

INNOCENT SPOUSE RELIEF

by Carey J. Messina
Kean Miller Hawthorne D'Armond McCowan & Jarman, L.L.P.
P.O. Box 3513
Baton Rouge, LA 70821-3513
(225) 387-0999
www.keanmiller.com

The IRS has issued interim guidance for taxpayers seeking equitable relief under Code §6015(f). The guidance sets forth (1) threshold conditions that a person must satisfy to be considered for equitable relief; (2) circumstances in which relief will be granted where one spouse did not know, and had no reason to know, that funds intended for tax payment were taken by the other spouse for that spouse's benefit; and (3) a partial list of factors used to determine eligibility for equitable relief for innocent spouses in other situations. The interim guidance became effective on December 7, 1998, and may be relied upon until permanent guidance is issued.

1. *Innocent Spouse Background.* The IRC Restructuring and Reform Act of 1998 enacted new IRC §6015, which provides for relief from joint and several liability for tax, interest, and penalties arising from a joint return. IRC §6015(b) and IRC §6015(c) specify two sets of circumstances under which relief is available. Where relief is not available under those sections, IRC §6015(f) gives IRS authority to grant relief if, based on all the facts and circumstances, it is inequitable to hold a taxpayer liable. The Act also added a similar equitable relief provision to Code §66(c), which applies to married individuals with community property income. The expanded innocent spouse relief provisions are effective for tax liabilities arising after July 22, 1998, and tax liabilities arising earlier that are unpaid on that date.

2. *Innocent Spouse Election.* An individual who meets the following conditions can be relieved of liability under IRC §6015(b):

- (a) A joint return was made;
- (b) There was an understatement of tax attributable to erroneous items of the individual's spouse;

- (c) In signing the return, the individual did not know, and had no reason to know, that there was a tax understatement (partial relief is available where the individual lacked knowledge of only a portion of the deficiency);
 - (d) Taking into account all the facts and circumstances, it is inequitable to hold the individual liable for the deficiency in tax; and
 - (e) The individual applies for relief within two years after IRS's first collection activity after July 22, 1998.
3. Separate Liability Election. Under IRC §6015(c) an individual can limit his liability for a deficiency related to a joint return if:
- (a) At the time relief is elected, he or she is no longer married to, is legally separated from, or has been living apart at all times for at least 12 months from his or her spouse or former spouse;
 - (b) He or she elects to apply for relief no later than two years after the date of IRS's first collection activity after July 22, 1998; and
 - (c) The liability remains unpaid at the time relief is elected.
4. Equitable Relief. Innocent spouse relief generally is not available for liabilities that were properly reported on the return but not paid. However, equitable relief under IRC §6015(f) may nonetheless be available for those liabilities. The legislative history to the 1998 Act shows that Congress wanted the IRS to grant equitable relief when a spouse did not know, and had no reason to know, that funds intended for the payment of tax were instead taken by the other spouse for that other spouse's benefit. Congress also intended for IRS to grant equitable relief in other situations where, taking into account all the facts and circumstances, it is inequitable to hold an individual liable for all or part of any unpaid tax or deficiency arising from a joint return.
5. Threshold Requirements for Equitable Relief. Notice 98-61 says that

all the following threshold conditions must be met for an individual to be considered for equitable innocent spouse relief under IRC §6015(f):

- (a) A joint return must have been made for the tax year for which relief is sought;
- (b) Relief must not be available under IRC §6015(b) or IRC § 6015(c);
- (c) Relief must be applied for no later than two years after IRS's first collection activity after July 22, 1998, with respect to the individual;
- (d) The liability must remain unpaid at the time relief is requested. However, an individual may get relief in the form of a refund of liabilities for:
 - Amounts paid after July 21, 1998, and before April 16, 1999; and
 - Installment payments, made after July 22, 1998 under an agreement on which the individual is not in default, that are made after the claim for relief is requested;
 - No assets were transferred between the individuals filing the joint return as part of a fraudulent scheme by them;
 - There were no disqualified assets transferred to the individual by the nonrequesting spouse. If there were disqualified assets transferred to the individual by the nonrequesting spouse, relief will be available only to the extent that the liability exceeds their value; and
 - The individual did not file the joint return with fraudulent intent.

An individual satisfying all these conditions may be relieved of the liability if, taking into account all the facts and circumstances, it is inequitable to hold that person liable for all or part of a tax liability.

6. When Equitable Relief Ordinarily Will Be Granted. Equitable relief ordinarily will be granted to an individual who meets the above-listed threshold requirements where:

- (a) The joint return liability was unpaid at the time the return was filed;
- (b) At the time relief is requested, the individual is no longer married to, or is legally separated from, the spouse with whom the joint return was filed, or has at no time during the 12-month period ending on the date relief is requested, been a member of the same household as that spouse;
- (c) At the time the return was filed, the individual did not know, and had no reason to know, that the tax would not be paid. The individual must establish that it was reasonable for him or her to believe that the other spouse would pay the reported liability (partial relief may be available); and
- (d) The individual would suffer undue hardship if relief from the liability were not granted. For this purpose, the term "undue hardship" has the meaning given to it by Reg §1.6161-1(b).

7. Factors for Determining Whether to Grant Equitable Relief. Married separate return filers in community property states who request relief under Code §66(c), and individuals who meet the threshold conditions above, but not the four conditions in the immediately preceding list, may qualify for equitable relief if, taking into account all the facts and circumstances, it is inequitable to hold them liable for the unpaid liability or deficiency.

The following is a list of positive and negative factors that IRS will take into account in determining whether to grant equitable relief:

A. Factors Favoring Relief.

... Marital status. The individual requesting relief is separated (whether legally or living apart) or divorced from the nonrequesting spouse;

... Hardship. The individual requesting relief will suffer hardship if the relief is not granted, even if it does not constitute undue hardship within the meaning of Reg §1.6161-1(b);

... Abuse. The individual requesting relief was abused by his or her spouse (but the abuse did not amount to duress; and

... Spouse's legal obligation. The nonrequesting spouse has a legal obligation under a divorce decree or agreement to pay the liability.

B. *Factors Weighing Against Relief.*

... Attribution. If an unpaid liability or item giving rise to a deficiency is attributable to the individual requesting relief;

... Knowledge, or reason to know. An individual's knowledge or reason to know of an unpaid liability or deficiency is an extremely strong factor weighing against relief, but equitable relief may still be available in limited situations where favorable factors are unusually strong;

... Significant benefit. The individual requesting relief has significantly benefitted (beyond normal support) from the unpaid liability or items giving rise to the deficiency; and

... Legal obligation. The individual requesting relief has a legal obligation under a divorce decree or agreement to pay the liability.

[Some portions reprinted from *RIA - Federal Taxes Weekly Alert.*]

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