantly benefited from the income omitted during the marriage year.¹⁴³

In *Dakil v. United States*¹⁴⁴ the Service raised the question whether the fact that the petitioner engaged in a "luxurious lifestyle" was a sufficient basis from which to infer that the spouse had significantly benefited. Here the government claimed that the ownership of three cars, country club memberships, vacation trips, private schools for the children, and house remodeling disclosed a lifestyle sufficiently luxurious to compel a finding that the petitioner had benefited significantly. The Circuit Court of Appeals stated that the record did not disclose the difference between a luxurious lifestyle and ordinary support for a doctor's wife.¹⁴⁵ This statement infers that a showing by the Service that the petitioner leads a luxurious lifestyle is not proof of a significant benefit from omitted income; rather, the court must determine whether the petitioner, prior to the receipt of the unreported income, was accustomed to a luxurious lifestyle. Thus, the courts cannot find that the petitioner derived a significant benefit from the omitted income unless they find that "but for" the unreported income, the petitioner would have been unable to make the expenditures necessary to maintain the luxurious lifestyle. This "but for" approach is a valid and necessary test which all courts should apply in making a determination of significant benefit.

The "but for" approach was applied by the court in *Clarence E. Haywood*.¹⁴⁶ In *Haywood*, the petitioner's spouse had embezzled \$106,100 over a four year period. During these years, the petitioner

141. *Id.* at 981.

142. 60 T.C. 300 (1973).

143. *Id.* at 303-04.

144. 496 F.2d 431 (10th Cir. 1974).

145. *Id.* at 433.

146. 33 T.C.M. (CCH) 1311 (1974).

and her spouse went on numerous gambling sprees to Las Vegas, took vacations, frequented casinos and bars, and bought a cruiser. The court stated as its reason for holding the petitioner significantly benefited that: "[P]etitioner presented no records to support her contention that the family income, aside from the embezzled sums, was adequate to meet their style of living. . . ." ¹⁴⁷

An express adoption by the courts of the "but for" test would provide them with an efficient, fair, consistent and effective method for properly analyzing whether the petitioner realized a significant benefit from unreported funds. ¹⁴⁸

B. *Inequitableness*

In numerous cases, the courts, upon finding that the petitioner "significantly benefited," have concluded prematurely that the petitioner could be denied relief for failing to satisfy subsection 6013(e)(1)(C) of the innocent spouse provision. ¹⁴⁹ The major question raised by subsection (1)(C), however, is whether it is inequitable to hold the petitioner liable. ¹⁵⁰ Therefore, significant benefit is only one factor to be considered in answering that question because "[w]hether it is inequitable to hold a person liable for the deficiency in tax . . . is to be determined on the basis of *all facts and circumstances*." ¹⁵¹

The court in *Dakil v. United States* ¹⁵² recognizing the distinction between a determination of significant benefit and a determination that it is inequitable to hold the petitioner liable, ruled that "significant benefit is not determinative if all other facts and circumstances make the imposition of the tax inequitable." ¹⁵³ In apply-

147. *Id.* at 1316.

148. The "but for" test would also bury the inconsistent contention often made by Internal Revenue Service agents and conferees that since the unreported income constituted more than twenty-five percent of the reported income, the petitioner has benefited significantly from the omitted funds. Upon first consideration, this argument sounds plausible, however, it is totally inconsistent with the intent of subsection 6013(e)(1)(A) to limit relief to cases where the income omitted represents a significant amount. According to the government's contention, any petitioner who satisfied the twenty-five percent rule, thus qualifying for relief under 6013(e)(1)(A) would thereafter be denied relief. This would render the Innocent Spouse provision totally useless.

149. See Clarence E. Haywood, 33 T.C.M. (CCH) 1311 (1974); Cecelia M. Harmon, 33 T.C.M. (CCH) 436 (1974); Raymond H. Adams, 60 T.C. 300 (1973); Louis Most, 31 T.C.M. (CCH) 1062 (1972); Georgiana Spaulder, 31 T.C.M. (CCH) 723 (1972).

150. Treas. Reg. § 1.6013-5(a)(4) (1960).

151. Treas. Reg. § 1.6013-5(b) (1960).

152. 496 F.2d 431 (10th Cir. 1974).

153. *Id.* at 433. See Sam Shapolsky, 31 T.C.M. (CCH) 260 (1972). In *Shapolsky*, the court stated: "The [Congressional] reports make it clear that to determine that it would be equitable to hold the spouse liable . . . we must find at the very least that the innocent spouse significantly benefited from the omission." *Id.* at 261.

ing that principle to the case at hand, the *Dakil* court continued: "Even if [the benefits are significant] the overwhelming considerations require that the unnecessarily harsh attempt to collect from her individually the tax liabilities of her husband should never have been made. . . . Even a tax collector should have some heart."¹⁵⁴

In *Bettye A. Sanders*,¹⁵⁵ due consideration was given to the fact that the petitioner would suffer hardship in the future if relief were denied her. In holding that a mere finding that the petitioner benefited will not be sufficient, the court rejected the government's assertion that the future hardship which the petitioner may be exposed to is not a proper factor for consideration if the petitioner has retained either unreported income or the fruits of the unreported income which could have been used to discharge the liability.¹⁵⁶ Noting that *all* facts and circumstances are to be taken into account the court stated: "[N]othing in the statute or its legislative history purports to forbid the consideration of probable future hardship when examining the equities of the case."¹⁵⁷

Divorce, separation and desertion are significant factors which have also influenced the determination of whether it was inequitable to hold the petitioner liable.¹⁵⁸ In *Patricia E. Mysse*,¹⁵⁹ the government, pointing to petitioner's harmonious marriage, argued that relief was intended primarily for the benefit of spouses who were deserted, divorced or separated. The court properly held that there is nothing in the innocent spouse provision which indicates that relief is limited "to spouses who are victims of broken marriages. Indeed, . . . whether the innocent spouse has been separated or divorced is only one of the factors to be considered in determining whether it is inequitable to hold her liable for deficiencies."¹⁶⁰

154. 496 F.2d at 433.

155. 509 F.2d 162 (5th Cir. 1975). The *Sanders* court stated that "[T]he presence of significant benefits from the unreported income [is] only one factor in the overall decision of whether it is inequitable to charge the spouse with the tax." *Id.* at 171 n.16.

156. *Id.* at 171 n.16, citing Appellant's Brief at 18. The government argued that the fact that Mrs. Sanders received proceeds from an insurance policy that increased in value from \$50,000.00 to \$145,000.00 during the period her husband omitted income and proceeds from the sale of property acquired also during that period, were sufficient to deny her relief. It appears that the government was relying on Treasury Regulation Section 1.6013-5(b) (1960) which states in part: "[I]f a person seeking relief receives from his spouse an inheritance of property or life insurance proceeds which are traceable to items omitted from gross income by his spouse, that person will be considered to have benefited from those items."

157. 509 F.2d at 171 n.16.

158. Patricia S. Hayes, 34 T.C.M. (CCH) 976 (1975); Jennie Allen, 61 T.C. 125 (1973); Raymond H. Adams, 60 T.C. 300 (1973); Patricia E. Mysse, 57 T.C. 680 (1972); Treas. Reg. § 1.6013-5(b) (1960) which states in part: "Other factors which may also be taken into account, if the situation warrants, include the fact that the person seeking relief has been deserted by his spouse or the fact that he has been divorced or separated from his spouse."

159. 57 T.C. 680, 699 (1972).

160. *Id.* at 700. In *Mysse*, the fact that the petitioner's husband was insolvent at death

In summary, Congress intended subsection (1)(C) to serve as the ultimate safety valve by which the innocent spouse could be relieved of tax liability for income omitted from a joint return. Therefore, the statute permits, indeed requires, the courts to give full consideration to all the facts and circumstances bearing upon the determination of whether or not it would be inequitable to hold the petitioner liable. Although Congress intended subsection (1)(C) of the innocent spouse provision to provide relief to the innocent spouse when the equities necessitated relief, an innocent spouse may be unduly subjected to liability under subsection (1)(B), which precludes relief if the claimant fails to prove that she had no reason to know of omitted income. Therefore, relief may be ultimately denied, regardless of the fact that it may be inequitable to hold the innocent spouse liable.

C. Dependency Theory

A survey of the cases which have determined whether or not to grant relief pursuant to the innocent spouse provision of the Internal Revenue Code has indicated that the key to achieving relief is to convince the court that the petitioner did not know and had no reason to know that income had been omitted from the joint return. There is a significant interdependence between subsection (1)(B), which requires that the petitioner prove she had no reason to know income was unreported,¹⁶¹ and subsection (1)(C), which requires that the petitioner show she did not significantly benefit from the omitted funds and that it would be inequitable to hold her liable.¹⁶²

The above mentioned survey indicates that where a finding that the petitioner had significantly benefited was the only means by which the courts could deny the petitioner relief, the courts have uniformly refused to find that the unreported income constituted a significant benefit.¹⁶³ In fact, the courts at times have engaged in legal gymnastics to reach the conclusion that the use of the omitted

was another factor which influenced the court's determination that it was inequitable to hold the petitioner liable.

161. I.R.C. § 6013(e)(1)(B); Jerome J. Sonnenborn, 57 T.C. 373 (1971); Nathaniel M. Stone, 56 T.C. 213 (1971).

162. I.R.C. § 6013(e)(1)(C).

163. In many cases which have held that the petitioner had no reason to know income was omitted, the courts found that the petitioner realized no significant benefit and that it was inequitable to hold the petitioner liable. See *Sanders v. United States*, 509 F.2d 162 (5th Cir. 1975); *Dakil v. United States*, 496 F.2d 431 (10th Cir. 1974); *Wissing v. Commissioner*, 441 F.2d 533 (6th Cir. 1971); *United States v. Davis*, 28 A.F.T.R.2d 6075 (D. Ariz. 1971); *Patricia S. Hayes*, 34 T.C.M. (CCH) 976 (1975); *Jennie Allen*, 61 T.C. 125 (1973); *Patricia E. Mysse*, 57 T.C. 680 (1972); *Sam Shapolsky*, 31 T.C.M. (CCH) 260 (1972). But see *Danied Cecere*, 34 T.C.M. (CCH) 1593 (1975).

income constituted nothing more than normal support.¹⁶⁴ On the other hand, where it has been determined that the petitioner did know or have reason to know that income had not been reported, the courts have not hesitated to deny the petitioner relief.¹⁶⁵

The requirements which the petitioner must satisfy to be granted relief under the innocent spouse provision cannot be considered to be independent of one another. In the great majority of the cases the courts' determination of whether or not it is equitable to hold the petitioner liable turns, in fact, on whether or not the petitioner is found to have knowledge or reason to know of omitted income. Furthermore, whether a petitioner had reason to know frequently turns on whether there was more than normal support.

Congress intended the innocent spouse provision to provide relief, where warranted by the equities, from liability arising from the filing of a joint return.¹⁶⁶ Subsection 6013(e) fails to achieve its equitable purpose where the claimant is unable to satisfy the requirements of paragraph (1)(B). In these situations relief is denied even though it is otherwise inequitable to hold the spouse liable. Thus, injustices continue and the Congressional intent is frustrated.

To remedy this dilemma, and to reflect the true Congressional intent underlying the passage of the innocent spouse provision, subsection (1)(B) should be incorporated into subsection (1)(C). It should be one factor to be taken into account, along with the question of significant benefit to the innocent spouse and all the other facts and circumstances. All of these factors go to the making of the ultimate and most important determination: whether it is inequitable to hold the petitioner liable for the deficiency in tax attributable to unreported income.

VI. BURDEN OF PROOF

In determining any controversy the placing of the burden of proof is of utmost importance in arriving at a conclusion. Except for subsection (B) of section 6013(e)(1),¹⁶⁷ the innocent spouse provision

164. See text accompanying note 85 *supra*.

165. In the nine cases which have held that the petitioner knew or had reason to know income had been omitted, eight of these also held that the petitioner had significantly benefited from these funds. Blaine S. Fox, 61 T.C. 704 (1974); Clarence E. Haywood, 33 T.C.M. (CCH) 1311 (1974); Cecelia M. Harmon, 33 T.C.M. (CCH) 436 (1974); Raymond H. Adams, 60 T.C. 300 (1973); Robert L. McCoy, 57 T.C. 732 (1972); Georgiana Spaulder, 31 T.C.M. (CCH) 723 (1972); Louis Most, 31 T.C.M. (CCH) 1062 (1972); Jerome J. Sonnenborn, 57 T.C. 373 (1971). *But see* Ann J. Anderson, 34 T.C.M. (CCH) 508 (1975).

166. See discussion in text accompanying note 124 *supra*.

167. The innocent spouse claimant will be relieved if he/she "establishes that in signing the return, he or she did not know of, and had no reason to know of, such omission. . . ." I.R.C. § 6013(e)(1)(B).

does not allocate this burden. Although it appeared to some that the Internal Revenue Service bore the initial burden of proving that the innocent spouse claimant had "significantly benefited" from omitted income,¹⁶⁸ the cases reveal that the burden of proof as to all elements of the section rests upon the innocent spouse claimant.¹⁶⁹ This, of course, specifically includes the element of no significant benefit.¹⁷⁰

The difficulty here is determining what quantum will satisfy the factual determination¹⁷¹ in any given case. At the very least, it is suggested that the innocent spouse claimant should take the stand and present his or her side of the story.

When the claimant fails to take the stand, besides leaving the impression of no affirmative action, he or she creates a negative inference in the fact finder's mind. The innocent spouse claimant's "failure to testify creates the normal inference that had she testified her testimony would have been unfavorable to her position."¹⁷² The Tax Court will not assume that there is no knowledge or significant benefit.¹⁷³

When the innocent spouse claimant takes the stand, on the other hand, many courts are willing to take his or her testimony at face value.¹⁷⁴ This is particularly true when the initial issue of actual knowledge is presented. In *Ann J. Anderson*,¹⁷⁵ for example, the Tax Court relied on Mrs. Anderson's testimony that she had no actual knowledge of her husband's embezzling of funds. "Considering the direct testimony on this point by both petitioner and [her husband] we believe petitioner has established that she did not have actual knowledge of the omission when she signed the 1969 return."¹⁷⁶ The court's faith in Mrs. Anderson's testimony continued as to actual knowledge in the subsequent year even though her "guilty" spouse was indicted for his illegal activities.¹⁷⁷

Similar faith was shown in *Cain v. Commissioner*¹⁷⁸ and *Sam*

168. Comment, *supra* note 121, at 456.

169. *E.g.*, Doris Swofford, 35 T.C.M. (CCH) 691, 694 (1975); *Ann J. Anderson*, 34 T.C.M. (CCH) 508, 512 (1975).

170. Louis Most, 31 T.C.M. (CCH) 1062 (1972); Herbert C. McManus, 31 T.C.M. (CCH) 999 (1972).

171. Note, *The Joint Tax Return and the Innocent Spouse*, 10 J. FAMILY L. 472, 477 (1971).

172. Louis Most, 31 T.C.M. (CCH) 1062, 1068 (1972).

173. Jerome J. Sonnenborn, 557 T.C. 373 (1971). *See also* Blaine S. Fox, 61 T.C. 704 (1974).

174. *E.g.*, Patricia S. Hayes, 34 T.C.M. (CCH) 976 (1975).

175. 34 T.C.M. (CCH) 508 (1975).

176. *Id.* at 513. *See also* Patricia S. Hayes, 34 T.C.M. (CCH) 976 (1975).

177. *Id.* at 514.

178. 460 F.2d 1243 (5th Cir. 1972).

Shapolsky.¹⁷⁹ In *Cain*, the claimant's husband, a government employee, received "kickbacks" from construction companies. In affirming the Tax Court's decision,¹⁸⁰ the United States Court of Appeals for the Fifth Circuit was satisfied that the wife had testified "to the best of her knowledge." In *Shapolsky*, the omissions resulted from income attributable to the "guilty husband's" business. The court held that Mrs. Shapolsky had met her burden of proof as to both actual knowledge and reason to know. "[Her] testimony and the facts and circumstances as revealed in the entire record are sufficient to meet this burden."¹⁸¹

Nevertheless, the advocate must use caution because the question is essentially factual and the testimony may not be convincing in all cases. In *Clarence E. Haywood*,¹⁸² for example, the active participation overrode the testimony of the innocent spouse claimant that she had not significantly benefited from her husband's other sources of income. More was needed.

The only evidence offered to show no significant benefit was vague and general testimony at trial from several neighbors and acquaintances that petitioner's standard of living was not noticeably higher. . . . This is not of itself sufficient to meet her burden of proof. . . . [P]etitioner presented no records to support her contention that the family income, aside from the embezzled sums, was adequate to meet their style of living, including trips to Nevada.¹⁸³

The innocent spouse claimant's testimony will be believed only in the initial stages of the inquiry to establish no actual knowledge. When the latter elements are considered, more is needed and the factors discussed above¹⁸⁴ can overcome the direct testimony no matter how convincing. The main problem with the positioning of the burden of proof in this section is the inherent difficulty in trying to prove a negative. The innocent spouse claimant must prove that he or she had *no* actual knowledge, *no* reason to know, and that he or she did *not* significantly benefit from the omitted funds. A total

179. 31 T.C.M. (CCH) 260 (1972).

180. 30 T.C.M. (CCH) 197 (1971).

181. 31 T.C.M. (CCH) at 261. See also Patricia E. Mysse, 57 T.C. 680 (1972). As an aside in *Mysse*, the Service argued that the innocent spouse section was intended to protect only those spouses who have become separated from or divorced from the "guilty" spouse. The court rejected this limitation: "We find nothing in the section, however, to indicate that its relief was intended to be limited to spouses who are victims of broken marriages." 57 T.C. at 700.

182. 33 T.C.M. (CCH) 1311 (1974).

183. *Id.* at 1316.

184. See part III. B. *supra*.

remedy of an inequitable situation cannot be had without a restructuring of the awesome burden of proof.

The penalty provisions for fraud are not imposed upon the "innocent spouse" unless the government can prove that the claimant actively participated in the fraud.¹⁸⁵ With regard to section 6013(e), there is no reason why a similar burden cannot be placed upon the government. Thus, the innocent spouse provision would not apply to "perfect" spouses only.

VII. CONCLUSION

The innocent spouse provision was enacted to remedy existing inequities in the area of joint and several liability. Basic inequities can still be seen in the case law which has developed since subsection 6013(e) was enacted. To the extent these inequities exist, the reform has failed.

Existing inequities can be resolved by taking several steps. First, the twenty-five percent requirement of subparagraph (1)(A) should be eliminated. On its face, it is discriminatory. Additionally, the discouragement of relatively insignificant cases is not a real problem since "insignificant," in a sense, means that the suit is not worth bringing in the first place. In any event, judicial economy should not outweigh equal treatment when all else is "equal."

The requirement of filing a joint return may require adjustment, particularly in light of some of the community property cases that have dealt with innocent spouse treatment. Perhaps the fairest measure would be to limit the threshold requirement to having omitted income attributable to the guilty spouse. But for their state of residence, many innocent spouses would not incur liability in the first instance. It seems fair, then, that they should have at least an equal opportunity for relief as spouses in noncommunity property states.

A major inequity stems from the placing of the burden of proof. Proving negatives is hard enough, but when coupled with the vast difference in investigative capabilities, it almost becomes insurmountable. As in the fraud relief provision, greater fairness would result from shifting the burden to the government to prove actual knowledge, reason to know or a definite significant benefit.

Finally, subparagraph (1)(B)'s lack of knowledge requirement should be merged with (C). In this manner, true equities can be seen as overriding unfortunate situations where the innocent spouse

185. I.R.C. § 6653(b); see Daniel Cecere, 34 T.C.M. (CCH) 1593 (1975); Nathaniel M. Stone, 56 T.C. 213 (1971).

claimant is automatically precluded from relief by a determination of "reason to know" based upon spurious or relatively innocuous factors.

The ultimate effect of these proposals will be to further the congressional intent manifest in subsection 6013(e). This effect will be in keeping with the judicial trend which was the impetus to action by Congress. Thus, these proposals will bring about the equitable results which subsection 6013(e) was intended to achieve.