

2.02 Duty of Inquiry

When a taxpayer seeking innocent spouse relief signs a return without reading it, the case may present a difficult issue involving knowledge. A court may find that the failure to review the return, often referred to in the cases as “turning a blind eye,” constitutes constructive knowledge. Price v. Commissioner, 887 F.2d. 959, 965 (9th Cir. 1989). Cases hold that the innocent spouse provisions are intended to protect the innocent, not the intentionally ignorant. See Cohen v. Commissioner, T.C. Memo. 1987-537. Representing a client who did not review the return requires an understanding of a taxpayer’s “duty of inquiry” and how it affects your client’s case.

Duty of Inquiry

Each taxpayer has a duty to correctly report his or her tax liabilities and this duty includes a “duty of inquiry”. See Price v. Commissioner, 887 F.2d. 959, 965 (9th Cir. 1989); Butler v. Commissioner, 114 T.C. 276, 284 (2000). A taxpayer cannot simply delegate the duty to file returns to his or her spouse and then claim innocent spouse relief. Hayman v. Commissioner, 992 F.2d. 1256, 1262 (2nd Cir. 1993), *affg.* T.C. Memo. 1992-228. In both omitted income and erroneous deduction cases, a taxpayer, who signs a return without reviewing it, may be charged with constructive knowledge for failing to inquire into the contents of the return. Hayman v. Commissioner, *supra*. Constructive knowledge can result in the client losing the knowledge element under section 6015(b) and the knowledge factor in section 6015(f) cases.

Because the IRS must prove actual knowledge, a failure to review the return would not automatically cause the loss of knowledge element in a section 6015(c) case. Nevertheless, the failure to review the return could present formidable problems in some section 6015(c) cases. If the omission of an income item would not have alerted the spouse to a problem, a court might rule that failing to review the return did not constitute actual knowledge. Conversely, if the income item was so material in relation to the income reported that a reasonable person would have acquired knowledge of the

income item from reviewing the return, a court might rule that a taxpayer, who failed to review the document, failed to fulfill their duty of inquiry. In cases involving deductions, the court will likely attribute knowledge of the deductions claimed to the requesting spouse who simply turned a blind eye when he or she was asked to sign the return. See the discussion below “Meeting the Duty of Inquiry Issue”.

The issue is whether a reasonably prudent taxpayer under the circumstances of the spouse at the signing of the return could be expected to know that the tax liability was erroneous or that further investigation was warranted. Juell v. Commissioner, T.C. Memo. 2007-219. The duty of inquiry can be satisfied if the requesting spouse asks the nonrequesting spouse a question about the return and the nonrequesting spouse assures her that it is correct. See Juell above and cases therein.

The courts employ a subjective test: whether a reasonably prudent taxpayer in the requesting spouse’s position would question the deduction or his or her tax liability in general. Price v. Commissioner, 887 F.2d. 959 (9th Cir. 1989). If there are sufficient facts to put the requesting spouse on notice as to the possibility of an understatement, the requesting spouse has a duty to inquire about the matter.

In applying the subjective test to a given taxpayer, the courts will consider:

- a) the taxpayer’s level of education;
 - b) the taxpayer’s involvement in the family’s business and financial affairs;
 - c) the evasiveness or deceit of the taxpayer’s spouse as to the couple’s finances;
- and
- d) unusual or lavish expenditures inconsistent with the couple’s level of income or standard of living.

Failure to Review the Return

It is not unusual for a client to inform me that they did not read the return when they signed it. This statement carries significant legal implications. In some marriages, by agreement, one spouse may take care of financial matters. In other marriages one spouse may dominate and control the financial decisions by coercive methods. If the

client relies on their spouse to take care of the finances in the home, including return preparation, a court may treat the “reliance” as a failure to exercise their duty of inquiry. When the only evidence is that the taxpayer did not review the returns, courts have shown resistance to granting relief from joint and several liability. Price v. Commissioner, 887 F.2d. 959, 965 (9th Cir. 1989).

Meeting the Duty of Inquiry Issue

Many of our clients fill out the Form 8857 by themselves and truthfully indicate that they did not review the returns.¹ The problem is that our clients often do not adequately explain that at the time the return was signed 1) the nonrequesting spouse did not tolerate questions or disagreement; 2) the requesting spouse believed that the nonrequesting spouse would retaliate if she asked questions; or 3) the nonrequesting spouse demanded that the requesting spouse sign the return as prepared and did not permit any kind of review.² In the absence of a thorough explanation (and sometimes even if the taxpayer provides facts regarding threats and violence), the IRS may take the position that the requesting spouse had constructive knowledge and did not fulfill their duty of inquiry.

When a taxpayer indicates on the Form 8857 that they did not review the return and the IRS charges them with constructive knowledge, the representative should gather facts, if they exist, establishing that the requesting spouse could not reasonably review the return or ask questions due to a history of threats and violence or the possibility of retaliation. If the IRS resists the client’s explanation and denies relief, the only option may be to file a petition in the Tax Court under I.R.C. § 6015(e) for a review of the IRS determination. If the requesting spouse is credible, there is a good possibility that the Court will not agree with the IRS.

¹ On Form 8857, in Part IV, a taxpayer is required to answer the following question: “You did not review the returns before they were signed. Explain below.”

² In some cases, the nonrequesting spouse simply files the return electronically without allowing the requesting spouse to see it. In other cases, the nonrequesting spouse goes alone to the tax preparer and later demands that the requesting spouse sign the prepared return.