

## JOINT INCOME TAX LIABILITY OF INNOCENT SPOUSES

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DECEMBER 30 (legislative day, DECEMBER 28), 1970.—Ordered to be printed

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Mr. LONG, from the Committee on Finance, submitted the following

## REPORT

[To accompany H.R. 19774]

The Committee on Finance, to which was referred the bill (H.R. 19774) to amend the Internal Revenue Code of 1954 to provide that in certain cases a spouse will be relieved of liability arising from a joint income tax return, having considered the same, reports favorably thereon without amendment and recommends that the bill do pass.

## I. SUMMARY

The committee's bill, H.R. 19774, provides relief for the situations which have been brought to the attention of the committee in connection with the imposition upon innocent spouses of large liabilities for taxes and penalties attributable to income omitted from a joint return by the other spouse. In several situations, under existing law, the Internal Revenue Service has been successful in assessing income tax liabilities and penalties (attributable to an omission from income) against a spouse wholly innocent of any wrongdoing insofar as the omission is concerned. This bill provides, that where certain conditions exist, the "other spouse" is to be relieved of tax liability to the extent that the liability is attributable to an omission from gross income. The bill also affords relief from the imposition of the 50-percent fraud penalty where the underpayment in tax is not attributable to the fraud of the spouse.

The Treasury Department has indicated that it does not oppose the enactment of this bill.

## II. REASONS FOR THE BILL

Under existing law individuals filing a joint income tax return are jointly and severally liable for any tax liability found to be due. Joint and several liability also exists with respect to penalties and additions

to tax: e.g., the 50-percent fraud penalty determined to be due as a result of the fraud of either spouse. Since a joint return does not show the respective incomes and deductions of the husband and wife, individually, and since the statute imposes a single tax upon the aggregate income, administrative simplicity makes it necessary that the filing of such a return create a liability that is joint and several.

Numerous cases have arisen in which the imposition of joint liability upon an innocent spouse has resulted in the committee's opinion, in grave injustice. A typical situation is one in which a husband embezzles funds (which are taxable income), and omits the proceeds from gross income. Because of the fact that the wife of the embezzler filed a joint return with her husband for the year in which the income should have been reported, the Internal Revenue Service may, under existing law, hold the innocent spouse liable for the tax liability resulting from the underpayment and for the 50 percent fraud penalty due as a result of the fraudulent omission from income. This liability may be imposed upon the spouse even though she had no knowledge of her husband's activities and the resulting omission from income, and even though she did not benefit in any way from the use of the funds. Several cases of this type have involved situations in which the innocent spouse has been deserted by her husband and the funds gained by embezzlement or theft have been squandered and spent by the wrongdoer.

Several of the instances in which joint liability has been asserted by the Internal Revenue Service have resulted in decided court cases. Although the courts in these situations have expressed sympathy for the innocent spouse, they have stated that the clear rule of the statute, imposing joint and several liability, did not permit any decision other than one holding the innocent spouse liable for the taxes and penalties. Some of these judicial decisions have carried pleas for legislative relief. For example, Judge Hoyt stated in *Louise M. Scudder*, 48 T.C. 36, 41 (1967):

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 individual liability for income taxes on the many married women who are unknowingly subjected to its provisions by filing joint returns. \* \* \*

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.

### III. GENERAL EXPLANATION

This bill deals with the problems outlined above by adding two provisions to the tax statutes. First, the bill provides that when three conditions exist, the "innocent spouse" is to be relieved of the tax liability to the extent that such liability is attributable to an omission from gross income. Second, the bill provides that the 50-percent fraud penalty is not to apply to a spouse unless some part of the underpayment on the joint return is due to the fraud of that spouse.

The first section of the bill provides that an innocent spouse is to be relieved of liability for tax, including interest, penalties, and other amounts, where three conditions exist: (1) a joint return has been filed and the omission from gross income (attributable to one spouse) amounts to more than 25 percent of the total gross income stated on the return; (2) the innocent spouse establishes that in signing the return he or she did not know of, and had no reason to know of, the omission from income, and; (3) taking into account whether or not the spouse significantly benefited from the items omitted from gross income and all other facts and circumstances, it is inequitable to hold the spouse in question liable for the deficiency in tax. This provision has applicability to an omission from gross income for any reason and is not limited to embezzlement, theft or similar activities.

The first requirement, that the amount omitted from gross income must equal more than 25 percent of the gross income shown on the return, is intended to limit the relief provided in the bill to those cases where the income omitted represents a significant amount relative to the reported income. Whether or not an omission meets this test is to be determined in a manner similar to the test applied under existing law in determining, for purposes of the 6-year statute of limitations, when an omission in excess of 25 percent of gross income exists.

The second condition imposes on the innocent spouse the burden of showing that he or she did not know of, and had no reason to know of, the omission from income. It is intended that the spouse, in such a situation, will have the usual burden of proof (preponderance of the evidence) on this issue and not the higher burden required of the Government in civil fraud cases.

The third condition requires a factual determination (by the Internal Revenue or the courts) as to whether the spouse seeking relief from liability significantly benefited, directly or indirectly, from the items omitted from gross income. It is not intended that the term "benefit" as used here include ordinary support of the innocent spouse. Unusual support or transfers of property to the spouse would, however, constitute "benefit" and should be taken into consideration in determining whether the spouse benefited from the items omitted from gross income. Such "benefit" may be received by the spouse several years after the year in which the omitted item should have been included in gross income. For example, if a spouse receives an inheritance of property or life insurance proceeds, and such receipt is traceable to items omitted from gross income by the other spouse in earlier years, that spouse will be considered to have benefited from those items. A mere finding that the spouse "benefited" from the items omitted from gross income will not be sufficient however, to prevent that spouse from obtaining relief from liability for the tax. For the spouse to be prevented from obtaining relief there must also be a finding that the benefit was "significant" and that "taking into account all other facts and circumstances," it is not "inequitable to hold the . . . spouse liable for the deficiency in tax \* \* \*"

Other factors which could also be taken into account, in appropriate situations, in determining whether it is inequitable to hold the spouse liable for the deficiency include the fact of whether the spouse in question is deserted or is divorced or separated.

The bill provides that the determination of the spouse to whom items of gross income, other than gross income from property, are attributable is to be made without regard to community property laws. Thus, the rules of community property are not followed with respect to earned income or income from theft or embezzlement. Income earned by a husband, for example, and omitted from a joint return, is to be attributed to the husband, even though it may constitute community property, in determining whether the wife is entitled to relief from the tax liability under this provision. On the other hand, income from property, such as rental income from an apartment house owned by the marital community (with neither spouse rendering substantial services in producing the rental income) is to be deemed the income of both spouses. Since income of this latter type is not "attributable to one spouse," a spouse would not be entitled to relief from any tax liability attributable to its omission from gross income.

The bill (sec. 2) also amends the provision imposing a 50-percent penalty when the underpayment is due to fraud (sec. 6653(b) of the code). In this case, the bill provides, in effect, that if one spouse is shown to be guilty of fraud in the filing of a joint return, the other spouse is not to be liable for the fraud penalty unless it is also established that he or she is also guilty of fraud. This potential relief from the fraud penalty applies even though the spouse in question may be jointly liable for the underpayment in tax due. This relief would apply, for example, where the underpayment resulted from fraudulent deductions (rather than on omission from gross income)—an example of a situation in which no relief is provided the spouse for the tax liability as such.

If a spouse is to be subject to the 50-percent fraud penalty as a result of the filing of a joint return, the Government must establish that some part of the underpayment is due to the fraud of that spouse in accordance with the burden of proof requirements imposed upon it by existing law. Thus, if the husband is convicted of the crime of tax evasion, and consequently collaterally estopped from denying that the joint return that he filed with his wife is false and fraudulent, the Government still must show that the wife is also guilty of fraud if it seeks to make her liable for the 50-percent fraud penalty.

The bill does not alter the rules with respect to the statute of limitations. If the Government establishes that an omission of gross income from a joint return is due to the fraud of one spouse, the tax liability due as a result of the underpayment may be assessed at any time. The other spouse may be held liable for that underpayment unless he or she is eligible for relief from such liability under the first provision of the bill. However, the other spouse is not, in any event, to be liable for the 50-percent fraud penalty asserted as a result of the underpayment unless the Government establishes that some part of that underpayment is due to the fraud of that spouse.

The amendments made by this bill are to apply to all taxable years to which the Internal Revenue Code of 1954 applies and corresponding provisions are to be deemed included in the Internal Revenue Code of 1939 and are to apply to all taxable years to which that code applies. The bill, of course, does not open a year which has been closed by the statute of limitations, *res judicata*, or otherwise.

#### IV. CHANGES IN EXISTING LAW

In compliance with subsection (4) of rule XXIX of the Standing Rules of the Senate, changes in existing law made by the bill, as reported, are shown as follows (existing law proposed to be omitted is enclosed in black brackets, new matter is printed in *italic*, existing law in which no change is proposed is shown in roman) :

##### SECTIONS 6013 AND 6653 OF THE INTERNAL REVENUE CODE OF 1954

#### SEC. 6013. JOINT RETURNS OF INCOME TAX BY HUSBAND AND WIFE.

(a) **JOINT RETURNS.**—A husband and wife may make a single return jointly of income taxes under subtitle A, even though one of the spouses has neither gross income nor deductions, except as provided below :

(1) no joint return shall be made if either the husband or wife at any time during the taxable year is a nonresident alien ;

(2) no joint return shall be made if the husband and wife have different taxable years; except that if such taxable years begin on the same day and end on different days because of the death of either or both, then the joint return may be made with respect to the taxable year of each. The above exception shall not apply if the surviving spouse remarries before the close of his taxable year, nor if the taxable year of either spouse is a fractional part of a year under section 443 (a) (1) ;

(3) in the case of death of one spouse or both spouses the joint return with respect to the decedent may be made only by his executor or administrator; except that in the case of the death of one spouse the joint return may be made by the surviving spouse with respect to both himself and the decedent if **no return** for the taxable year has been made by the decedent, no executor or administrator has been appointed, and no executor or administrator is appointed before the last day prescribed by law for filing the return of the surviving spouse. If an executor or administrator of the decedent is appointed after the making of the joint return by the surviving spouse, the executor or administrator may disaffirm such joint return by making, within 1 year after the last day prescribed by law for filing the return of the surviving spouse, a separate return for the taxable year of the decedent with respect to which the joint return was made, in which case the return made by the survivor shall constitute his separate return.

(b) **JOINT RETURN AFTER FILING SEPARATE RETURN.**—

(1) **IN GENERAL.**—Except as provided in paragraph (2), if an individual has filed a separate return for a taxable year for which a joint return could have been made by him and his spouse under subsection (a) and the time prescribed by law for filing the return for such taxable year has expired, such individual and his spouse may nevertheless make a joint return for such taxable year. A joint return filed by the husband and wife under this subsection shall constitute the return of the husband and wife for

such taxable year, and all payments, credits, refunds, or other repayments made or allowed with respect to the separate return of either spouse for such taxable year shall be taken into account in determining the extent to which the tax based upon the joint return has been paid. If a joint return is made under this subsection, any election (other than the election to file a separate return) made by either spouse in his separate return for such taxable year with respect to the treatment of any income, deduction, or credit of such spouse shall not be changed in the making of the joint return where such election would have been irrevocable if the joint return had not been made. If a joint return is made under this subsection after the death of either spouse, such return with respect to the decedent can be made only by his executor or administrator.

(2) LIMITATIONS FOR MAKING OF ELECTION.—The election provided for in paragraph (1) may not be made—

(A) unless there is paid in full at or before the time of the filing of the joint return the amount shown as tax upon such joint return; or

(B) after the expiration of 3 years from the last date prescribed by law for filing the return for such taxable year (determined without regard to any extension of time granted to either spouse); or

(C) after there has been mailed to either spouse, with respect to such taxable year, a notice of deficiency under section 6212, if the spouse, as to such notice, files a petition with the Tax Court of the United States within the time prescribed in section 6213; or

(D) after either spouse has commenced a suit in any court for the recovery of any part of the tax for such taxable year; or

(E) after either spouse has entered into a closing agreement under section 7121 with respect to such taxable year, or after any civil or criminal case arising against either spouse with respect to such taxable year has been compromised under section 7122.

(3) WHEN RETURN DEEMED FILED.—

(A) ASSESSMENT AND COLLECTION.—For purposes of section 6501 (relating to periods of limitations on assessment and collection), and for purposes of section 6651 (relating to delinquent returns), a joint return made under this subsection shall be deemed to have been filed—

(i) Where both spouses filed separate returns prior to making the joint return—on the date the last separate return was filed (but not earlier than the last date prescribed by law for filing the return of either spouse);

(ii) Where only one spouse filed a separate return prior to the making of the joint return, and the other spouse had less than \$625 of gross income (\$1,250 in case such spouse was 65 or over) for such taxable year—on the date of the filing of such separate return (but not earlier than the last date prescribed by law for the filing of such separate return); or

(iii) Where only one spouse filed a separate return prior to the making of the joint return, and the other spouse had gross income of \$625 or more (\$1,250 in case such spouse was 65 or over) for such taxable year—on the date of the filing of such joint return.

(B) CREDIT OR REFUND.—For purposes of section 6511, a joint return made under this subsection shall be deemed to have been filed on the last date prescribed by law for filing the return for such taxable year (determined without regard to any extension of time granted to either spouse).

(4) ADDITIONAL TIME FOR ASSESSMENT.—If a joint return is made under this subsection, the periods of limitations provided in sections 6501 and 6502 on the making of assessments and the beginning of levy or a proceeding in court for collection shall with respect to such return include one year immediately after the date of the filing of such joint return (computed without regard to the provisions of paragraph (3)).

(5) ADDITIONS TO THE TAX AND PENALTIES.—

(A) ADDITIONS TO THE TAX.—Where the amount shown as the tax by the husband and wife on a joint return made under this subsection exceeds the aggregate of the amounts shown as the tax upon the separate return of each spouse—

(i) NEGLIGENCE.—If any part of such excess is attributable to negligence or intentional disregard of rules and regulations (but without intent to defraud) at the time of the making of such separate return, then 5 percent of the total amount of such excess shall be added to the tax;

(ii) FRAUD.—If any part of such excess is attributable to fraud with intent to evade tax at the time of the making of such separate return, then 50 percent of the total amount of such excess shall be added to the tax.

(B) CRIMINAL PENALTY.—For purposes of section 7206(1) and (2) and section 7207 (relating to criminal penalties in the case of fraudulent returns) the term “return” includes a separate return filed by a spouse with respect to a taxable year for which a joint return is made under this subsection after the filing of such separate return.

(c) TREATMENT OF JOINT RETURN AFTER DEATH OF EITHER SPOUSE.—For purposes of sections 21, 443, and 7851(a)(1)(A), where the husband and wife have different taxable years because of the death of either spouse, the joint return shall be treated as if the taxable years of both spouses ended on the date of the closing of the surviving spouse's taxable year.

(d) DEFINITION.—For purposes of this section—

(1) the status as husband and wife of two individuals having taxable years beginning on the same day shall be determined—

(A) if both have the same taxable year—as of the close of such year; and

(B) if one dies before the close of the taxable year of the other—as of the time of such death; and

(2) an individual who is legally separated from his spouse

under a decree of divorce or of separate maintenance shall not be considered as married; and

(3) 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.

(e) *SPOUSE RELIEVED OF LIABILITY IN CERTAIN CASES.*—

(1) *IN GENERAL.*—Under regulations prescribed by the Secretary or his delegate, if—

(A) a joint return has been made under this section for a taxable year and on each 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.

(2) *SPECIAL RULES.*—For purposes of paragraph (1)—

(A) 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, and

(B) the amount omitted from gross income shall be determined in the manner provided by section 6501(e)(1)(A).

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**SEC. 6653. FAILURE TO PAY TAX.**

(a) *NEGLIGENCE OR INTENTIONAL DISREGARD OF RULES AND REGULATIONS WITH RESPECT TO INCOME OR GIFT TAXES.*—If any part of any underpayment (as defined in subsection (c)(1) of any tax imposed by subtitle A or by chapter 12 of subtitle B (relating to income taxes and gift taxes) is due to negligence or intentional disregard of rules and regulations (but without intent to defraud), there shall be added to the tax an amount equal to 5 percent of the underpayment.

(b) *FRAUD.*—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 income taxes and gift taxes, this amount shall be in lieu of any amount determined under subsection (a). 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.

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