Sivils v. Commissioner, 86 T. C. 79, 1986 U. S. Tax Ct. LEXIS 161, 86 T. C. No. 5 (T. C. 1986)

An innocent spouse cannot exclude fraudulently omitted income from base period years when using income averaging to calculate current tax liability.

Summary

In Sivils v. Commissioner, Georgia Sivils sought to exclude her husband's fraudulently omitted income from their base period years (1973-1976) when calculating their 1977 tax liability using income averaging. The Tax Court held that while Georgia qualified as an innocent spouse for the base years, she could not exclude the omitted income for income averaging purposes. Additionally, she was not entitled to innocent spouse relief for the 1977 deficiency because there were no grossly erroneous items on the 1977 return. The decision underscores that the innocent spouse provision does not alter the computation of tax under income averaging, requiring the use of correct taxable income for each base period year.

Facts

Georgia Sivils and her husband, Glen, filed joint tax returns from 1973 to 1977. Glen fraudulently omitted income from illegal activities on their returns for 1973-1976, of which Georgia was unaware. They divorced in 1979. For 1977, they reported all income but failed to classify Glen's commissions as self-employment income, resulting in a deficiency. Georgia sought to use income averaging for 1977, excluding Glen's fraudulently omitted income from the base period years.

Procedural History

The Commissioner determined deficiencies and additions to tax for 1973-1977. Georgia contested the 1977 deficiency, seeking innocent spouse relief and the exclusion of omitted income for income averaging. The case was heard by the United States Tax Court, which ruled against Georgia on both issues.

Issue(s)

1. Whether Georgia Sivils is entitled to innocent spouse relief under section 6013(e) for the 1977 tax deficiency.
2. Whether Georgia can exclude her husband's fraudulently omitted income from the base period years when using income averaging to calculate her 1977 tax liability.

Holding

1. No, because the 1977 return did not contain any grossly erroneous items as defined by section 6013(e)(2).
2. No, because section 6013(e) does not affect the computation of tax under the income averaging provisions, requiring the use of correct taxable income for each

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base period year.

Court’s Reasoning

The court applied the innocent spouse relief provisions of section 6013(e) to determine that Georgia qualified as an innocent spouse for 1973-1976, relieving her of liability for those years. However, for 1977, the court found no grossly erroneous items on the return, as all income was reported, though mischaracterized, thus denying relief. On the income averaging issue, the court emphasized that the method requires using the correct taxable income for each base period year, unaffected by section 6013(e). The court cited Unser, reinforcing that income averaging does not involve recomputation of prior years’ taxes but uses their correct income to calculate current tax. The court concluded that including Glen’s omitted income in the base years did not impair Georgia’s relief from liability for those years’ deficiencies.

Practical Implications

This decision clarifies that innocent spouse relief does not extend to altering income used in income averaging calculations. Practitioners should advise clients that while they may be relieved of liability for deficiencies due to a spouse’s fraud, they cannot exclude that income when using income averaging. This ruling impacts how attorneys approach innocent spouse claims, emphasizing the need to carefully analyze the specific tax year’s return for grossly erroneous items. The decision also informs future cases involving the interplay between innocent spouse relief and income averaging, guiding courts to maintain the integrity of the income averaging method by using accurate historical income data.

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