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Taxation: Liability of Spouses on Joint Returns

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LIABILITY OF SPOUSES ON JOINT RETURNS

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In a recent decision of the United States Tax Court, *Henry M. Rodney and Lucille H. Rodney,*[1] decided November 25, 1969, a majority of the Tax Court found that:

> The fact that a determination for a particular year against a husband who filed a joint return for tax year with his wife is not res judicata against the wife for the same year is the underlying basis of our holding in Nadine I. Davenport, 48 TC 921 (1967). The inescapable conclusion from these cases and others of similar import is that a wife who files a joint return with her husband is not a party privy to her husband in litigation before this Court.[2]

The most unusual aspect of this case is that six of the judges dissented from this holding. It is surprising that there could be so much doubt about the decision, since both precedent and fairness seem to justify it.

The purpose of this article is to demonstrate that the conclusion of the United States Tax Court is a correct application of the legal principles underlying the doctrines of res judicata and collateral estoppel in tax cases.

The problem is illustrated by the following example, which is a simplified statement of the facts in *Rodney*. Assume that for the year 1964 a husband and wife file a joint federal income tax return prior to April 15, 1965. Thereafter, the Internal Revenue Service makes an examination of the return and discovers a deficiency, determining that the income from a certain transaction was not properly reported, or that a loss should be disallowed, or that a deduction taken should not be granted. For one reason or another, one of the spouses does not desire to contest the deficiency at that time and thus does not respond to the statutory notice of deficiency (90-day letter). Instead, only one spouse, for example the husband, contests the matter in the United States Tax Court, and after a final judgment is entered against him, the Internal Revenue Service is unable to collect the judgment. In the interim, the Internal Revenue Service proceeds against the wife, who did not contest the deficiency, by making an assessment against her.

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[1] 53 T.C. 287 (1969).

[2] *Id.* at 307.

She pays the tax in question. Thereafter, the wife files a claim for refund of the tax paid on the ground that the determination of the deficiency was improper. The claim is disallowed, and the wife files suit in the United States District Court for refund.

In the course of the proceeding in the District Court, the Commissioner pleads that the plaintiff is barred either by res judicata or by collateral estoppel from asserting the right to the refund because of the prior judgment in the Tax Court against the husband. Should the plaintiff be barred from contesting the matter because of the Tax Court's prior decision? In *Rodney* this question was especially important because if the wife were to be given a new and separate trial, the statute of limitations would intervene.

The Internal Revenue Code of 1954 provides[3] that a husband and wife may, with certain exceptions, file a joint return even though one of the spouses does not have gross income or deductions. Under the Internal Revenue Code, if a joint return is filed, the tax is computed on the aggregate income, and the liability with respect to the tax "shall be joint and several."[4]

Under Revenue Ruling 56-92,[5] it is the position of the Internal Revenue Service that although a joint return is to be treated as the return of a single unit for tax computation purposes, nevertheless the liability of each spouse is joint and several. Applying this logic, the IRS has stated that:

> . . . in the event of an overpayment of tax as returned and paid by husband and wife pursuant to their joint and several liability, both the husband and wife, jointly and severally, represent the persons who made the overpayment within the meaning of Section 6402, . . . and therefore the amount thereof may be credited upon the *separate* tax liability of either the husband or wife for a prior year. (emphasis added)

It is believed that the above ruling is correct, because, although there is a single taxable base (the net taxable income) shown on the return to which the tax is applied, the husband and the wife are separate taxpayers. Thus, a determination against one spouse should not bar the other from having his day in court. The theory is that even though the husband and wife sign a joint return, they are not in legal *privity* and thus, as separate taxpayers, cannot be barred by either the doctrine of res judicata or that of collateral estoppel from contesting liability, unless they choose to do so in a joint contest.

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[3] INT. REV. CODE of 1954, § 6013(a).
[4] INT. REV. CODE of 1954, § 6013(d)(3).
[5] 1956-1 CUM. BULL. 364.

Holdings of the Tax Court, the Supreme Court of the United States, and the Fifth Circuit Court of Appeals in *Dolan,*[6] *Mitchell,*[7] *Sunnen v. Commissioner,*[8] *Moore v. U.S.,*[9] and other cases establish the basis for this position.

In *Dolan,* the Tax Court specifically held that a husband and wife, filing joint returns, are separate taxpayers. The court stated that:

> The case law also supports treating as separate "taxpayers" a husband and wife who have filed a joint return. In what appears to be the only case in which the single entity theory was expressly ruled upon, the court held that husband and wife who filed a joint return were separate taxpayers, so that an assessment entered pursuant to a notice of deficiency sent to the husband was ineffective as to the wife. . . . This Court will accept separate petitions from the parties to a joint return, even though section 6213(a) and section 272(a)(1) of the 1939 Code provided that "the taxpayer" may petition for redetermination of a deficiency. . . .
>
> Since John was a separate "taxpayer" within section 6213 (d), it follows that he had an absolute right at any time to waive the restrictions on assessment and collection contained in Section 6213(a).[10] (citations omitted)

In *Dolan,* Judge Dawson in his concurring opinion expanded on the theory with reference to the bankruptcy situation in the following language:

> First even though a husband and wife may file a joint return, they remain separate and distinct taxpayers .... The essential characteristic of joint and several liability is that a creditor may, *at his option,* sue each party to such liability separately or all parties together.... (Emphasis added)
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> ... Before a deficiency notice can be sent, the husband alone is placed in bankruptcy. If it is concluded that the husband is a separate taxpayer for the purpose of Section 6871(a), the Commissioner is permitted to make an immediate assessment against the husband, and the obvious purpose of the section is fulfilled. ... If, however, it is concluded that the filing of a joint return creates not two separate taxpayers, but only one, the Commissioner cannot avail himself of Section 6871, a result which is attributable to the fact that the taxpayer entity, consisting of husband and wife, is not itself bankrupt. It is evident that the adoption of the latter conclusion would not only place an unnecessary limiation on Section 6871, but would seriously hinder the purpose for which the section was enacted. . . .[11] (citation omitted).

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[6] 44 T.C. 420 (1965).
[7] 51 T.C. 641 (1969).
[8] 333 U.S. 591 (1948).
[9] 360 F.2d 353 (1965).
[10] 44 T.C. 420 at 428 (1965).
[11] *Id.* at 436 (1965).

The position in *Dolan* was also adopted in *Anne Goyne Mitchell,*[12] which held that a prior assessment of income tax against a wife and husband in a community property state was invalid and void as to the wife, who had not consented to the assessment. The court reasoned:

> The fact that the assessment may have been valid against Emmett is of no consequence in the instant case, when Anne neither consented to the execution of form 870 nor authorized Emmett to act on her behalf.[13]

It thus seems reasonably clear from the preceding discussion that the husband and wife are different taxpayers, even though their liability is joint and several for each year in which a joint return is filed. Having established that there are two individual taxpayers, it is necessary to examine the application of the doctrine of collateral estoppel to joint obligations of this type:

> The rule provides that where a court of competent jurisdiction has entered a final judgment on the merits of a cause of action, *the parties to the suit* and their *privies* are thereafter bound "not only as to every matter which was offered and received to sustain or defeat the claim or demand, but as to any other admissable matter which might have been offered for the purpose"....[14]
>
> These same concepts are applicable in the federal income tax field. Collateral estoppel operates, in other words, to relieve the Government and *the taxpayer* of redundant litigation of the identical question of the statute's application to the *taxpayer's status*....[15] (Emphasis added).

In the above statement of the law the italicized words indicate the parties to whom the doctrine can be applied. These apparently include only the parties to the suit—the taxpayers—and their privies. It is submitted that under the doctrine of *Dolan* and the previously described Revenue Ruling 56-92, not only are the husband and wife different taxpayers, but the condition of being husband and wife and of having signed a joint return for a particular year does not put them in privity with each other.

By way of analogy, the general rule pertaining to collection of judgments against one spouse from the property of the other treats husbands and wives as individuals. It has been stated that the "interest of the husband in the realty of his wife cannot be affected by a decree against his wife when she has not been joined in the suit"[16] and that "the wife must be made a party if relief is being sought out of her separate estate."[17]

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[12] 51 T.C. 641 (1969).
[13] *Id.* at 650.
[14] 333 U.S. 591 at 597 (1948).
[15] *Id.* at 598.
[16] 41 AM. JUR. 2d *Husband and Wife,* § 541 (1968); see: Watts v. Waddle, 10 U.S. 164 (1832).
[17] *Id.; See also* Feitner v. Lewis, 119 N.Y. 131, 23 N.E. 296 (1890).

Reference is made to the discussion of this problem in *American Jurisprudence,*[18] which notes that the minimum identification with the controversy where the judgment is rendered must be that of privity. Under this rule, a judgment is conclusive of the issues involved in a controversy as between the parties and the persons in privity with them. Privity is described as denoting "mutual or successive relationship to the same right of property."[19] As to joint and several obligors, it states that:

> There is authority that in the absence of a satisfaction, a judgment rendered against one or more persons severally liable *is not* a bar to an action against the remaining obligors, who are *not* considered as in privity with the judgment debtors."[20] (emphasis added).

It is further noted that, in the absence of a satisfaction, a judgment against one of several joint obligors will not bar an action against the others.[21] This rule can be applied in a variety of situations:

> Thus a judgment in an action by one spouse for personal injuries is not res judicata and constitutes no estoppel with respect to a suit by the other for personal injuries, where the injuries of each occurred in the same accident and were the result of the same wrongful act or negligence of the defendant. . .[22]

As between husband and wife, it is stated that there is no legal privity such as to cause a judgment for one spouse to preclude the other, where the action involves their separate property, rights or interests.[23]

Applying the preceding general rules, and bearing in mind the decision in *Dolan,* the following cases are noted in the tax field. *Moore v. U.S.*[24] specifically holds that where a husband and wife file a joint return and thereafter the husband alone is a party to a criminal proceeding in which he is convicted of willfully attempting to evade and defeat payment of income tax for the year involved, the wife *is not collaterally estopped* thereby from litigating the question of the *husband's fraud* in a subsequent civil suit involving the application of a fraud penalty. The court stated:

> Due process requires that she be accorded her day in court on the issue of her husband's fraud . . . *nor should his conviction prejudice her position in the civil proceeding.* (emphasis added)[25]

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[18] 46 AM. JUR. 2d *Judgments,* § 531-534 (1968).
[19] *Id.,* § 532.
[20] *Id.,* § 542; *see*: Stacy v. Thrasher, 16 U.S. 596 (1847).
[21] *Id.,* § 545.
[22] 41 AM JUR. 2d., *Husband and wife,* § 459; Lindsay v. Oregon Short Line P. Co., 13 Idaho 477.
[23] 50 C.J.S. Judgments, § 798 (1947).
[24] 360 F.2d 353 *cert. denied,* 385 U.S. 1001 (1965).
[25] *Id.* at 358.

Similar results have been reached in other cases. In *Seligman v. Comm'r,*[26] it was held that where a divorced wife contested the inclusion of certain amounts of income as alimony payments paid by a former husband under a divorce decree, a prior judgment of the Tax Court holding that the husband was entitled to deduct the payments in question as alimony was *not* res judicata as to the treatment of the same payments as income to the ex-wife, since she was *not a party* to the proceeding in the Tax Court involving the husband.

In *U.S. v. Wilson,*[27] where the Tax Court had determined in a proceeding involving a son and member of a claimed family partnership that the father, Asbury Wilson, was a valid member of a family partnership and therefore had reduced the deficiency proposed against the son, the holding in the proceeding against the son was not res judicata on the issue of whether the father was a member of the partnership in a separate proceeding against the father in the District Court.

The *Seligman* case was followed by the Tax Court in *Estate of Haldeman,*[28] in which the court stated:

> Nor is our prior holding binding on decedent under the doctrine of res judicata since *she was not a party to the prior proceeding involving her husband.* (Emphasis added)[29]

In *Dorothy Douglas,*[30] where the parties filed a joint return as husband and wife, the government sought to rely on a stipulation in the husband's case to the effect that the husband was liable for a fraud penalty for the year 1947, as proof that the wife was liable for the penalty in her case before the Tax Court for the same year. The Tax Court rejected this as proof of the wife's liability for the fraud penalties for the year 1947, even though a joint return was filed.

Thus, it is clear that the tax cases follow, as they must, the principles set out above in *Sunnen v. Commissioner.*

Judge Tannenwald of the Tax Court, in his concurring opinion in the *Rodney* case, expounds the same theory relating to joint and several obligations when he notes that

> [t]he obligee of a joint and several obigation may proceed separately against each obligator. A judgment against one obligator is not a basis for collateral estoppel against another; *each joint and several obligator is entitled to be heard on the merits of the claim asserted against him.* (Emphasis added; citations omitted)[31]

The correct position appears to be, as noted by the Court of Appeals for the Fifth Circuit in *Moore v. U.S.*[32] that:

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[26] 207 F.2d 489 (1953).
[27] 117 F. Supp. 957 (1953).
[28] 15 T.C.M. 900.
[29] *Id.*
[30] 27 T.C. 306 (1956).
[31] 53. T.C. 287 at 322 (1969).
[32] 360 F.2d 353 (1965).

> Due process requires that she be accorded her day in court on the issue of her husband's fraud ... nor should his conviction prejudice her position in the civil proceeding.[33]

The doctrine should not be limited to fraud penalties.[34] The fact that one spouse has had his day in court on the issue of tax liability should not preclude the other spouse from a separate hearing. Anything other than a separate trial would deny the spouse who has not contested the case the requisites of due process.

There are those who argue that this conclusion should not be reached, on the ground that, since the issue of liability is essentially identical in the case of the husband and wife and there is only a single proceeding involved, economy and convenience require application of res judicata to end litigation.

One authority contends that the doctrine of privity should be extended to persons whose interests are protected, regardless of the relationship between them and the party in the prior action.[35]

While economy may be a desirable end, it is submitted that with the present state of the law where the liability of the husband and wife on a joint return is joint and several, the issue should not be treated differently in this type tax case than in any other case involving joint and several liability. The Supreme Court of the United States long ago noted in *Stacy v. Thrasher,* relating to joint and several obligors: "Their common liability to pay the same debt creates no privity between them either in law or in estate."[36]

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[33] *Id.* at 358.
[34] *See*: 48 T.C. 921 (1967); 117 F. Supp. 957 (1953); 207 F.2d 489 (1953); 360 F.2d 353 (1965); 44 T.C. 420 (1965); 51 T.C. 641 (1968).
[35] 50 IOWA L. REV. 26, 45 (1945).
[36] Stacy v. Thrasher, 16 U.S. 596 (1847).