No. 02-59

In the Supreme Court of the United States

KATHRYN CHESHIRE, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

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QUESTION PRESENTED

Whether petitioner was entitled to innocent spouse relief under Section 6015(c) of the Internal Revenue Code, 26 U.S.C. 6015(c), when she had actual knowledge of the income that was not reported on the tax return.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 3a-25a) is reported at 282 F.3d 326. The opinion of the Tax Court (Pet. App. 26a-68a) is reported at 115 T.C. 183.

JURISDICTION

The judgment of the court of appeals was entered on February 8, 2002. The petition for rehearing was denied on April 9, 2002. Pet. App. 1a. The petition for a writ of certiorari was filed on July 5, 2002. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATUTE INVOLVED

Section 6015(c) of the Internal Revenue Code, 26 U.S.C. 6015(c), provides in relevant part:

> **(c) Procedures to limit liability for taxpayers no longer married or taxpayers legally separated or not living together.—**
>
> * * * * *
>
> **(3) Election**
>
> * * * * *
>
> **(C) Election not valid with respect to certain deficiencies.**—If the Secretary demonstrates that an individual making an election under this subsection had actual knowledge, at the time such individual signed the return, of any item giving rise to a deficiency (or portion thereof) which is not allocable to such individual under subsection (d), such election shall not apply to such deficiency (or portion). * * *

STATEMENT

1. Petitioner's husband retired from Southwestern Bell Telephone Company in 1992 and received retirement distributions totaling $229,924. Pet. App. 4a. He rolled over $42,183 into a qualified, nontaxable account and deposited $184,377 into the Cheshires' joint checking account, which earned interest of $1168 for 1992. *Id.* at 4a-5a. Petitioner knew of her husband's receipt of retirement distributions of $229,924 and of the interest of $1168. *Ibid.*

The Cheshires withdrew $99,425 from their bank account to pay off the mortgage on the family residence,

and they withdrew $20,189 to purchase a Ford Explorer. Mr. Cheshire also used some of the retirement proceeds to provide start-up capital for his new business, to satisfy certain loans, to pay family expenses, and to establish a college fund for the Cheshires' daughter. Petitioner knew of each of these expenditures. Pet. App. 5a.

The Cheshires filed a joint federal income tax return for 1992, which was prepared by Mr. Cheshire. On line 17a of their return, they reported receiving retirement distributions of $199,771.05.[1] They claimed, however, that only $56,150.12 of this amount was taxable. Pet. App. 5a.

Before signing the return, petitioner questioned Mr. Cheshire about the tax consequences of the distributions. He replied that John Mican, a certified public accountant, had advised him that retirement proceeds used to pay off a mortgage were nontaxable. Petitioner accepted this answer, and she made no further inquiries before signing the return. In fact, Mr. Cheshire had not consulted Mr. Mican, and retirement distributions that are not rolled over into a qualified account are taxable. Pet. App. 5a-6a.

After the Cheshires divorced, the Internal Revenue Service audited their joint return for 1992. The Service determined that Mr. Cheshire received taxable retirement distributions of $187,741 in that year—the difference between the total distributions ($229,924) and the rollover amount ($42,183)—and that the Cheshires had thus understated their taxable distributions by $131,591. The Service also determined that the

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[1] This amount corresponds to the amount of the lump sum distribution. It excludes several other retirement-related distributions. Pet. App. 5a n.2.

Cheshires had underreported the interest income earned on the retirement distributions by $717. Pet. App. 6a.

2. Petitioner commenced this action in the Tax Court. She did not challenge the calculation of the deficiencies owed on the joint return. Instead, she asserted entitlement to relief from the deficiency as an innocent spouse under Section 6015(b) and (c) of the Internal Revenue Code, 26 U.S.C. 6015(b) and (c). Those provisions were enacted as part of the Internal Revenue Service Restructuring and Reform Act of 1998, Pub. L. No. 105-206, § 3201(a), 112 Stat. 734. Section 6015(b), which applies to all joint filers, authorizes relief from liability for a tax understatement that is attributable to erroneous items of one spouse when the other spouse establishes that she did not know and had no reason to know of the understatement and that it is inequitable to hold her liable for it.[2] 26 U.S.C. 6015(b)(1)(C) & (D). Section 6015(c), which applies to taxpayers who filed a joint return but are no longer married, allows such a taxpayer to elect to limit her liability for unpaid taxes on the joint return to her separate liability amount. Relief under Section 6015(c) is unavailable, however, if the electing spouse "had actual knowledge, at the time such individual signed the return, of any item giving rise to a deficiency * * *." 26 U.S.C. 6015(c)(3)(C).

Petitioner contended in Tax Court that Section 6015(c)(3)(C) bars relief for spouses only if they had actual knowledge that an entry on the joint tax return is incorrect. The Commissioner argued, however, that,

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[2] Both the court of appeals and the Tax Court denied petitioner relief under Section 6015(b). Pet. App. 12a-18a, 40a-42a. Petitioner does not challenge that holding in this Court.

by its plain terms, Section 6015(c)(3)(C) bars relief for spouses that have knowledge of the income-producing "item," even if they lacked knowledge that the tax reporting of that transaction was incorrect. Pet. App. 19a.

In a reviewed opinion, the twelve-judge Tax Court majority rejected petitioner's argument (Pet. App. 42a-47a) because the statutory language does not support it (*id.* at 44a-45a):

> Section 6015(c)(3)(C) does not explicitly state or reasonably imply that relief is denied only where the electing spouse has actual knowledge that the item giving rise to the deficiency (or any portion thereof) is incorrectly reported on the return. As the Supreme Court has stated, "courts must presume that a legislature says in a statute what it means and means in a statute what it says there." *Connecticut Natl. Bank* v. *Germain*, 503 U.S. 249, 253-254 * * * . Were we to interpret section 6015(c)(3)(C) narrowly * * *, we would be redrafting the statute, something we may not do.

The majority held that the phrase "actual knowledge * * * of any item giving rise to a deficiency," contained in Section 6015(c)(3)(C), means "actual and clear awareness * * * of the omitted income." Pet. App. 44a. The court noted that ignorance of the tax law is generally not a defense to a deficiency and that the word "item" is used elsewhere in the Internal Revenue Code without reference to tax consequences. *Id.* at 46a-47a. Since petitioner admitted that she had knowledge of the omitted income, she was not excused from her liability for the deficiency under Section 6015(c). *Id.* at 48a.

Four members of the Tax Court dissented. They would have adopted petitioner's interpretation of

Section 6015(c)(3)(C) and have accorded her relief under Section 6015(c). Pet. App. 53a- 68a.

3. The court of appeals affirmed. Pet. App. 3a-25a. Like the Tax Court, it observed that the term "item" is used elsewhere in Section 6015 and in other Sections of the Internal Revenue Code to refer to the income itself, without reference to tax consequences. *Id.* at 19a-20a. The court held that "the plain meaning of Section 6015(c)(3)(C)" is thus that a spouse with actual knowledge of the income-producing transaction is not entitled to relief under Section 6015(c). Pet. App. 21a. "This reading of the plain meaning" is "compelling in light of the general principle that ignorance of the law is not a defense." *Ibid.* The court "declined[d] to allow inconclusive legislative history to affect [its] interpretation of the plain meaning of § 6015(c)(3)(C)." *Id.* at 22a.

ARGUMENT

The decision of the court of appeals is correct and does not conflict with any decision of this Court or any other court of appeals. Further review is therefore not warranted.

1. The only other appellate decision that addresses the question presented in this case is *Mitchell* v. *Commissioner*, 292 F.3d 800 (D.C. Cir. 2002). In that case, as here, the court held that the plain language of the statute requires the conclusion that Section 6015(c)(3) precludes relief whenever the spouse is aware of the "item" of income, regardless of whether she was aware of the erroneous treatment of that item on the joint return. 292 F.3d at 805. Petitioner concedes that this interpretation of the statute in *Mitchell* "is consistent with the Fifth Circuit's interpretation in the instant case." Pet. 1 n.1. There is thus no conflict among the circuits to warrant further review.

2. a. The court of appeals correctly interpreted the "plain language" of Section 6015(c)(3)(C). *Mitchell* v. *Commissioner*, 292 F.3d at 805. The tax relief that Section 6015(c) authorizes for separated and divorced spouses is unavailable if the electing spouse had "actual knowledge at the time such individual signed the return, of any item giving rise to a deficiency." 26 U.S.C. 6015(c)(3)(C). Congress could have made Section 6015(c) relief available if the electing spouse "had actual knowledge, that an item on a return is incorrect," as petitioner asserts was intended (Pet. 10-12). But it did not do so. And, it is well established that, in interpreting a statute, "courts must presume that a legislature says in a statute what it means and means in a statute what it says there." *Connecticut National Bank* v. *Germain*, 503 U.S. 249, 253-254 (1992). See also *United States* v. *Ron Pair Enterprises, Inc.*, 489 U.S. 235, 241-242 (1989).

The *Mitchell* court explained that the interpretation of Section 6015(c)(3)(C) advocated by petitioner in this case is "semantically awkward" and is "a strained interpretation of the sentence read as a whole." 292 F.3d at 805:

> [The argument] depends for its force on treating the entire phrase "any item giving rise to a deficiency" as the indivisible object of knowledge. The more natural reading of the sentence is that it refers to a person who has knowledge of an *item*, and that item gives rise to a deficiency without regard to whether the person who knows of the item knows of that consequence.

Examination of the use of the word "item" in other subsections of Section 6015 and elsewhere in the Internal Revenue Code provides additional support for

the conclusion that the prohibition on relief contained in Section 6015(c)(3)(C) does not depend on the electing spouse's knowledge of the incorrect tax reporting of an item. For example, Section 6015(d)(4) uses the phrase "an item of deduction or credit." As the court of appeals observed in this case, "[t]his use of the term 'item' suggests that the term refers to an actual item of income, deduction, or credit, rather than the incorrect [tax] reporting of such an item." Pet. App. 19a-20a. Similarly, Section 6015(b)(1)(B) refers to "an understatement of tax attributable to erroneous items of one individual filing the joint return." If, as petitioner asserts, the word "item" means "incorrect tax reporting of an item," then the reference to "erroneous items" in this Section is redundant. Pet. App. 19a.

Other Sections of the Internal Revenue Code also use the word "item" without reference to tax consequences. Section 61(a) defines "gross income" to include such "items" as compensation for services, interest, rents, royalties, dividends and thus uses the term "item" to mean an item of income. Section 6231(a)(3) defines the term "partnership item" as "any item required to be taken into account for the partnership's taxable year under any provision of subtitle A * * *." In each of these examples, as in the statute involved in this case, Congress used the word "item" to refer to an "item of income, deduction, or credit." See *Commissioner* v. *Lundy*, 516 U.S. 235, 250 (1996) ("identical words used in different parts of the same act are intended to have the same meaning"); *Gustafson* v. *Alloyd Co.*, 513 U.S. 561, 568, 570 (1994) (same); *Wisconsin Dep't of Revenue* v. *William Wrigley, Jr., Co.*, 505 U.S. 214, 225 (1992) (same).

b. Petitioner's assertion that "actual knowledge * * * of any item giving rise to a deficiency" means

actual knowledge of an incorrect tax reporting of that item also runs afoul of the rule that a taxpayer is presumed to know the law and that ignorance of the law is not a defense to a deficiency. See, *e.g.*, *Bokum* v. *Commissioner*, 992 F.2d 1132, 1135 (11th Cir. 1993); *Price* v. *Commissioner*, 887 F.2d 959, 964 (9th Cir. 1989); *Montana Power Co.* v. *United States*, 232 F.2d 541, 544 (3d Cir.), cert. denied, 352 U.S. 843 (1956). Courts have long relied on this principle in rejecting the argument that ignorance of the tax law is a basis for an innocent spouse defense. See *Hayman* v. *Commissioner*, 992 F.2d 1256, 1262 (2d Cir. 1993); *Bokum* v. *Commissioner*, 992 F.2d at 1135; *Price* v. *Commissioner*, 887 F.2d at 964; *Purcell* v. *Commissioner*, 826 F.2d 470, 473-474 (6th Cir. 1987), cert. denied, 485 U.S. 987 (1988); *Sanders* v. *United States*, 509 F.2d 162, 169 n.14 (5th Cir. 1975). See also *Mitchell* v. *Commissioner*, 292 F.3d at 803-805.

If ignorance of the law were a basis for the innocent spouse defense, spouses who signed the same joint tax return could be treated differently with respect to the same tax liability. For example, if the accountant had, in fact, told Mr. Cheshire that the retirement proceeds were nontaxable, Mr. Cheshire would still be liable for the tax deficiency because ignorance of the law is not a defense to a deficiency. Under petitioner's interpretation of Section 6015(c)(3)(C), however, she would not be liable for the deficiency. That differential treatment would conflict with the principle that the tax laws are to be interpreted and applied to "ensure as far as possible that similarly situated taxpayers pay the same tax." *Thor Power Tool Co.* v. *Commissioner*, 439 U.S. 522, 544 (1979). As the District of Columbia Circuit emphasized in the *Mitchell* case, "it is unlikely that Congress would have employed such subtle and ambiguous

phrasing to overrule the well-established principle that ignorance of tax law is not a defense to liability." *Mitchell* v. *Commissioner*, 292 F.3d at 805.

3. Although petitioner does not directly challenge the conclusion of the court of appeals that the meaning of Section 6015(c)(3)(C) is plain, she nevertheless attempts to rely on legislative history (Pet. 10-12) to support her position. It is well settled, however, that courts may "not resort to legislative history to cloud a statutory text that is clear." *Ratzlaf* v. *United States*, 510 U.S. 135, 147-148 (1994). "Where, as here, the statutory language is unambiguous, the inquiry ceases." *Barnhart* v. *Sigmon Coal Co.*, 122 S. Ct. 941, 944 (2002). See also *Hughes Aircraft Co.* v. *Jacobson*, 525 U.S. 432, 438 (1999); *United States* v. *Ron Pair Enterprises, Inc.*, 489 U.S. at 241.

In any event, the legislative history does not support petitioner's position. To the contrary, it contains an example of the statute's application that supports the conclusion of the court of appeals that the term "item" refers to any item of income that was, or should have been, reported on the return (H.R. Rep. No. 599, 105th Cong., 2d Sess. 253-254 (1998) (emphasis added)):

> For example a married couple files a joint return with wage income of $150,000 allocable to the wife and $30,000 of self employment income allocable to the husband. On examination, an additional $20,000 of the husband's self-employment income is discovered, resulting in a deficiency of $9,000. The IRS proves that the wife had actual knowledge of $5,000 of this additional self-employment income, but had no knowledge of the remaining $15,000. In this case, the husband would be liable for the full amount of the deficiency, since the item giving rise

> to the deficiency is fully allocable to him. In addition, *the wife would be liable for the amount that would have been calculated as the deficiency based on the $5,000 of unreported income of which she had actual knowledge*. The IRS would be allowed to collect that amount from either spouse, while the remainder of the deficiency could be collected from only the husband.

See also S. Rep. No. 174, 105th Cong., 2d Sess. 58 (1998).

4. Contrary to petitioner's contention (Pet. 12), the courts below did not import the "reason to know" standard of Section 6015(b) into Section 6015(c)(3)(C). The court of appeals emphasized that "a mere 'reason to know'" of the existence of an item of income "is not enough to preclude tax relief under § 6015(c)." Pet. App. 23a n.26. Similarly, the Tax Court pointed out that there must be an "actual and clear awareness (as opposed to reason to know) of the existence of an item" for the spouse to be barred from relief under Section 6015(c). *Id.* at 44a. The interpretation of Section 6015(c) adopted in this case thus "does not ignore [the] remedial nature" of this statute and does not "improperly substitut[e] the knowledge requirement from § 6015(b)(1)(C) * * * for the stricter knowledge requirement of § 6015(c)(3)(C)." Pet. App. 23a n.26. See also *Mitchell* v. *Commissioner*, 292 F.3d at 806.

5. The question presented in this case lacks recurring importance. Recent regulations incorporate the holding of the court of appeals in this case in providing that a spouse has actual knowledge of an item giving rise to a deficiency if she has "knowledge of an erroneous item that is allocable to the nonrequesting spouse." 26 C.F.R. 1.6015-3(c)(2)(i). See 67 Fed. Reg.

47,282, 47,289 (2002). In cases involving the failure to report income on a return, knowledge of the erroneous item is satisfied by "knowledge of the receipt of the income." 26 C.F.R. 1.6015- 3(c)(2)(i)(A). This regulation applies to cases arising under Section 6015(c) after July 18, 2002. 26 C.F.R. 1.6015-9. See 67 Fed. Reg. at 47,296.

Treasury Regulations are to be sustained unless they are unreasonable or plainly inconsistent with the statute. *National Muffler Dealers Ass'n* v. *United States*, 440 U.S. 472, 488 (1979); *United States* v. *Correll*, 389 U.S. 299, 306-307 (1967). As this Court has emphasized, courts are to defer to Treasury Regulations "which, 'if found to "implement the congressional mandate in some reasonable manner," must be upheld.'" *National Muffler Dealers Ass'n* v. *United States*, 440 U.S. at 476 (quoting *United States* v. *Cartwright*, 411 U.S. 546, 550 (1973) (quoting *United States* v. *Correll*, 389 U.S. at 307)). The decisions in *Mitchell* and in the present case reflect that the regulations issued by the Treasury under Section 6015(c) "implement the congressional mandate in [a] reasonable manner" and should therefore be controlling in future cases (*National Muffler Dealers Ass'n* v. *United States*, 440 U.S. at 476). There is thus no substantial continuing importance to the question addressed in this case.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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