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Innocent Spouse Relief Under IRC Section 6015

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

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Today's faculty features:

Pietro E. Canestrelli, Atty, **Reid & Hellyer**, Temecula, Calif.

Stephen J. Dunn, Partner, **DUNN Counsel**, Troy, Mich.

Scott A. Schumacher, Associate Professor of Law, **University of Washington School of Law**, Seattle

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RELIEF FROM A JOINT INCOME TAX RETURN[i]

Stephen J. Dunn

The making of a joint income tax return is an election by each spouse to be jointly and severally liable for the tax reported, or properly reportable, on the return.[ii] The election may be revoked by either spouse on or before the due date (with extensions) for filing the tax return.[iii] In other words, once that deadline has passes, the election is irrevocable.

There are two circumstances in which a spouse should *not* sign a joint income tax return. The first is where the tax return reports a substantial balance due attributable to the other spouse. A spouse domiciled in a common law property state is not liable for income tax on her spouse's income if they do not file a joint income tax return. The spouse who earned the income may urge that he will have the means to pay the tax balance due in the near future. But unless he pays the balance due with the filing of the tax return, the other spouse must not sign the joint tax return.

The other circumstance where a spouse should not sign a joint income tax return is where she has reason to doubt that the return reports all of her spouse's income, or that deductions claimed on the return are not valid, lawful deductions. The IRS likely will examine the return, and assess additional tax as well as penalties and interest with respect to it. Once a spouse signs the return, she is jointly and severally liable not only for the tax reported on the return, but also for additional tax and for penalties and interest which may be assessed on audit later of the return.

No rational spouse, informed of the consequences of filing such a tax return, and acting free of coercion, would join in such a tax return.

A spouse aggrieved by an ill-advised joint income tax return is not without remedies. She may request relief from the Internal Revenue Service under Internal Revenue Code of 1986, as amended, § 6015 ("innocent spouse relief"). She may also have a malpractice claim against the professional who prepared the joint tax return or advised her to sign it.

I. Malpractice Claim

Where a joint income tax return is filed with substantial unpaid tax liability, reported or latent, attributable to only one of the spouses, the other spouse (herein called the "requesting spouse" or "innocent spouse"), may have a malpractice claim against the accountants who prepared the return, or against the accountants or attorneys who advised her to sign it. The malpractice claim is an important source of financing for the effort to seek innocent spouse relief from the joint income tax returns. It also is important in educating tax preparers of spouses' rights concerning a joint tax return.

II. Innocent Spouse Relief

Internal Revenue Code §§ 6015(b) and (f) are supposed to provide relief from joint income tax returns. Relief under either section comes down to one question: whether it is inequitable to hold the requesting spouse liable for the joint income tax return. In Revenue Procedure 2003-61,[iv] the Internal Revenue Service posited factors for determining whether it is inequitable to hold a requesting spouse liable for a joint income tax return. Section 6015 is an ameliorative statute, to be applied liberally to achieve Congress' intent in enacting it.[v]

But the Tax Court has interpreted the factors narrowly, allowing relief where the factors numerically preponderate for relief.

On January23, 2012, the IRS issued Notice 2012-8,[vi] reaffirming the relief factors of Revenue Procedure 2003-61, but broadening requesting spouses' ability to satisfy them. No longer must the relief factors be given equal weight; relief can be granted even where the factors do not numerically preponderate in favor of relief. Pertinent factors other than those listed may be considered. The ultimate issue is whether it is inequitable to hold the requesting spouse liable for the joint income tax return. Notice 2012-8 was effective upon issuance, and supersedes Revenue Procedure 2003-61.[vii]

A. Equitable Relief Factors

1. Marital status. Whether the requesting spouse is separated (whether legally separated or living apart) or divorced from the nonrequesting spouse. Acknowledging the abhorrent policy of predicating relief upon dissolution of a marriage, Notice 2012-8 provides that this factor is neutral if the spouses remain married and cohabitating.

2. Economic hardship. Whether the requesting spouse will suffer economic hardship if relief is not granted. An economic hardship exists if satisfaction of the tax liability in whole *or in part* will cause the requesting spouse to be unable to pay reasonable basic living expenses. This literally means that, if the requesting spouse can enter into an installment agreement with the IRS to a monthly amount, however small, there is no economic hardship. This would have the practical effect of making the economic hardship factor weigh against relief in every case.

Notice 2012-8 alleviates this injustice by providing that, where the requesting spouse fails to satisfy the economic hardship factor, the factor is neutral. Requesting spouses should not stop there. To tip the economic hardship factor in favor of relief, requesting spouses should introduce into evidence the Notice of Federal Tax Lien ("NFTL") recorded against them in the local Register of Deeds' office. They should also introduce into evidence their credit report showing the recorded NFTL. A recorded NFTL disables a taxpayer from selling or mortgaging an interest in real property. It can also disqualify the taxpayer from certain employments.

3. Knowledge or reason to know.

(i) Understatement cases. Where the tax in question arose from an understatement of tax on an income tax return, this factor weighs in favor of relief if the requesting spouse did not know, and had no reason to know, of the item giving rise to the understatement. This factor weighs against relief if the requesting spouse knew or had reason to know of the item giving rise to the understatement. Revenue Procedure 2003-61 provided that the requesting spouse's knowledge or reason to know of the item giving rise to the understatement weighed heavily against relief, but Notice 2012-8 abandons this super-weighting.

Notice 2012 -8 provides that, depending on the facts and circumstances, if the requesting spouse was abused by the nonrequesting spouse, or the nonrequesting spouse maintained control of the household finances by restricting the requesting spouse's access to financial information and, therefore, the requesting spouse was not able to challenge the treatment of any items on the joint return for fear of the nonrequesting spouse's retaliation, this factor weighs in favor of relief even if the requesting spouse had knowledge or reason to know of the items giving rise to the understatement.

(ii) Underpayment cases. In the case on income tax liability reported on a joint income tax return but not paid, this factor weighs in favor of relief where the requesting spouse did not know or have reason to know at the time she signed the joint tax return that the nonrequesting spouse would not or could not pay the tax liability at the time the joint return was filed or within a reasonably prompt time thereafter. This factor weighs against relief if it was not reasonable for the requesting spouse to believe that the nonrequesting spouse would or could pay the reported tax liability within a reasonably prompt time after filing of the return. If, at the time of signing the joint tax return, the requesting spouse was aware of the nonrequesting spouse's prior bankruptcies, financial difficulties, or other issues with the IRS or other creditors, or was otherwise aware of difficulties in timely payment of bills, then this factor weighs against relief.

Even if the requesting spouse had knowledge or reason to know of the nonrequesting spouse's intent or ability to pay the taxes due on the joint income tax return, depending on the facts and circumstances this factor may weigh in favor of relief where the nonrequesting spouse abused the requesting spouse.

(iii) Reason to know. The facts and circumstances considered in determining whether the requesting spouse had reason to know of an understatement, or reason to know the nonrequesting spouse would not or could not pay the reported tax liability, include, but are not limited to, the requesting spouse's education, any deceit or evasiveness by the nonrequesting spouse, the requesting spouse's degree of involvement in the activity generating the income tax liability, the requesting spouse's business or financial expertise, and any lavish or unusual expenditures compared with past spending levels.

(iv) Abuse by nonrequesting spouse. Notice 2012-8 provides that, if the requesting spouse establishes that she was the victim of abuse, then, depending on the facts and circumstances, the abuse may result in certain factors weighing in favor of relief which otherwise would have weighed against relief. Notice 2012-8 goes well beyond Revenue Procedure 2003-61 in recognizing that abuse can include physical, psychological, sexual, or emotional abuse; efforts to control, isolate, or humiliate the requesting spouse; and the effects of alcohol or drug abuse by the nonrequesting spouse. Abuse, more than any other factor, can tip the scale toward relief.

4. Legal obligation. If the nonrequesting spouse has the sole legal obligation to pay the outstanding income tax liability pursuant to a divorce decree or agreement, this factor weighs in favor of relief. This factor is neutral, however, if the requesting spouse knew or had reason to know, when entering into the divorce decree or agreement, that the nonrequesting spouse would not pay the income tax liability. If the requesting spouse has the sole legal obligation to pay the tax liability, this factor weighs against relief.

5. Significant benefit. Whether the requesting spouse received significant benefit (beyond normal support) from the unpaid income tax liability or the item giving rise to the deficiency. Revenue Procedure 2003-61 stopped there. Notice 2012-8 adds:

> If the requesting spouse enjoyed a lavish lifestyle, such as owning luxury assets and taking expensive vacations, this factor will weigh against relief. If the nonrequesting spouse controlled the household and business finances or there was abuse such that the nonrequesting spouse made the decision on spending funds for a lavish lifestyle, then this mitigates this factor so that it is neutral.

"Normal support" is measured by the context of the taxpayers' circumstances.[viii] If the family's standard of living did not improve during the years in controversy, this militates against a finding that the requesting spouse benefitted beyond "normal support."[ix]

The IRS has argued in my cases that sending the family's children to parochial school is evidence of a lavish lifestyle, beyond normal support. This position is a departure from rationality, as well as from established precedent of the Tax Court.[x] In Notice 2012-8, the IRS clearly abandons the position that sending one's children to a parochial school is evidence of a lavish lifestyle.

I have also seen the IRS argue that helping to support one's elderly parent is evidence of a lavish lifestyle. This, too, seems a departure from rationality. But certainly if a family was in the practice year in and year out of helping an elderly parent, doing so in the years in question would not exceed the bounds of "normal support."

6. Compliance with income tax laws. Whether the requesting spouse has made a good faith effort to comply with the income tax laws in the taxable years following the years for which the requesting spouse requested innocent spouse relief. This factor requires not compliance in fact, but only a good faith effort at compliance. If the spouses remain married, and they continue to file joint income tax returns, this factor will be neutral.

7. Mental or physical health. Whether the requesting spouse was in poor physical or mental health, at the time of signing the joint tax return(s) or at the time of requesting relief from them. Notice 2012-8 provides that if the requesting spouse was not in poor mental or physical health, this factor is neutral.

8. Knowledge of right to file separately, or of consequences of filing jointly. Revenue Procedure 2003-61 states, and Notice 2012-8 reaffirms, that the list of factors set forth therein is nonexclusive, and that the Service will consider other pertinent factors. In a typical case, joint returns are placed before a spouse. She is told where to sign. She has no background in accounting or taxes. She thinks that she is required to sign. She does not know that she is not required to sign the joint tax returns. She does not know of her right to report her income and deductions on her own income tax return as married filing separately. She does not know that the filing of a joint income tax return is an irrevocable election by each spouse to be jointly and severally liable for the tax reported, or properly reportable, on the joint tax returns. Indeed, if a joint tax return reports substantial tax liability attributable to the other spouse, what rational spouse aware of her rights, not under duress or coercion, would sign the joint return? This factor, where present, should be pressed for the requesting spouse.

B. Form 8857

An innocent spouse case begins with the filing of Form 8857, Innocent Spouse Relief, with the IRS.[xi]

1. When to file. 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.

As noted above, Notice 2012-8, recently issued by the IRS, 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.

2. 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.

C. IRS Appeals Office

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

D. Tax Court

1. 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.

2. Standard of review. The standard of review in Tax Court is de novo.[xii] 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.

3. Essential evidence. Essential evidence for a requesting spouse includes the following:

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

- 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.

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

- Requesting spouse's current bank statements.

- Requesting spouse's current pay stubs.

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

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

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

- 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.

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

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

4. 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.

5. 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.

6. Trial; appeal. 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 is something a challenge. In a very real sense you are trying the case to the Court of Appeals.

A requesting spouse unhappy with the U.S. Court of Appeals' decision in her case may petition the U.S. Supreme Court for certiorari. The U.S. Supreme Court takes very few cases, and fewer yet tax cases.

E. Collection Action During the Pendency of the Case.

Where the IRS assesses tax against a taxpayer, and the taxpayer fails to pay it after demand, a federal tax lien arises against all of the taxpayer's property and interests in property, then owned or acquired during the ten-year term of the collection stature of limitations. The IRS will record an NFTL where the account balance equals or exceeds $5,000.[xiii] In an innocent spouse case, a recorded NFTL can help establish economic hardship, as noted above.

Where a federal tax lien has arisen against a taxpayer's property, the IRS may, upon notice of its intent to do so, levy (seize) the taxpayer's property to satisfy the lien.[xiv] Though the IRS' levy authority extends to all of a taxpayer's property subject to federal tax lien, the IRS prefers to exercise it as to liquid assets, such as bank or brokerage accounts, or wages.

IRC § 6015(e)(1)(B)(1) 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. The collection statute of limitations on an assessment is tolled during the time the IRS is prohibited from levying to collect it by IRC §§ 6015(b), (c), or (f).[xv]

There are three ways a requesting spouse can prevent levy of her property pending appeal of the Tax Court's decision denying her relief under IRC §§ 6015(b), (c), or (f). First, she can enter into an installment agreement with the IRS. The IRS will not enter into an installment agreement with a taxpayer requiring a monthly less than the taxpayer is able to pay, determined by the IRS' collection standards.[xvi]

Second, if under the IRS' standards the requesting spouse cannot afford to pay the IRS anything, she can have her account posted as currently not collectible ("CNC").[xvii] Where the IRS has posted a taxpayer as CNC, the IRS will send the taxpayer an annual statement of the balance due, but not levy the taxpayer's property.

Third, a requesting spouse can post an appeal bond with the IRS. 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. [xviii]

Neither the entry of the taxpayer into an installment agreement with the IRS, nor the posting of her account as CNC, nor the posting of an appeal bond by her with the IRS tolls the collection statute of limitations on her outstanding balance owing to the IRS.

F. Joint Liability for Tax on Community Income

The foregoing applies with equal force to a joint income tax return filed for spouses domiciled in a community property state as well as to one filed for spouses domiciled in a common law property state. But where spouses domiciled in a community property state file separate income tax returns, each is liable for income tax on 50 percent of the community income.[xix] Treasury Regulations provide relief against provide a requesting spouse spouse relief from income tax liability on community income in the following circumstances:

- The spouses live apart;[xx]
- The nonrequesting spouse realizes the income, treats it as his or her own, and does not inform the requesting spouse of the nature and amount of it before the due date (with extensions) of the requesting spouse's income tax return for that year;[xxi]
- The requesting spouse did not know, and had no reason to know, of the item of community income, and taking into account all the facts and circumstances it is inequitable to hold her liable for income tax on it;[xxii] or
- It is otherwise inequitable to hold the requesting spouse liable for income tax on the item of community income.[xxiii]

The same factors for determining whether it is inequitable to hold a requesting spouse liable for a joint income tax return also apply in determining whether it is inequitable to hold her liable for income tax on community income realized by the nonrequesting spouse.[xxiv] A spouse uses Form 8857 to request relief from income tax on community income.[xxv]

III. Conclusion

It is far better that an ill-advised joint income tax return not be filed in the first place. But if one is filed, the innocent spouse is not without remedies.

Stephen J. Dunn *practices in tax litigation, estate planning and administration, and matrimonial law. His matrimonial law practice includes drafting marital agreements, and serving as tax counsel in divorces. He has litigated many innocent spouse cases. His office is in Troy, Michigan. Reach him at* sjd@dunncounsel.com.

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[i] A version of this article will be published in the Michigan Family Law Journal.
[ii] IRC § 6013(d)(3).
[iii] IRC § 6013(f)(4).
[iv] 2003-2 C.B. 296.
[v] House Report No. 105-364, at 60, 61 (1997), available at http://www.gpo.gov/fdsys/pkg/CRPT-105hrpt364/pdf/CRPT-105hrpt364-pt1.pdf (last viewed Mar. 4, 2012); Senate Report No. 105-174, at 55 (Apr. 22, 1998), available at http://www.gpo.gov/fdsys/pkg/CRPT-105srpt174/pdf/CRPT-105srpt174.pdf (last viewed Mar. 4, 2012).
[vi] I.R.B. 2012-4.
[vii] Eventually the IRS will re-issue Notice 2012-8 as a Revenue Procedure.
[viii] E.g., *Thomassen v. Commissioner*, 2011 Tax Ct. Memo LEXIS 85, at p. 13; T.C. Memo 2011-88; 191 T.C.M. (CCH) 1397; *Porter v. Commissioner*, 132 T.C. 203, 209 (2009); *Friedman v. Commissioner*, 1995 Tax Ct. Memo LEXIS 576, at p. 5; T.C. Memo 1995-576, 70 T.C.M. (CCH) 1491; *Estate of Krock v. Commissioner*, 93 T.C. 672, 678-79 (1989).
[ix] E.g., *Marzullo v. Commissioner*, 1997 Tax Ct. Memo LEXIS 314, at p. 6; T.C. Memo 1997-261; 73 T.C.M. (CCH) 2293; *Foley v. Commissioner*, 1995 Tax Ct. LEXIS 16, at p. 5; T.C. Memo 1995-16; 69 T.C.M. (CCH) 1661.
[x] E.g, *Thomassen*, supra, 2011 Tax Ct. Memo LEXIS 85, at p. 13 (Catholic school tuition for as many as eight of petitioner's children); *Friedman*, supra, 1995 Tax Ct. Memo 576, at pp. 2, 6 (tuition and expenses for petitioner's daughters to attend private schools, tutoring, and college); *Marzullo*, supra, 1997 Tax Ct. Memo LEXIS 314, at p. 6 (tuition for petitioner's sons to attend private school); *Foley* supra, 1995 Tax Ct. LEXIS 16, at p. 5 (petitioner's children attended private schools).
[xi] Form 8857 and its Instructions are available at the IRS' website, www.irs.gov.

[xii] *Porter v. Commissioner*, 132 T.C. No, 11 (2009), At one time the Tax Court applied an abuse of discretion standard in § 6015(f) cases, limiting the petitioner to the four corners of the Form 8857. E.g., *Johnson v. Commissioner*, 118 T.C. 125, (2002), aff'd, 353 F.3d 1181 (10th Cir. 2003).

[xiii] IRM 5.12.2.4.1.

[xiv] IRC § 6331(a). The notice must be—

(A) given personally to the taxpayer,

(B) left at the taxpayer's dwelling or usual place of business, or

(C) sent by certified registered or mail to the taxpayer's last known residence,

at least 30 days before the property is seized. IRC § 6331(d)(1).

[xv] IRC § 6015(e)(2).

[xvi] The IRS applies national standards for (1) food, housekeeping supplies, apparel and services, personal care products and services, and miscellaneous expenses; and (2) out-of-pocket health care expenses. The IRS applies local standards for (1) housing and utilities; and (2) transportation. The IRS' collection standards can be found at http://www.irs.gov/individuals/article/0,,id=96543,00.html (last viewed Mar. 3, 2012).

[xvii] IRM 5.16.1.

[xviii] IRC § 7485(a)(1).

[xix] *Poe v. Seaborn*, 282 U.S. 101, 75 L. Ed. 239, 51 S. Ct. 58 (1930); *U.S. v. Mitchell*, 403 U.S. 190, 29 L. Ed. 2d 406, 91 S. Ct. 1763 (1971); Treas. Reg. § 1.66-1(a).

[xx] Treas. Reg. § 1.66-2.

[xxi] Treas. Reg. § 1.66-3.

[xxii] Treas Reg. § 1.66-4(a).

[xxiii] Treas. Reg. § 1.66-4(b).

[xxiv] Id., citing Rev. Proc. 2000-15, 2000-1 C.B. 447.

[xxv] Treas. Reg. § 1.66-4(j)(1).