Ketchum v. Commissioner, 77 T. C. 1204 (1981)

Disclosure on a tax return of income from a subchapter S corporation precludes innocent spouse relief even if the disclosed amount is incorrect.

Summary

In Ketchum v. Commissioner, Susan Ketchum sought innocent spouse relief from a tax deficiency resulting from her husband's subchapter S corporation, T. B. Ketchum & Son, Inc. , which had reported a loss. The IRS disallowed the loss and increased the couple's taxable income. The Tax Court held that Susan did not qualify for innocent spouse relief under IRC Section 6013(e) because the income in question was disclosed on their joint return, referencing the subchapter S corporation's return. This ruling emphasizes that disclosure of income, even if incorrectly reported, prevents relief under the innocent spouse rule.

Facts

Susan and Thomas Ketchum filed a joint federal income tax return for 1974, reporting a loss from T. B. Ketchum & Son, Inc. , a subchapter S corporation owned by Thomas. The corporation's return showed a loss of $49,094. The IRS disallowed $74,076. 74 of the corporation's deductions, resulting in an increase in taxable income for the Ketchums by $24,982. 74. Susan, separated from Thomas and not involved in his business, sought innocent spouse relief, claiming she had no knowledge of the incorrect loss.

Procedural History

The IRS determined a deficiency in the Ketchums' 1974 federal income tax. Susan Ketchum petitioned the U. S. Tax Court for relief as an innocent spouse under IRC Section 6013(e). The Tax Court ruled against Susan, holding that the income was disclosed on their joint return, thus precluding innocent spouse relief.

Issue(s)

1. Whether an understatement of income from a subchapter S corporation, disclosed on a joint return, qualifies as an "omission from gross income" under IRC Section 6013(e)(2)(B).

Holding

1. No, because the income was disclosed on the joint return, referencing the subchapter S corporation's return, and thus did not constitute an "omission from gross income" under IRC Section 6013(e)(2)(B).

Court's Reasoning

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The court reasoned that IRC Section 6013(e)(2)(B) explicitly refers to Section 6501(e)(1)(A) for determining omissions from gross income. Under Section 6501(e)(1)(A)(ii), an amount is not considered omitted if it is disclosed in the return or an attached statement in a manner adequate to apprise the IRS of its nature and amount. The court found that the Ketchums' joint return disclosed the income from the subchapter S corporation, including its employer identification number and the reported loss, which was sufficient disclosure. The court relied on precedent, such as Roschuni v. Commissioner, which held that disclosure on a subchapter S return, referenced in the individual return, precludes finding an omission. The court also noted the legislative history and the intent to apply the same disclosure standard to both the innocent spouse rule and the statute of limitations, leading to the conclusion that Susan Ketchum did not qualify for innocent spouse relief.

Practical Implications

This decision impacts how attorneys should advise clients on the innocent spouse rule, particularly when dealing with subchapter S corporations. It clarifies that merely disclosing income on a joint return, even if the amount is incorrect, prevents innocent spouse relief. Practitioners must ensure clients understand the importance of reviewing and understanding all aspects of their joint returns, especially income from business entities. The ruling also underscores the need for legislative reform of the innocent spouse provisions to address perceived inequities, as noted by the court's sympathy for Susan's situation but its inability to grant relief under existing law. Subsequent cases have followed this precedent, reinforcing the strict disclosure standard for innocent spouse relief.

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