

Innocent Spouse Relief Under IRC Section 6015

Navigating New Tax Rules to Avoid Liability for Divorced, Widowed or Married Clients

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Innocent Spouse Relief

The Overview

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Innocent Spouse Problem

- ▶ Joint Tax Liability
 - Husband and Wife
 - Joint Tax Return
 - Advantages
 - Each is 100% liable
- ▶ Requesting Spouse
 - The spouse requesting the relief
- ▶ Non-Requesting Spouse
 - The spouse who will be solely liable if Requesting Spouse is successful

Ethical Considerations

- ▶ **Potential Conflict of Interest**
 - Previously Represented one Spouse
 - Previously Represented both Spouse
 - Informed Consent and Waiver
- ▶ **Actual Conflict of Interest**
 - Previously Represented one Spouse
 - Previously Represented both Spouses
 - Representing Requesting Spouse
 - Representing Non-Requesting Spouse
- ▶ **Duty of Competence**
 - Not Raising Innocent Spouse Defenses
 - Malpractice issues for Attorneys and Preparers

Brief History

- ▶ Prior to 1971 no relief
- ▶ Innocent Relief under IRC §6013(e)
 - The “grossly erroneous item” requirement
 - 10% and 25% liability thresholds
- ▶ The IRS Restructuring and Reform Act of 1998
 - Made favorable changes to innocent spouse relief
 - Current statutes
- ▶ Rev. Proc. 2003-61 provided rules for requesting relief

Kinds of Spouse Relief

- ▶ Innocent Spouse under IRC §6015(b)
- ▶ Separation of Liability under IRC §6015(c)
- ▶ Equitable Relief under IRC §6015(f)
- ▶ Community Property Relief under IRC §66(c)

IRC §6015(b) Innocent Spouse Relief

- ▶ Understatement of tax
- ▶ The understatement is due to “erroneous items”
- ▶ Requesting spouse had no reason to know or did not know at the time he/she signed the return that an understatement existed
- ▶ Taking into account all the facts and circumstances, it would be inequitable to hold the individual liable for the deficiency.

IRC § 6015(c) Separation of Liability

- ▶ Applies to deficiencies only
- ▶ At the time of electing relief, the individuals are no longer married, or are legally separated, or lived apart for 12 months prior to electing relief.
- ▶ IRC §6015(d) Allocation of liabilities. Any item giving rise to an understatement is allocated between the spouses who filed the joint return in the same way the item should have been reported on separate returns.

IRC §6015(f) Equitable Relief

- ▶ Relief under 6015(b) and (c) is not available,
- ▶ Applies to understatements of tax *and* unpaid taxes
- ▶ It would be inequitable to hold the taxpayer liable
- ▶ IRS *may* relieve the taxpayer of liability for the unpaid tax

IRC § 66(c) Community Property Relief

- ▶ In Community Property States Spouses Filing Separate Returns Pick up 50% or each others items of income and deductions.
- ▶ Relief Available When:
 - No joint tax return filed
 - No community property income included in return
 - No actual or reasonable knowledge of item of community income, and
 - Inequitable to include the item of community income in gross income

Innocent Spouse Relief Under IRC Section 6015: Navigating New Tax Rules to Avoid Liability for Divorced, Widowed or Married Clients

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Procedures under 6015(f)

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- Rev. Proc. 2000-15
- Rev. Proc. 2003-61
- Notice 2012-8

Significant Changes in Notice 2012-8

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- Two-year rule eliminated
- Procedures apply to 66(c) cases
- Weighing of factors changed
- Hardship quantified
- Lack of hardship not weighed against relief
- Abuse or financial control can cancel out knowledge of understatement or nonpayment of tax
- Definition of abuse broadened
- Subsequent compliance with tax laws now a factor

Notice 2012-8, Threshold Factors

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- Joint return filed
- Relief is not available under (b) or (c)
- Relief is requested within
 - 10 year CSED
 - 6511 period if refund requested
- No assets were transferred between the spouses as part of a fraudulent scheme and fraudulent return not filed

Threshold Factors (cont'd)

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- Did not transfer disqualified assets [principal purpose of transfer is to avoid payment of tax] to the requesting spouse
- Tax liability attributable to the nonrequesting spouse
 - Partial relief possible
- Even if tax attributable to requesting spouse, relief
 - Only because of community property laws
 - Misappropriation of funds
 - Abuse
 - Fraud

Streamlined Determinations (sec. 4.02)

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Relief granted if:

- Divorced, legally separated, or lived apart for past 12 months
- Will suffer economic hardship if relief not granted
- Did not know and had no reason to know of understatement or that the nonrequesting spouse would not pay liability
 - Satisfied in cases of abuse or financial control

If don't qualify under 4.02, IRS weighs:

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- Marital status
- Economic hardship
- Knew or had reason to know about items that caused understatement or that the tax would not be paid at time of signing the return;
- Legal obligation to pay tax
- Significant benefit from the unpaid taxes
- Subsequent compliance with income tax laws
- Mental or physical health



Abuse

For purposes of this revenue procedure, if the requesting spouse establishes that he or she was the victim of abuse (not amounting to duress), then depending on the facts and circumstances of the requesting spouse's situation, the abuse may result in certain factors weighing in favor of relief when otherwise the factor may have weighed against relief.

Abuse

Abuse comes in many forms and can include physical, psychological, sexual, or emotional abuse, including efforts to control, isolate, humiliate and intimidate the requesting spouse, or to undermine the requesting spouse's ability to reason independently and be able to do what is required under the tax laws. All the facts and circumstances are considered in determining whether a requesting spouse was abused. The impact of a nonrequesting spouse's alcohol or drug abuse is also considered in determining whether a requesting spouse was abused.

Economic Hardship

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- If income is below 250% of the Federal poverty guidelines, or
- If monthly income exceeds reasonable basic monthly living expenses by \$300 or less
- Unless requesting spouse has assets to make payments towards the tax liability
- If no economic hardship, factor is neutral

PROSECUTING THE INNOCENT SPOUSE CASE

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Form 8857

An innocent spouse case begins with the filing of Form 8857, Innocent Spouse Relief, with the IRS. Form 8857 and its Instructions are available at the IRS' website, www.irs.gov.

When to File Form 8857

Form 8857 may be filed any time the IRS may act to collect the joint income tax liability in question—within 10 years after the later of (a) the joint income tax return was filed, or (b) the IRS assessed additional tax with respect to it.

Notice 2012-8

Notice 2012-8, IRB 2012-4, issued by the IRS immediately effective on January 23, 2012, markedly changed the law of innocent spouse relief.

- A requesting spouse who was denied relief under the prior law, Revenue Procedure 2003-61, should consider requesting relief again, this time under Notice 2012-8, even if the prior case was litigated.
- Notice 2012-8 can be found at the IRS' website, www.irs.gov.

Importance of Thoroughness

A Form 8857 should be as thorough and complete as possible. This will maximize the likelihood that the IRS will grant relief. Moreover, a requesting spouse will likely face cross examination on why facts offered at trial were omitted from the Form 8857.

IRS Appeals Office

If the IRS denies a request for innocent spouse relief, the requesting spouse should request review by the IRS Appeals Office. The Appeals Office is a separate, quasi-judicial office within the IRS.

IRS Appeals Office

A requesting spouse must file a written protest of the IRS' denial of her request for innocent spouse relief within 30 days after the notifies her in writing of denial of her innocent spouse claim.

Tax Court

Time. A requesting spouse may petition the U.S. Tax Court for review of her case within 90 days after the IRS Appeals Office denies her request for innocent spouse relief.

Tax Court

Standard of review. The standard of review in Tax Court is de novo. The Tax Court weighs all of the evidence before it, whether or not it was presented to the IRS below, and decides whether it is inequitable to hold the requesting spouse liable for the tax in controversy.

Tax Court

Essential evidence

- **Certified account transcript form the IRS for the requesting spouse for each year in controversy. The requesting spouse should request these in discovery.**

Tax Court

Essential evidence

- **Demands for payment, Notices of Levy, and other documentation of collection action by the IRS concerning the tax in controversy. This is available from the IRS in discovery.**

Tax Court

Essential evidence

- **Form 8857, including supplemental statement thereto. If the requesting spouse does not have this, it is available from the IRS in discovery.**

Tax Court

Essential evidence

- **Requesting spouse's current bank statements.**

Tax Court

Essential evidence

- **Requesting spouse's current pay stubs.**

Tax Court

Essential evidence

- **Proof of the requesting spouse's monthly living expenses.**

Tax Court

Essential evidence

- **Requesting spouse's credit reports. The requesting spouse can obtain these without cost directly from Equifax, Experian, and Trans Union.**

Tax Court

Essential Evidence

- **Copy of the Notice of Federal Tax Lien recorded against the requesting spouse. This is available from the Register of Deeds' office.**

Tax Court

Essential Evidence

- If the requesting spouse and the nonrequesting spouse are divorced, a copy of the Judgment of Divorce, file-stamped by the court that entered it.

Tax Court

Essential evidence

- **Police reports or other documentation of abuse suffered by the requesting spouse.**

Tax Court

Essential evidence

- Medical records of any health issues of the requesting spouse.

Tax Court Standing Pretrial Order

- **The Tax Court Standing Pretrial Order requires the parties to exchange exhibits at least 14 days before the calendar call at the beginning of their trial docket. An exhibit not so exchanged may not be admitted into evidence.**

Stipulation of Facts

- **Rule 91(a) of the Tax Court Rules of Practice and Procedure, as well as the Tax Court Standing Pretrial Order, requires the parties to stipulate to the facts to the broadest extent possible. It is in the requesting spouse's best interests to include as many of her facts as possible in stipulation of facts. The stipulation of facts should also include the parties' trial exhibits.**

Trial

- **The taxpayer has the burden of proof in Tax Court. There is no jury; the case is decided by a judge appointed for a term of years. Due process for a taxpayer in Tax Court is something a challenge. In a very real sense you are trying the case to the Court of Appeals.**

Appeal

A final decision by the Tax Court may be appealed to the U.S. Court of Appeals.

Certiorari

A requesting spouse unhappy with the U.S. Court's of Appeals' decision may petition the U.S. Supreme Court for certiorari.

The U.S. Supreme Court takes very few cases, and fewer yet tax cases.

Collection Action During the Pendency of the Case

IRC § 6015(e)(1)(B)(i) provides that “no levy or proceeding in court shall be made, begun, or prosecuted against an individual” seeking innocent spouse relief under IRC §§ 6015(b), (c), or (f) during the pendency of the request through the 90th day following the request during which the individual may petition the Tax Court, nor, if the individual petitions the Tax Court, until the Tax Court’s decision in the case becomes final.

A requesting spouse can prevent collection action on appeal by posting a bond pursuant to IRC § 7485. The bond must be filed on or before the filing of the notice of appeal in the Tax Court; in such amount as the Tax Court determines, not to exceed twice the amount of the deficiency; and with surety approved by the Tax Court.

Collection Action During the Pendency of the Case

The collection statute of limitations is tolled during the time the IRS is prohibited from levying the requesting spouse's property. IRC § 6015(e)(2).

Collection Action During the Pendency of the Case

The IRS is not prohibited from recording a Notice of Federal Tax Lien against the requesting spouse in the local register of deeds' office, and undoubtedly it will record a NFTL against her. A recorded NFTL can help establish economic hardship.